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Performance Audit

# **Health Group IT Outsourcing Tender Process**

**Department of Finance and Administration**

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of Australia 2002

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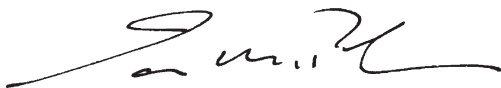
Canberra ACT  
29 October 2002

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Finance and Administration in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Health Group IT Outsourcing Tender Process*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely



Ian McPhee  
Acting Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

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# Abbreviations/Glossary

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AGS	Australian Government Solicitor
ANAO	Australian National Audit Office
APS	Australian Public Service
ATO	Australian Taxation Office
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CEOs	Chief Executive Officers
CN	Competitive Neutrality
CPGs	Commonwealth Procurement Guidelines
CSC	CSC Australia Pty Limited
DDC	Deakin Data Centre
DHAC	Department of Health and Aged Care
DISR	Department of Industry, Science and Resources
DCITA	Department of Communications, Information Technology and the Arts
DSD	Defence Signals Directorate
EDS	EDS (Australia) Pty Ltd
ESP	External Service Provider
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMV	Fair Market Value
GBE	Government Business Enterprise
HIC	Health Insurance Commission
HIC Act	<i>Health Insurance Commission Act 1973</i>
IBM GSA	IBM Global Services Australia
ID	Industry Development
IDET	Industry Development Evaluation Team
IT	Information Technology
IT Initiative	Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative

IT&T	Information Technology and Telecommunications
LAN	Local Area Network
MPL	Medibank Private Limited
NPV	Net Present Value
NBV	Net Book Value
OASACS	Office of Asset Sales and Commercial Support
OASITO	Office of Asset Sales and IT Outsourcing
OPA	Output Pricing Agreement
RFT	Request For Tender
SOPs	Standard Operating Procedures
SME	Small to Medium Enterprises
TDC	Tuggeranong Data Centre
TSA	Technology Services Agreement
WDC	Woden Data Centre





# Summary



# Summary

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## Background

1. In the 1997–98 Budget, the Government announced the Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative (IT Initiative). The measure was directed at achieving long-term improvements in the structuring and sourcing of information technology (IT) services across agencies to facilitate greater integration in the delivery of programs and realise significant cost savings. The Government also identified an opportunity to enhance the growth and competitiveness of the Australian information technology and telecommunications (IT&T) industry through the IT Initiative, particularly in regional Australia. Responsibility for the overall management and coordination of tender processes conducted under the IT Initiative rested initially with the then Office of Government Information Technology, until it was transferred to the then Office of Asset Sales and IT Outsourcing (OASITO) in November 1997.
2. This performance audit considered the conduct of the Health Group IT tender process. The Health Group consisted of the then Department of Health and Aged Care (DHAC)<sup>1</sup>, the Health Insurance Commission (HIC) and Medibank Private Limited (MPL). It was the fifth tender to be put to the market under the IT Initiative. The Request for Tender (RFT) was issued in November 1998. Tenders closed on 15 February 1999, with responses being received from three tenderers—IBM Global Services Australia (IBM GSA), CSC Australia Pty Limited (CSC) and EDS (Australia) Pty Ltd (EDS). The preferred tenderer, IBM GSA, was announced in September 1999. Contracts were exchanged on 6 December 1999 for services to DHAC and the HIC to the value of \$351 million for the supply of IT services over 5 years, with options to extend for up to a further four years. MPL entered into a separate contract with IBM GSA.
3. Since the completion of the above tender, the IT Outsourcing Initiative has been the subject of a number of reviews. As a consequence, there has been substantial revision of the implementation strategy for the Government’s policy in regard to IT outsourcing, heavily influenced by the review conducted by Mr Richard Humprey AO.

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<sup>1</sup> In the Administrative Arrangements Order of 26 November 2001, the Department of Health and Aged Care (DHAC) was renamed the Department of Health and Ageing. All references to the Department in this report will use DHAC, as this was the acronym in use at the time of the Health Group tender.

4. On 7 November 2000, the then Minister for Finance and Administration announced that Mr Humphry would conduct an independent review in relation to aspects of the IT Initiative. The report of the Humphry Review, *Review of the Whole of Government Information Technology Outsourcing Initiative*, released by the Minister on 12 January 2001, made 10 recommendations relating to the further implementation of the Initiative. All were agreed or agreed with qualification by the Government. Significant changes arising from the Review were the devolution of responsibility for implementing the Initiative from OASITO to agency Chief Executives or Boards, and that decisions as to which outsourcing model to adopt are to be taken by agency Chief Executives or Boards in accordance with their responsibilities under the *Financial Management and Accountability Act 1997* (FMA Act) and *Commonwealth Authorities and Companies Act 1997* (CAC Act). In July 2001, OASITO was re-named the Office of Asset Sales and Commercial Support (OASACS) to reflect its revised functions. Subsequently, in the Administrative Arrangements Order of 26 November 2001, OASACS was abolished and its functions absorbed by the Department of Finance and Administration (Finance). In discussing the activities undertaken in the Health Group tender, this report refers to OASITO, as it was known at the time.

### **Senate Committee request for audit**

5. On 30 November 2000, the Chairman of the Senate Finance and Public Administration References Committee (the Senate Committee) announced an inquiry into the Government's Information Technology Outsourcing Initiative. The inquiry was completed in August 2001, with the Senate Committee making 22 recommendations directed at improving the conduct of future IT outsourcing activities within the Australian Public Service. The Senate Committee noted that, during the course of the inquiry, serious questions were raised about the probity of the Health Group tender, particularly the unauthorised disclosure of pricing information to a tenderer and the acceptance of a tender lodged after the required time. The final report, *Re-booting the IT agenda in the Australian Public Service*, was released in August 2001.

6. On 21 June 2001, the Senate Committee Chair wrote to the Auditor-General requesting that he conduct an audit of the circumstances surrounding the unauthorised disclosure of tender information during the Health Group IT outsourcing process. The Chair advised the Auditor-General that the Senate Committee's request arose from its concerns about the processes that followed

the disclosure, including the acceptance of a late tender offer.<sup>2</sup> On 28 June 2001, the Auditor-General wrote to the Chair advising that, in light of the Senate Committee's request, he had decided to undertake a performance audit of aspects of the Health Group IT outsourcing process as a public interest issue.

## Health Group tender process

7. The Health Group RFT identified cost savings and industry development (ID) as key Commonwealth objectives for the project, and identified evaluation criteria relating to cost savings, service and risk, and ID. The RFT established two preconditions to the awarding of a contract. Firstly, the service and risk evaluation criteria were threshold criteria that had to be satisfied in order for the Commonwealth to consider a tenderer's proposed cost savings and ID. Secondly, the RFT stated that achievement of substantial cost savings was a precondition to the awarding of a contract. If more than one tenderer satisfied the requirement for substantial and acceptable cost savings, the Commonwealth would select the tender that, in the Commonwealth's view, offered the best combination of ID and cost savings. The Commonwealth also reserved the right to take account of service and risk considerations in determining that best combination.

8. An Evaluation Committee, overseen by and reporting to a Steering Committee, was responsible for evaluating the IT&T services elements of the tenders received. OASITO chaired both committees. A separate evaluation of tenderers' ID offerings was conducted by the Industry Development Evaluation Team, consisting of external advisers engaged by OASITO and representatives from the Department of Communications, Information Technology and the Arts (DCITA). The outcomes of the two evaluations were first combined when considered by an Options Committee comprising representatives from OASITO (again as chair), DCITA, the then Department of Industry, Science and Resources,

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<sup>2</sup> ANAO had planned to conduct a performance audit of the Health tender process in 2001-02, but advised the Committee on 17 May 2001 that, in light of the extensive audit of earlier IT outsourcing contracts and the significant changes subsequently made to the implementation strategy for the IT Initiative following the Humphry Review, it had decided not to proceed with the audit. The Committee expressed concern in its June 2001 second interim report that a serious flaw in the tender process for that Group would now not be subjected to an independent audit.

and two invited members from industry.<sup>3</sup> The Options Committee was responsible for formulating selection options for consideration by the relevant Ministers.

9. The Health Group tender evaluation process was complex, lengthy and costly for all parties. A number of issues arose in the course of the tender that had the potential to compromise the probity of that process, or to at least give rise to a perception that it may have been or had been compromised. These included OASITO inadvertently sending a tenderer, IBM GSA, confidential pricing information relating to other tenderers on 28 July 1999 (disclosure event), and the subsequent late lodgement of a revised pricing offer by the same tenderer on 2 August 1999. The tender process also saw substantial change in financial rankings following the fourth and final pricing round<sup>4</sup> and revision to savings identified by the evaluation following a review by Finance.<sup>5</sup>

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<sup>3</sup> It was normal practice in the OASITO-managed tender processes for the Group agencies not to be represented on the Options Committee. On 27 August 1999, OASITO advised the then Minister for Finance and Administration that at a recent meeting with the principals of the HIC and DHAC, the then Secretary of DHAC had requested that he be invited to participate on the Options Committee. OASITO recommended to the Minister that, given the Secretary's overall portfolio responsibilities and the 'single agency' characteristic of the Health Group, his participation in the Options Committee deliberations would be, on balance, appropriate. The Minister agreed to the request on 31 August 1999. However, the Secretary did not attend the Options Committee meeting held on 8 September 1999 at which the outcomes of the IT&T Services and ID evaluations were considered. That meeting had been rescheduled a number of times. The Secretary recorded that he was briefed on the Options Committee papers by OASITO the previous day and noted that both the IT&T services evaluation and ID evaluation on balance favoured IBM GSA, that none of the ID bids were particularly strong for the health industry per se, and there was no basis for discriminating on that score. The Secretary recorded that it was agreed that, only if the other members of the Options Committee took a different view, would there be a need for a further meeting of the Committee with all members present. The Options Committee recommended to the Minister, on 8 September 1999, that IBM GSA be selected as preferred tenderer. The recommendation was not signed by the Secretary, and made no reference to the Secretary having been formally approved as a member of the Committee, being absent from the meeting, or formally withdrawing from the Committee.

<sup>4</sup> Throughout the course of the tender process each tenderer made changes to their bid prices, and the relative positions of the tenderers in relation to the financial aspects of their bids altered considerably.

<sup>5</sup> Finance advised ANAO in May 2002 that: '...the final resolution of agency cost baseline issues by Finance ...was the culmination of a long period of debate between OASITO and the group agencies about current costs and forecast costs if IT infrastructure was to remain in-house. These discussions had no bearing on the selection of the successful tenderer'. This review was completed by Finance prior to the decision in relation to the successful tenderer.

## IT&T services evaluation

**10.** There were significant disparities in the prices initially tendered in February 1999, with the difference between the highest and lowest tender being some \$137 million over five years. At that point, no tenderer appeared to offer savings when compared with the internal cost baselines of the HIC and DHAC. However, OASITO argued that the service levels sought in the RFT were in excess of industry standards, and of the standards already being achieved by agencies and reflected in their cost baselines.<sup>6</sup>

**11.** Over the course of the tender, the Group agencies made a number of changes to the requirements originally specified in the RFT and tenderers were provided with multiple opportunities to revise aspects of their tenders. Subsequent to tender closure on 15 February 1999, tenderers were asked to formally submit revised pricing offers on three occasions: 21 May 1999, 21 June 1999 and 2 August 1999. Tenderers were also invited to make revisions to their technical and ID offerings.

**12.** On 21 May 1999, all three tenderers submitted revised financial and technical offers, including pricing against baseline and alternative service levels, based on revised requirements advised by agencies. Two tenderers slightly increased their tendered pricing. The third, CSC, significantly reduced its base offer, but attached a substantially greater price premium to the alternative service level options than did the other tenderers. IBM GSA also submitted a substantially revised ID offering.

**13.** Another round of revised offers was sought from tenderers on 21 June 1999. All three tenderers lowered their tendered pricing, with IBM GSA making the most significant reduction. IBM GSA also highlighted further changes to its in-scope ID offer, with the level of small to medium enterprise (SME) participation being reduced. This was followed by the submission by it of five additional out-of-scope ID initiatives on 25 June 1999. At this stage of the evaluation, IBM GSA was the least competitive in its pricing and in the contractual terms it was proposing. However, it was not clear that any tenderer was capable of offering savings, with the adjustments required to be made to tenderers' bids and agency cost baselines not yet agreed. The Steering Committee agreed that a decision to shortlist, or select a preferred tenderer, be deferred on the basis that further work needed to be done to clarify pricing uncertainty and address outstanding issues identified by the corporate and technical teams; and that OASITO would reactivate its review of the HIC cost baseline.

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<sup>6</sup> This was not in general accepted by agencies, particularly the HIC. Over the course of the tender there was substantial effort applied to this issue by both OASITO and its advisers, with the HIC and its expert consultants offering a different view. On the basis of the available information, some adjustments to increase the HIC cost baseline were ultimately agreed, but they were considerably lower than OASITO had suggested were required.

14. A third opportunity to re-price their offers was provided to tenderers on 2 August 1999. As part of that process, tenderers were provided with a package of information including finalisation of the service levels each agency desired to contract for; agency comments on tenderers' pricing assumptions; confirmation of the exclusion of DHAC voice services from scope; and updated HIC mainframe configuration material.

### *Disclosure event*

15. As part of the re-pricing process, tenderers were also to be provided with OASITO's interpretation of their previous pricing, including proposed adjustments.<sup>7</sup> OASITO faxed an Excel spreadsheet containing that information to each tenderer on 27 July 1999. The documents were to be discussed at meetings with each tenderer scheduled in Canberra the following day. The following morning, 28 July 1999, IBM GSA contacted OASITO by telephone advising that the fax it had received was illegible in part and requesting that it be provided with an electronic version of the document. An IBM GSA representative collected a computer disk from the OASITO offices at about 10.45 am that same morning. Later that day, the IBM GSA Vice President Operations contacted OASITO by telephone to advise that the document provided by OASITO appeared to contain information relating to other companies. OASITO retrieved the disk from the IBM GSA office sometime later that same day.

16. Between 29 July 1999 and 4 August 1999, Statutory Declarations were provided by a number of IBM GSA officers, including the Vice President Operations on behalf of the Company, to the effect that the information had not been examined in any detail, copied or otherwise retained in any form. On 30 July 1999, OASITO and the Probity Auditor met with the Chief Executive Officers (CEOs) of the other two tenderers to advise them of the disclosure event. The CEOs were shown the Statutory Declaration provided by the IBM GSA officer who had first identified that the document contained information relating to other tenderers. Both tenderers were concerned about the disclosure but, having regard for the Statutory Declaration, accepted that the tender would continue, albeit with varying degrees of comfort with the situation. The tenderers were advised that it was OASITO's intention to proceed with the process given the very late stage of the tender process and the close proximity of the Health Group to a decision point. In discussions with the Australian National Audit Office (ANAO), both tenderers indicated that in the circumstances they had not considered it worthwhile to attempt to escalate the issue.

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<sup>7</sup> Under the financial evaluation methodology, adjustments were applied to both tenderers' pricing and the agency cost baselines to ensure they were being compared on the basis of equivalent services and service levels.



**17.** All three tenderers submitted revised offers on 2 August 1999, with IBM GSA being late in lodging its offer on that day. In response to the revised service level and other information provided to tenderers<sup>8</sup>, IBM GSA and CSC reduced their tendered pricing from that submitted on 21 June 1999 by 18.1 per cent and 20.9 per cent respectively.<sup>9</sup> In contrast, EDS increased its tender by 2.5 per cent. IBM GSA also significantly increased the level of SME participation included in its ID offer. Having regard for the revised and clarified requirements advised by Group agencies over the course of the tender evaluation process<sup>10</sup>, the net change made by tenderers to their originally tendered prices over the course of the three re-pricing rounds was a reduction of 25.2 per cent by IBM GSA, a reduction of 33.4 per cent by CSC, and an increase of 5.8 per cent by EDS.<sup>11</sup>

**18.** The Evaluation Committee completed the Health Group IT&T Services Final Evaluation Report on 2 September 1999. That report encapsulated the findings of the Financial, Technical and Corporate Evaluation Teams against the evaluation criteria relating to cost savings and service and risk. The report found that IBM GSA offered combined net financial savings to DHAC and the HIC over five years representing two per cent of projected agency business-as-usual expenditure. Those net savings comprised a financial cost to DHAC of eight per cent over five years and financial savings to the HIC of seven per cent. Net savings, after the application of notional competitive neutrality (CN) adjustments, were assessed at 9.4 per cent over the same period. The Financial Evaluation Report prepared by the Financial Evaluation Team ranked IBM GSA first for the HIC and MPL's requirements, but third for DHAC's.

**19.** The Evaluation Committee concluded that the savings offered under the three tenders were sufficiently close to fall within the potential margin of uncertainty implicit in a project of this size and complexity. In addition, differences in the pricing structure and contractual terms proposed by each

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<sup>8</sup> The price movements identified for each tenderer in the 2 August 1999 re-pricing round exclude the reduction in each tenderer's price arising from the removal from scope in the final round of DHAC voice services.

<sup>9</sup> This included the removal from both tenderers' prices of substantial provisions each had previously made for pass through postage costs associated with bulk printing for the HIC (for CSC this applied from the 21 May 1999 re-pricing round). EDS had made no such provision. On 16 July 1999, CSC was advised that this item was a cost retained by the agencies as part of the information provided to it by OASITO for the 2 August re-pricing. Excluding the effects of the removal of bulk print postage costs, the reductions made were 11.8 per cent for IBM GSA and 8.2 per cent for CSC.

<sup>10</sup> Excluding costs associated with DHAC voice services, which were removed from scope in the final round.

<sup>11</sup> Excluding the effect of removal of bulk print pass through costs in the final round, the net change made to its originally tendered price by IBM GSA was a reduction of 15.8 per cent. CSC's net change remains a reduction of 33.4 per cent as it did not include the bulk print postage costs in its originally tendered price. This saw CSC move from the least competitive financial position in the initial round of RFT responses to a marginal second ranking in the final financial evaluation, after the application of adjustments.

tenderer could produce different financial outcomes in different scenarios over the term of the Services Agreement. Consequently, the Committee found that a case could be made to support the selection of any of the three tenderers based on purely financial considerations. Each tenderer was assessed as satisfying the RFT financial evaluation criteria.

**20.** The Evaluation Committee found each tenderer to be acceptable in terms of the threshold service and risk evaluation criteria. However, because IBM GSA proposed primarily an ‘as-is, where-is’ technical solution, it was considered to present the least migration risk. The Committee also found that there were other marginal technical advantages associated with the IBM GSA solution. In forming a recommendation as to the preferred tenderer, the Evaluation Committee had regard to the right reserved under the RFT to take account of service and risk considerations in determining the best combination of industry development and cost savings. Thus, although the decision was a close one, on balance the Evaluation Committee recommended that IBM GSA be designated as the preferred tenderer.

**21.** The Steering Committee considered the Evaluation Committee’s report on 3 September 1999. After an errata by the Evaluation Committee to incorporate corrections and clarifications suggested by it<sup>12</sup>, the Steering Committee agreed to a recommendation that IBM GSA be selected as the preferred tenderer based on an overall assessment against all of the relevant IT&T services evaluation criteria.

## **ID evaluation**

**22.** The ID offerings of the three tenderers were subject to revision and alteration over the course of the evaluation period. In some cases this related to flow-on effects from changes made to technical solutions, but also related to efforts by the tenderers to improve aspects of their ID offers. The most substantial changes were made by IBM GSA, which, after an initial round of clarification questions, had been considered to provide the least favourable ID offering.

**23.** The ID Evaluation Report completed on 1 September 1999 concluded that IBM GSA had the highest rated ID proposal when considered against the criteria set out in the RFT. The report stated that ID proposals were received from the three tenderers at the close of tenders on 15 February 1999, and that tenderers were also asked to provide revised ID offerings by 21 May 1999. It made no reference to revisions to ID offers that were made as part of the 21 June 1999 and 2 August 1999 re-pricing exercises, or of the submission of additional out-of-

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<sup>12</sup> The changes requested included text clarifications and amendment of errors in the reporting of financial results. The Steering Committee agreed that the changes and clarifications it sought would not change the conclusions of the IT&T Services Final Evaluation Report.

scope initiatives by IBM GSA on 25 June 1999. IBM GSA was identified as most preferred in terms of both in-scope and out-of-scope ID commitments.

## **Selection of preferred tenderer**

**24.** The Options Committee considered the IT&T Services Final Evaluation Report and the ID Evaluation Report on 8 September 1999. The Committee concluded that IBM GSA offered the best combination of savings and ID; also having regard to the advantages presented by its tender relative to the 'service and risk' evaluation criteria. The Options Committee therefore recommended, on 8 September 1999, that IBM GSA be selected as the preferred tenderer.

**25.** In forwarding the Options Committee's recommendation to the then Minister for Finance and Administration, OASITO advised that its view was that financial savings for the Health Group would be \$52.83 million over five years, \$82.93 million with CN adjustments of \$30.1 million taken into account (net present value (NPV) \$75.08 million based on a three per cent discount rate<sup>13</sup>).<sup>14</sup> This compared to the financial savings identified in the IT&T Services Final Evaluation Report of \$7.39 million over five years, \$37.49 million under CN (NPV \$33.49 million). The Minister declined to endorse the recommendation for the preferred tenderer and advised OASITO that he would sign off only when agreement on savings had been achieved. The Minister instructed that, if necessary, Finance should be asked to intervene and independently establish the savings. Adjustments recommended by Finance had the effect of increasing the projected savings over those identified in the IT&T Services Final Evaluation Report, with a net increase of \$16.6 million in projected financial savings from \$7.39 million to \$23.99 million over five years. Post-CN savings over the same period were increased from \$37.49 million, as projected in the Evaluation Report, to \$54.09 million.

**26.** The revised savings arising from the Finance review were not referred to the Evaluation Committee that had prepared and signed-off on the IT&T Services Final Evaluation Report, including the financial evaluation. The Steering Committee agreed that the expected value of savings from the Health Group information technology infrastructure outsourcing contract should be expressed as 'at least \$53.9 million over the first 5 years'.<sup>15</sup> A confirmation of its earlier

<sup>13</sup> The financial evaluation calculated net present values using a range of discount rates (three, five and eight per cent). The NPV savings figures reported to the Minister by OASITO were based on a three per cent discount rate.

<sup>14</sup> OASITO considered contract management costs included by agencies were in excess of best practice, that cost projections for staff overheads were understated, and that HIC cost model figures for infrastructure costs and desktop support were understated.

<sup>15</sup> The report provided to OASITO by Finance, and forwarded to the Minister, identified the revised savings as \$54.09 million. The reason for the adjustment to \$53.9 million was not identified by OASITO in its 22 September 1999 brief to the Minister advising of the revised savings position.

recommendation, endorsed by the Options Committee, stated that it agreed that the revised savings figures did not change the recommended outcome of the tender process, and that IBM GSA should be confirmed as the recommended tenderer for the project. The Minister endorsed the recommendation that IBM GSA be selected as preferred tenderer on 23 September 1999, announcing total savings over five years in the order of \$54 million.

## Finance internal audit review

27. In July 2001, at the request of the then Minister for Finance and Administration, Finance instructed its Internal Audit Unit to conduct a review of the 1999 Health Group IT outsourcing process. The Minister's request followed information that came to the attention of Finance and the Minister in June 2001 regarding the nature of the sign-offs that had been provided in respect to the Health Group tender by the Legal Adviser and the Probity Auditor. That information arose in the course of deliberations regarding the Senate Committee's requests for the Health Group evaluation reports. The review was to include consideration of the risk management, probity and commercial aspects of the Health Group tender process. The internal audit review was conducted as an agreed-upon procedures engagement.<sup>16</sup> The final internal audit review report, provided to Finance in July 2002, identified the scope limitations that applied (see paragraph 1.22).

28. Consistent with the agreed-upon procedures nature of the engagement and identified scope limitations, the final report of the internal audit review stated that:

As we have not reviewed all documentation connected with the Process, and have not held discussions with all participants in the Process, we do not, as part of this review, conclude on the probity of the Health Group tender process.

29. In that context, the Internal Audit Unit reported that:

We do note that, based upon the evidence currently available to us, none of the findings in this report are sufficient individually or collectively to suggest that the procurement outcome was inappropriate. Specifically in connection with the relatively well-publicised inadvertent release of information and the late receipt

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<sup>16</sup> Australian Auditing Standard *AUS 106* provides that: 'An agreed-upon procedures engagement does not enable the auditor to express assurance. The auditor is engaged to carry out procedures of an audit nature in order to meet the information needs of those parties that have agreed to the procedures to be performed. However, because the auditor does not determine the nature, timing and extent of the procedures performed, no assurance is expressed. The recipients of the report of factual findings must form their own conclusions from the agreed-upon procedures performed and the factual findings reported by the auditor. The report of factual findings is ordinarily addressed to those parties that have requested the procedures to be performed, since others, unaware of the reasons for the procedures, may misinterpret the results.'

of tenders, we believe that although they presented significant probity exposures, OASITO managed them in a manner that was not unreasonable. Although in both cases, we believe that there were other steps that (with the benefit of hindsight) OASITO could have taken to improve its management of these issues, nevertheless we do not believe that these significantly compromised the probity of the Process.

**30.** The report further noted: ‘However, our procedures have revealed some opportunities for improvement regarding the probity structures surrounding the Health Group tender process.’ The areas for improvement noted related to the merging of probity audit and probity adviser roles; the nature of sign-offs sought from expert advisers; the clarity of the definition of probity against which the probity auditor was providing assurance; documentation of the tender process, including of correspondence and liaison with tenderers; and communication with the Minister (see Figure 1.2).

## Audit approach

**31.** Pursuant to the Senate Committee’s request and the Auditor-General’s response to the Committee, the objective of this performance audit was to examine and report on the selection of the preferred tenderer in the Health Group IT outsourcing process. In particular, the audit examined the circumstances surrounding OASITO’s administration of the:

- disclosure to a tenderer of information provided by other tenderers;
- subsequent acceptance of a late re-pricing offer from a tenderer; and
- advice to the decision-maker leading to the selection of the preferred tenderer.

**32.** The audit focused particularly on assessing the administrative processes undertaken in the selection of the preferred tenderer for the Health Group. Audit emphasis was placed on the management of the probity aspects of the tender process, particularly in regard to events that occurred between June 1999, when the tenderers provided their penultimate pricing, and the selection of the preferred tenderer in September 1999.

**33.** The audit scope did not include a review of the implementation of the Health Group contracts, the management of those contracts by the relevant agencies, nor of the performance of the successful tenderer in the delivery of services since the awarding of the contracts. One of the parties to the tender, MPL, is a Government Business Enterprise (GBE) and was a voluntary participant in the Health Group. The audit scope did not include consideration of the internal decision-making processes undertaken by MPL in regard to its voluntary participation in the Health Group tender nor its selection of a preferred tenderer for the delivery of its tendered IT services.

34. Under Australian Auditing Standard *AUS 106*, the auditor's objective in an audit engagement is to provide a high level of assurance through the provision of relevant and reliable information and a positive expression of opinion about an accountability matter. In contrast to an agreed-upon procedures engagement, the scope of the work performed for an audit remains the responsibility of the auditor. The nature, timing and extent of the procedures performed are those determined as necessary by the auditor to provide sufficient appropriate audit evidence to enable reasonable conclusions to be drawn. Consistent with that, the audit procedures undertaken by ANAO in the course of this performance audit necessarily represented a more expansive level of inquiry than that conducted under the Finance internal audit agreed-upon procedures engagement.

35. The approach taken in the audit was to review the documentation relating to the Health Group tender held by OASACS; DHAC; the HIC; Finance; the Legal Adviser to the IT Initiative; and some documentation made available by the Probity Auditor to the IT Initiative. Interviews were held with 35 participants in the Health Group tender. ANAO engaged the Australian Government Solicitor (AGS) to provide legal advice on a number of matters, including in regard to good practice in the management of probity issues in competitive tenders; the legal standing of draft advices; procedural fairness matters; and the appropriate protocol for examining a computer floppy disk on which confidential information was provided to a tenderer, IBM GSA, in the course of the Health Group tender. ANAO also engaged the Defence Signals Directorate (DSD) to undertake expert examination of the computer floppy disk provided to IBM GSA. This quite detailed approach to the audit was considered necessary in view of the issues involved in responding to the Senate Committee's request.

## Consultation process

36. Under section 19 of the *Auditor-General Act 1997*, in July 2002 the proposed audit report or relevant extracts were issued for comment to relevant Commonwealth agencies (Finance, the Department of Health and Ageing, the HIC, and DSD) and 27 other parties having a special interest in the report. The comments received were considered in the preparation of the final audit report.

37. In light of the significant changes made to the administrative and policy arrangements for the implementation of IT outsourcing by Commonwealth agencies since the conduct of the Health Group tender, ANAO has not made specific recommendations in this report. However, the report does highlight areas in which lessons can be learned from that tender to assist agencies in effectively managing the probity aspects of future competitive tendering processes.



## Overall audit conclusions

**38.** On the basis of the evidence available, ANAO is not able to provide an assurance that no tenderer unfairly gained a competitive advantage in the Health Group tender process. Limitations in the documentation available, the apparent misunderstanding by some relevant parties of the extent to which they could rely on assurances provided by external advisers in finalising the tender, and the elapsed time since the tender activity, which has contributed to the inherent limitations in the available evidence, prevented ANAO from reaching a firm conclusion on the question.

**39.** There was a lack of transparency of the manner in which probity issues were considered by OASITO, particularly in respect to the potential for a broader cumulative effect on the probity of the process to arise given the sequence of significant events that occurred. That is, the disclosure event of 28 July 1999 when sensitive price information from the other tenderers was inadvertently passed to IBM GSA by OASITO, the subsequent late lodgement by IBM GSA of its revised pricing offer on 2 August 1999, and the substantial price reductions made in the 2 August re-pricing round by two of the three tenderers. Deficiencies in the contemporaneous documentation regarding the actions and deliberations undertaken on significant issues affecting the tender process, together with inconsistencies in individuals' recollections of events that occurred in mid-1999, did not allow ANAO to conclude that probity issues that arose during the course of the tender process were appropriately and effectively managed.

**40.** ANAO identified a number of areas in which the handling of the probity issues that arose during the Health Group tender process could have been improved to provide more transparency, accountability and rigour to the competitive tendering processes. Both the Government and the Parliament have underlined the importance of these principles in procurement transactions involving the expenditure of public monies.

**41.** The sign-off on the evaluation phase of the tender process provided by the Probity Auditor on 3 September 1999, which indicated no awareness of unresolved probity issues or concerns, made no reference to specific probity issues considered or inquiries undertaken in the course of the tender (see paragraphs 73 to 74 and 77). In September 2002, the previous Minister for Finance and Administration advised ANAO that:

When the disc containing all three bids was delivered to IBM GSA in error my reaction on being informed directly by OASITO was to cancel the tender. I could not see that a tender process with integrity could continue. I conveyed this view to OASITO and I requested two things. Firstly, that all parties associated with the tender be informed of the potential breach of confidentiality and their views obtained. Secondly, that the Probity Auditor be immediately informed and that

all subsequent dealings on this issue be in the presence of the Probity Auditor so that a separate audit report could be prepared on this issue to underpin either cancelling the Health tender or proceeding with the concurrence of all parties.

At the conclusion of the tender I was both disappointed and annoyed at the limited role of the Probity Auditor and the absence of a separate report on this issue.

**42.** The documentation maintained by OASITO in respect to its management of both the disclosure of the other tenderers' pricing to IBM GSA on 28 July 1999 and the late lodgement by IBM GSA of its revised offer on 2 August 1999 does not provide a sufficiently comprehensive account of all relevant actions relating to these significant probity issues. Adequate records were not consistently maintained of significant discussions that occurred, nor of some of the key decisions taken and their underlying rationale.

**43.** Based upon the available documentation, all requests by OASITO for advice from both the Legal Adviser and the Probity Auditor regarding the disclosure event were oral. Oral requests to advisers for advice are not uncommon, but it is sound practice to document those requests and, particularly for significant issues, follow them up with written instructions. There was no record retained by OASITO of its conversations with either the Legal Adviser or the Probity Auditor in relation to the disclosure event, the instructions provided about the event and the nature of the advice sought by OASITO, nor of the options discussed with either party. The question as to whether the tender had been compromised to the extent that it should be terminated was clearly of particular significance to the appropriate consideration and resolution of this major probity issue. Yet, uncertainty and differing views remain about the extent to which the Legal Adviser was empowered to consider that question in framing their legal advice on the issue.

**44.** There is no written advice from the Probity Auditor (who was overseas at the time), nor from his representatives, regarding the probity aspects of accepting the late offer from IBM GSA following the disclosure event; either before or after the decision to accept it had been made.<sup>17</sup> OASITO made no record of having received such advice orally. There was also no record of the Legal Adviser's advice on the issue having been provided to the Probity Auditor. As with the

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<sup>17</sup> While the 2 August 1999 tender opening process was managed under the control of a representative of the Probity Auditor, OASITO did not formally refer the issue of whether the late offer received on that day should be accepted to the Probity Auditor. The file note prepared by the Probity Auditor's representative recorded that she spoke to the OASITO Executive Coordinator and requested that the Executive Coordinator prepare a file note stating that he had considered the late bid by IBM GSA and was prepared to accept it. The file note records that the OASITO officer advised that he would state that he was prepared to consider the late bid and that: '...the Committee could decide if it were to be accepted or not.' In July 2002, the Probity Auditor advised ANAO that the representative of the Probity Auditor did contact her manager by telephone during this process. An internal OASITO minute regarding acceptance of the late offer was prepared. However, there is no evidence of any of the Committees being formally advised of the issue nor being asked to consider whether it should be accepted.



disclosure event, there is no specific reference to the late lodgement in the sign-off provided by the Probity Auditor at the conclusion of the evaluation process, some five weeks after the decision to accept the late offer had been made.

**45.** The actions taken in respect to the late lodgement by IBM GSA leave open to interpretation important aspects of the management of that event by OASITO. In the circumstances, it would have been prudent for the documentation of OASITO's deliberations on the late lodgement by IBM GSA to have more fully reflected the timing of the actual decision to accept the late offer into the evaluation, and the nature and form of information available at that time to support that decision.

**46.** It would also have been prudent for further inquiries to have been undertaken of IBM GSA in regard to its internal pricing approval process. If it could be established that the pricing lodged on Monday 2 August 1999 had been substantively finalised prior to the disclosure event on the preceding Wednesday, 28 July 1999, much of the potential individual and cumulative implications of the disclosure and subsequent late lodgement could be appropriately put aside. In discussions with ANAO, officers of the former OASITO confirmed that no specific inquiries were undertaken of IBM GSA in this regard. IBM GSA advised ANAO in a letter of 8 March 2002 that, despite extensive enquiries and searches, it had been unable to find any specific contemporaneous document showing pricing approval for the 2 August 1999 bid response.<sup>18</sup> IBM GSA also confirmed to ANAO in that letter that the enquiries and searches did not reveal any e-mail or other document to indicate that any adjustment was made to the pricing of the 2 August 1999 bid response on or after the events of Wednesday, 28 July 1999. ANAO notes that the potential to obtain any relevant documentation from IBM GSA in this regard would have been significantly greater if inquiries of this nature had been undertaken by OASITO at the time of the events in question.

**47.** The Evaluation, Steering and Options Committees were not well served in being able to fulfil their proper roles, as they were not informed at the time, as Committees, of the disclosure event or subsequent late lodgement involving IBM GSA. There is also no reference in the evaluation reports to any probity issues having arisen during the tender. In their advice of 30 July 1999, the Legal Adviser recommended that OASITO inform the Group Agencies of the disclosure event. In the normal course of arrangements, OASITO advised the Group Agencies of matters relating to the tender through the formal Committees

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<sup>18</sup> IBM GSA advised ANAO that: '...given the internal approval and planning cycle, it is our view and belief that IBM GSA would have practically been unable to adjust its pricing within a period of less than a week'. IBMGSA further advised that its internal processes did not require the retention of pricing and other approvals for each tender response in the Health Group tender process; rather it only required evidence of relevant approvals for final contract signing (which occurred in late 1999).

established for the process. In the case of the disclosure event, however, OASITO instead advised the heads of each agency directly. There is no documentation of the deliberations that led to OASITO electing to adopt that strategy, nor of the rationale underlying it. There is no evidence of OASITO seeking advice from the Probity Auditor as to which participants in the tender evaluation process should be advised of the disclosure in order that they could adequately discharge their responsibilities. AGS advised ANAO that reporting to the Evaluation Committee of a major probity issue which had significant implications for the evaluation, and of the advice obtained regarding it, should occur before a decision is taken on how to resolve the issue.

**48.** There was an information asymmetry among members of the Evaluation, Steering and Options Committees in respect to the probity aspects of the Health Group tender. The OASITO chairs of those Committees were aware of all relevant information. ANAO received advice from some other members of the various Committees that they recalled becoming aware during the tender process of the disclosure and/or late lodgement issues. But recollections in this regard varied substantially. No documentation was available to assist the ANAO in clarifying which of the other members became aware of the disclosure and/or late lodgement events, nor in what circumstances, and who else may have been briefed on the various probity issues. It is clear, however, that at least some members were not aware of one or more of the probity issues that arose.

**49.** A consequence of the approach adopted was that those latter members were not in a position to consider the potential cumulative effect on perceptions about the probity of the tender process before agreeing to sign-off on it. There is a strong argument that the Committees should have been provided with the opportunity to make an independent judgement on these significant issues. That they were not, diminished the transparency with which the tender process was managed. This appears to have contributed to the environment in which perceptions and concerns about the lack of sufficient probity in the tender process were perpetuated.

**50.** It is difficult to make comparisons between the prices offered by each tenderer at different points in the tender process. This is due to a number of factors, including the changes made to the scope of services they were asked to tender for. Also, particularly in the earlier rounds, this process was used as a means of testing the pricing effects of various options in terms of service levels that could be requested. Further, many of the adjustments made to tendered prices to ensure comparability between tenders, and with the agency cost baselines, were not finalised until very late in the evaluation. As a result, the prices tendered in earlier rounds are not directly comparable to the adjusted prices used in the final financial evaluation. Nevertheless, it was clear that the

relative positions of the tenderers in relation to the financial aspects of their bids altered considerably over the course of the re-pricing process, including in the final round, which closed after the disclosure event (see paragraph 17).

**51.** As neither the Evaluation Committee nor the Steering Committee were aware, as a Committee, of the disclosure event, they did not examine the movements in price in the final re-pricing round in that context. There is also no record of the Options Committee being advised of the reasons for, or nature of, changes to tenderers' offers that occurred over the course of the tender.

**52.** It is not apparent that there was the necessary level of clarity in the Health Group tender process surrounding the question as to whether each round represented a re-pricing or re-bidding process. ANAO did not find any evidence of OASITO obtaining probity or legal advice in respect of the decision to undertake each re-pricing round, including whether the changes made to agency requirements in respect of any of the three rounds gave rise to a re-bidding situation.

**53.** Nor is it clear who was responsible on each occasion for the decision to seek revised offers. Based upon the available documentation, including Committee minutes, it appears to have been OASITO that determined, in the first instance, the requirement to provide tenderers with each of the opportunities to improve their bids. While the Steering and Evaluation Committees were informed of those decisions, in some instances there was not a clear record of the Committees formally agreeing to proceed to each round of revised tenders. ANAO considers that there was clear scope to enhance the transparency of the decision-making process leading to formal revised offers being sought, particularly in the later stages of the tender.

# Key Findings

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## Evaluation

**54.** As noted, the Health Group IT&T Services Final Evaluation Report, completed by the Evaluation Committee on 2 September 1999, encapsulated the findings of the Financial, Technical and Corporate Evaluation Teams against the evaluation criteria relating to cost savings and service and risk. The ID Evaluation Report set out the findings of the ID Evaluation Team against the ID evaluation criteria. ANAO identified aspects of the methodology for the assessment of tenderers against the identified evaluation criteria that could have been improved.

**55.** In respect to the financial evaluation, ANAO identified areas for improvement relating to the methodologies applied in calculating adjustments in respect of end-of-term assets and obligations, and to the processes followed more generally for reconciling all adjustments applied in the financial evaluation.

**56.** The methodology to be employed in the Health Group financial evaluation in calculating adjustments in respect of end-of-term assets and obligations was not finalised until very late in the tender evaluation. This was a factor that made comparisons between tenderers' financial positions over the course of the tender process difficult. Ultimately, two different methodologies were used by the HIC and DHAC evaluation teams in the one tender process. ANAO identified issues with both methodologies (see Chapter 3).

**57.** The aggregate effect of adjustments identified by ANAO in respect of the treatment of end-of-term agency and tenderer assets reduces the financial savings identified in the financial evaluation against the preferred tenderer by over \$9 million, and by some \$7 million against the second-ranked tenderer. In the context of the close outcome of the financial evaluation in the Health Group tender, movements of that nature would have changed the indicative financial rankings of the tenderers, but would also result in no tenderer offering financial savings (before the application of additional savings identified by Finance—see paragraphs 18 to 19 and paragraph 25). The net estimated adjustments would result in a cost premium to the Health Group from outsourcing, before the application of notional CN adjustments, of some \$1 million over five years, and post-CN savings of \$29 million based on the CN adjustments applied in the financial evaluation (also before the application of additional savings identified by Finance).

**58.** ANAO's review of the Financial Evaluation Report prepared by the Financial Evaluation Team identified a number of errors and internal inconsistencies in the construction of adjustments figures within the summary

and body of the Report, and its Appendices. ANAO also identified errors in the calculation or application of adjustments.<sup>19</sup> Many of the errors identified appear to have been the result of a last-minute rush to complete the adjustments process, particularly in respect to services to the HIC. Financial consultants were engaged by OASITO to manage and reconcile the entry of financial adjustments into the Savings Model. Within the documentation available for review, ANAO could not locate a final reconciliation of the adjustments and savings assessed against each tenderer that agreed with the adjustments and final outcome shown in the Financial Evaluation Report. In August 2002, the financial consultant engaged by OASITO advised ANAO that:

...we were not required to provide final sign off in relation to the reconciliation of the savings model and in fact the final adjustments to the model were made by OASITO and [the Strategic Adviser] without [our] involvement and without [our] being required to provide a final reconciliation.

**59.** The Health Group RFT explicitly stated that ‘achievement of substantial cost savings is a precondition to the award of a contract.’ It was stipulated that the Commonwealth would not award a contract unless it were satisfied that the preferred tenderer would deliver a substantial and acceptable level of cost savings based on an assessment against the criteria relating to cost savings specified in the RFT. The financial evaluation methodology did not explicitly provide for an evaluation against the cost savings precondition. In ANAO Audit Report No.9 2000–01, *Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative*, ANAO considered that the transparency and accountability of the decision-making process in the Australian Taxation Office (ATO) and Group 5 tenders would have benefited from improved documentation/recording of the respective evaluation Committees’ conclusions and advice as to whether the preconditions stipulated in the RFT had been satisfied by the recommended preferred tenderer, and the factors considered in reaching that conclusion. ANAO formed a similar conclusion in respect to the conduct of the Health Group tender.

**60.** The service and risk evaluation criteria were assessed by the Technical and Corporate Evaluation Teams. Each tenderer was assessed as meeting the threshold requirements as stated in the RFT. The Technical Team reported that it was unable to arrive at a Group position in regard to the level of compliance and risk associated with the technical solutions. However, the DHAC, HIC and MPL Technical Teams each assessed IBM GSA as the preferred tenderer. An

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<sup>19</sup> For example, ANAO noted apparent errors in the application of adjustments that appeared to result in the total costs against one tenderer being overstated by some \$3 million. As noted, the Evaluation Committee found that all tenderers fell within a financial range that was not in itself a material differentiating factor (see paragraph 19). The errors identified by ANAO are not likely to have changed that assessment.

important differentiating factor in that assessment related to the level of migration risk that was assessed as being associated with each tenderer's solution, particularly the location and delivery of data centre operations.

**61.** As part of their technical solution, all three tenderers proposed to migrate DHAC's mainframe services to another site. IBM GSA and CSC proposed to retain the HIC's mainframe services at the existing data centres, with DHAC's services being migrated to the HIC site. EDS proposed to migrate the mainframe processing and disaster recovery for all Group Agencies to its data centres in Sydney. It also proposed re-locating help desk and other services interstate.

**62.** In assessing tenderers' proposed solutions for the provision of data centre services, the Evaluation Committee stated that the migration risk that is necessarily inherent in any change must be justified on the basis of some financial, technical or corporate advantages offered by the tendered solution. The available documentation indicates that the HIC had a strong preference, for strategic business reasons, for retaining the data centre operations at their existing sites. Although no weightings were identified for the evaluation criteria or sub-criteria, the consideration of this aspect of the tenders in the evaluation demonstrated a preference for a no change, low risk solution that tenderers offering alternative solutions had to overcome through an offsetting advantage in another aspect of their tender. In such circumstances, better practice would have been for that preference to be made clear to tenderers in the RFT and for the evaluation methodology to be designed to ensure that the application of any pre-existing preferences in the evaluation was consistent and transparent.

**63.** The evaluation methodology used in the Health Group tender to assess the ID offerings of tenderers was not finalised prior to the opening of tenders and was not signed-off by the Probity Auditor. The ID Evaluation Report stated that the industry development offerings were evaluated in accordance with the evaluation methodology which had previously been approved by OASITO's Probity Auditor as being consistent with the RFT.

## **Probity management**

**64.** ANAO identified shortfalls in good practice in a number of areas of the probity management process for this significant government contract. Some aspects of the shortfalls related to the unique tender management structure that existed under the IT Initiative until the Government's endorsement of the recommendations of the Humphry Review of December 2000. The problems identified primarily relate to:

- inadequate documentation of the tender process, including communications with tenderers;

- lack of transparency of the consideration of all relevant options, risks and information in the management of probity issues; and
- the adequacy of the information available to the decision-maker on probity issues, of the role of the probity expert engaged for the tender process, and of the scope and nature of sign-offs provided by external advisers.

### *Documentation*

**65.** ANAO's capacity to examine the management of the probity aspects of the Health Group tender was limited by deficiencies in the contemporaneous records made. In a number of areas, the recollection of individuals was the only means of establishing important elements of the sequence of events.

**66.** The issue of communication with tenderers was an area of some ongoing focus in the conduct of the Health Group tender process. It is apparent from contemporaneous documentation and subsequent discussions with ANAO that not all parties were confident that they were aware of all communication that occurred between tenderers, OASITO, its advisers and/or Group Agency representatives, or that the content of that communication had been properly recorded. The likelihood of such perceptions arising was increased by environmental factors, including perceived preferences for particular tenderers and the dual role played by OASITO in managing both the whole of Government IT Outsourcing Initiative and each tender process. The approach taken to documenting contact with tenderers did not assist in removing such perceptions. A coherent record of all meetings and conversations with each tenderer involving tender evaluation teams, OASITO or its advisers, and/or Group Agency representatives was not kept during the tender evaluation phase. A Contact Register was not maintained. The individual tenderer files did not contain all correspondence and contact with that tenderer. Negotiation and clarification meetings with tenderers were not generally minuted, although the Legal Adviser advised ANAO in August 2002 that negotiations with tenderers in relation to the terms and conditions of the Services Agreement were documented and provided to all Group Agencies. Due to the ad-hoc structure of the available records, it was not possible to conclude whether all contact with tenderers had been properly recorded for accountability purposes.<sup>20</sup>

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<sup>20</sup> Finance advised ANAO in May 2002 that: 'OASITO's role in managing the whole of government Initiative required that organisation to consult with interested parties constantly about upcoming tender processes, performance under existing contracts and related topics...Agencies may have perceived this regular contact as 'extraneous communication' but it did not create a problem for the process'.



**67.** Transparency and confidence in the tender process would have been enhanced through independent scrutiny of the procedures used in managing and recording contact with tenderers. The schedule of services for the Probity Auditor did not require assessment or certification of procedures adopted for the general management of the tender process, including communication with tenderers.<sup>21</sup>

**68.** The need for sound procedures in regard to managing and recording the dissemination of information to tenderers was highlighted by the disclosure event. OASITO was responsible for managing all communication to, and from, tenderers. In this instance, OASITO made no contemporaneous record, prior to providing IBM GSA with the disk, of:

- receiving a request from IBM GSA for an electronic version of the document previously faxed to it;
- the request by an OASITO officer or a member of the evaluation team for an electronic copy of the document, including the nature of that request;
- a disk containing confidential tenderer information being removed from the secure Evaluation Centre;
- the identity and contents of the document contained on the disk; or
- a disk containing pricing information being provided to a tenderer.<sup>22</sup>

**69.** No correspondence was prepared to accompany the disk. There was no examination made of the disk's contents prior to it being handed over to the tenderer. Nor was a hardcopy of the electronic document contained on the disk produced or retained at that time as a record of the information provided.

**70.** Following the disclosure event, OASITO recognised the need to improve its information management processes and, on 2 August 1999, introduced revised interim procedures for the dissemination of hardcopy and electronic information to tenderers or agencies. OASITO engaged the Probity Auditor to review its operating procedures for the handling and security of tenderer information and communications with tenderers. The Probity Auditor strongly recommended

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<sup>21</sup> Finance advised ANAO in May 2002 that the Probity Auditor had a role in reviewing and sometimes producing protocols and procedures governing management of the tender process and also provided briefings to those involved in the process.

<sup>22</sup> Finance advised ANAO in May 2002 that: '[*This paragraph*] appears to suggest that the disclosure event was somehow related to inadequacies in documentation. This was not the case. The process for having the Evaluation Team's interpretation of pricing viewed and confirmed for accuracy by the bidders was well understood by all those involved. The variable that caused the problem was the accession to the (not unreasonable) request for a soft copy of the data sent by facsimile'. ANAO notes that following sound procedures for recording the contents of information provided to IBM GSA in electronic form, prior to the disk being handed over, would have been of considerable assistance in enabling OASITO to avoid the possibility of the disclosure of information relating to other tenderers (see paragraph 69).



that the procedures necessary for maintaining security of information within OASITO, both hard copy and electronically based, be more comprehensively documented and promulgated as standard operating procedures (SOPs). The Probity Auditor agreed to formulate a set of SOPs for OASITO, providing recommendations in February 2000.

### *Transparency*

71. Assurances that the disclosed pricing information had not been examined, or retained, were provided by relevant IBM GSA personnel through contemporaneous Statutory Declarations made following the disclosure event on 28 July 1999. Those assurances were confirmed in subsequent interviews with ANAO during the latter half of 2001. In advising the other two tenderers of the disclosure event, OASITO provided the Statutory Declaration received to that time to the bidders for their review. OASITO advised each tenderer that it was OASITO's intention to proceed with the tender process.

72. Based upon available documentation and oral advice provided in discussions with ANAO, OASITO and the Probity Auditor relied extensively upon the assurances contained in the Statutory Declarations to conclude that the tender process could continue.<sup>23</sup> AGS advised ANAO that, in these circumstances, Statutory Declarations provide a reliable record of a contemporaneous note by the witness as to what happened.<sup>24</sup> ANAO considers that there were other inquiries that could reasonably have been undertaken in order to improve the capacity to demonstrate that all relevant information had been considered in forming conclusions about the disclosure event.<sup>25</sup> The Statutory Declarations did not provide a complete and reconcilable picture of the timing and sequencing of events. During the latter half of 2001, ANAO held discussions with the IBM GSA declarants in an attempt to clarify events, but minor gaps, discrepancies and anomalies remained. This was due in part to the considerable time that had elapsed since the events in question and inconsistencies in individuals' recollections of events that occurred in mid-1999.

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<sup>23</sup> The Statutory Declarations signed by the six IBM GSA employees were all made pursuant to the *Oaths Act 1900* (NSW).

<sup>24</sup> However AGS further advised that, generally speaking, the Statutory Declarations would not be sufficient evidence of what occurred for the purposes of any legal action relating to the tender process. If legal action were taken, further affidavits would have to be sworn and the witnesses would have to be available for cross-examination in order for the testimony to be used.

<sup>25</sup> Further inquiry conducted by ANAO included, for example, discussions with IBM GSA employees to clarify and supplement the various accounts of events presented in the Statutory Declarations, examination of the disk provided to IBM GSA in error, and inquiry into IBM GSA's internal approval processes for tender submissions.

73. Neither the Probity Auditor nor the Legal Adviser provided any further written advice or comments specifically relating to the resolution of the disclosure event, having regard to the actions taken following their initial advice (provided on 29 July 1999 and 30 July 1999 respectively). Also, neither provided a specific sign-off on the management of the disclosure event. In July 2002, the Probity Auditor advised ANAO that a request to provide any additional sign-offs or further written advice in respect of the disclosure event was never made by OASITO. The Legal Adviser similarly advised ANAO that no request was made by OASITO for the Legal Adviser to provide further advice or a specific sign-off on the disclosure event or to be involved in the briefing of tenderers or the Agencies. Better practice was subsequently followed by OASITO in respect to a probity issue that arose in the Group 1 tender process in May 2000. In that case, following a request from OASITO for a probity audit of the issue, the Probity Auditor prepared a full report setting out the scope of inquiries undertaken and the conclusions reached. The report was subsequently provided to the then Minister for Finance and Administration.

74. As noted earlier, the sign-off on the evaluation phase of the Health Group tender process provided by the Probity Auditor on 3 September 1999 indicated no awareness of unresolved probity issues or concerns, and made no reference to specific probity issues considered or inquiries undertaken (see paragraphs 41 and 77). ANAO considers that a probity report of the type prepared in relation to the Group 1 tender, available at the time of a probity event, provides transparency and timely closure on the issue. In the absence of such a report, a clear accountability trail was not maintained of a decision being formally taken by an appropriately authorised entity that the tender should continue after the disclosure event, and the basis for that conclusion. In July 2002, the Probity Auditor advised ANAO that:

As there were no unresolved probity issues or concerns, we formed the view that to provide additional detail may have unnecessarily caused incorrect concerns regarding the probity of the process. We believe that there was no lack of transparency.

75. There is no documented consideration by the Probity Auditor of the potential for a cumulative effect to have arisen from the disclosure event, the late lodgement and significant movements in tendered prices, or of advice to OASITO that it should consider such an effect. The internal OASITO minute regarding the late lodgement made no reference at all to the earlier disclosure event involving the same tenderer or to relevant comments about subsequent tender lodgement made by the Probity Auditor at the time of that event. OASITO records provide some basis for concluding that the movement in IBM GSA's pricing on 2 August 1999 was not a direct result of the disclosure event. However, given the sequence of events, it would have been beneficial for OASITO to have

sought to complement those initial indicators with additional inquiries and assessments to provide further support for its position. There is no evidence of OASITO examining the pricing lodged in the final re-pricing exercise of 2 August 1999 in order to be satisfied that there was no apparent connection between the information disclosed and the price movements, nor of the Probity Auditor recommending such analysis be undertaken.<sup>26</sup>

## Decision-making process

76. Sign-offs were provided by the Legal Adviser and the Probity Auditor at various stages of the Health Group tender, including at the completion of the evaluation process. The Consultancy Agreement for the Legal Adviser did not specify a general oversight role in respect of the conduct of individual tender processes. Nor did it detail any specific requirement for the Legal Adviser to provide sign-offs, nor the form such sign-offs should take. The Legal Adviser was required to provide OASITO with written reports as requested from time to time. The sign-offs provided by the Legal Adviser were qualified by the extent of their involvement in the tender process and reliance upon advice and assertions from OASITO.

77. The Probity Auditor provided three of the four milestone sign-offs required under the schedule of services in his Consultancy Agreement with OASITO, but did not provide the fourth (that the recommendation to the Minister accorded with the final report). Nor was the Probity Auditor's sign-off on the ID evaluation methodology obtained. The milestone sign-off on the evaluation phase of the Health Group tender provided by the Probity Auditor on 3 September 1999 essentially represented a statement of 'negative assurance'. That is, it stated that the Probity Auditor was not aware at that time of any circumstances arising out of the evaluation and parallel negotiation phases of the Health competitive tender process which presented unresolved probity issues or concerns. However, the sign-off provided no detail as to the scope of the engagement nor the tasks undertaken by the Probity Auditor in order to be aware of such issues or concerns. Nor did it identify the probity issues that the Probity Auditor had been aware of, or the inquiries or deliberations undertaken to arrive at a conclusion that those issues were 'resolved' (see paragraph 41 and paragraphs 73 to 74).

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<sup>26</sup> In discussions with ANAO, the Probity Auditor advised that he had given OASITO oral advice that analysis of the IBM GSA offer should be undertaken to ascertain whether there was any indication that the information on the disk had been used, and had received oral advice back from OASITO that there was no indication of that.

**78.** None of the sign-offs provided by advisers to the Health Group tender represented a clean sign-off on the tender process as a whole. ANAO's examination of the tasks described in the Consultancy Agreements with the Legal Adviser and the Probity Auditor, and of the available evidence regarding the nature and extent of involvement or oversight by those advisers of the various aspects of the tender process, confirmed that neither appeared to have been in a position to provide a final sign-off on the complete process. However, there does not appear to have been a shared and consistent understanding across all relevant parties, including the relevant decision-makers and responsible Committees, as to the scope and nature of the sign-offs that were to be provided and, therefore, the level of assurance that could reasonably be derived from them.

**79.** In interviews with ANAO, a number of the members of the Evaluation, Steering and Options Committees indicated that it had been their understanding that the legal and probity sign-offs could be relied upon as a clean sign-off of the overall tender process. Members indicated that they had been given no advice or indication that the scope of the sign-offs was qualified or limited in any way. ANAO understands from advice received that the Office of the then Minister for Finance and Administration was kept abreast of developments in the Health Group tender process, and in the IT Initiative more broadly. However, ANAO did not sight evidence of OASITO advising the then Minister of any such limitation or qualification.

**80.** In a February 2000 brief to the Minister's office regarding the disclosure event, OASITO stated that:

...The signoff provided by the Probity Auditor for the project confirmed that no unresolved probity issues remained. This signoff covered the Health project in its entirety—including the events described in this brief and its attachments.

**81.** On 14 June 2001, Finance and OASITO provided the then Minister with a joint briefing on a request from the Senate Finance and Public Administration References Committee for the Minister to reconsider providing it with unexpurgated copies of the evaluation reports of the Health Group tender. The briefing stated, inter alia, that OASITO was not aware of any outstanding probity issues in relation to the Health Group project, and that: '...Full probity and legal sign-offs were obtained to the effect that there were no outstanding probity/legal issues at the end of the project...'.

**82.** At the suggestion of the Minister, Finance sought a report from the Probity Auditor of his views on the nature of the Legal Adviser's sign-off. On 27 June 2001, Finance advised the Minister that the Probity Auditor's report had provided new information to Finance that only milestone sign-offs were obtained from advisers, and that the legal and probity sign-offs were qualified by the extent of

the involvement of those advisers in the process. Finance advised the Minister that it had signed the joint brief of 14 June 2001 on the basis of verbal advice from OASITO that a final legal and probity sign-off had been obtained by OASITO. The Minister subsequently requested that the Finance Internal Audit Unit undertake the internal audit review of the Health Group tender process discussed at paragraphs 27 to 30. Finance advised ANAO in May 2002 that:

The signoffs provided were largely consistent with those provided to the Commonwealth by the same advisers for outsourcing processes audited by ANAO. The fact that some of these signoffs are limited to the issues or processes in which those advisers were involved is to be expected and is not out of the ordinary.

**83.** Decision-makers place considerable reliance on the sign-offs provided by expert advisers in forming conclusions about the tender outcome. It is important, therefore, that they are fully informed as to any qualifications or limitations that may attach to the scope of a sign-off. The experience of the Health Group tender highlights the need for agencies to ensure that there is a clear understanding, on the part of all parties at the commencement of a tender process, as to the level of assurance the Commonwealth will be seeking from an adviser. This is critical to ensuring that the roles and tasks to be played by the advisers are appropriately aligned with that expectation.

**84.** The basis on which probity advice will be provided, and the means by which the appropriateness of the actions taken will be subsequently audited, is an area in which particular clarity is needed prior to commencing the tender process. It is essential that all parties have a clear understanding of the scope of the probity engagement, the deliverable(s) expected to be provided, and the nature of the inquiry, analysis or review tasks that will be undertaken in order to support any opinions or conclusions expressed. An effective means of accomplishing this outcome is for the nature or form of the sign-offs that will be sought to be agreed between the parties before the process commences and incorporated into the consultancy agreement. This was recommended in regard to probity auditing services in Audit Report No.9 2000–01.<sup>27</sup> The whole-of-government response provided by Finance agreed with that recommendation.<sup>28</sup>

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<sup>27</sup> Audit Report No.9 2000-01, *Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative*, pp. 90–91.

<sup>28</sup> The agreement carried this comment: ‘...providing it is acknowledged that the decision-maker was advised of probity auditor sign offs at relevant project milestones and that the sign offs agreed with the probity auditor were in an acceptable form.’



# **Audit Findings and Conclusions**





# 1. Introduction

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*This chapter details the background to the IT Initiative, other reviews conducted on the Initiative and Health Group tender process, and the audit approach and scope.*

## Background

**1.1** In the 1997–98 Budget, the Government announced the Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative (IT Initiative). The measure was directed at achieving long-term improvements in the structuring and sourcing of information technology (IT) services across agencies to facilitate greater integration in the delivery of programs and realise significant cost savings. The Government also identified an opportunity to enhance the growth and competitiveness of the Australian information technology and telecommunications (IT&T) industry through the IT Initiative, particularly in regional Australia.

**1.2** In anticipation of savings being realised from whole-of-Government IT consolidation and outsourcing, reductions were made to the forward estimates of Budget-funded agencies in the 1997–98 Budget. In the implementation of the IT Initiative, if specific tender processes resulted in savings in excess of the Budget reductions, those savings were to be retained by agencies. If the tender processes resulted in lower savings, agencies were required to fund the difference internally.

**1.3** Implementation of the IT Initiative was originally planned to be completed by June 1999. As at December 2000, six of the 12 major tenders planned under the IT Initiative had been completed, with five resulting in executed Service Agreements. To that time, the Initiative had been based upon a framework in which the IT infrastructure and telecommunications requirements of agencies were gathered into a number of groups to be offered to the market.

**1.4** The IT&T services that agencies were required to include in competitive tenders under the Initiative (known as ‘in-scope services’) were all mainframe services, midrange systems, distributed and desktop operations, support services and data networks. The inclusion of voice telecommunications services and/or applications development and support was optional for agencies. Providers were required to tender, at a minimum, to act as Prime Contractor or procurement agent for all services identified in the relevant Request for Tender (RFT). They were also to propose an industry development (ID) plan consisting of ID commitments relating to the performance of the Services Agreement (‘in-scope commitments’) and commitments not relating to the performance of the services (‘out-of-scope commitments’).

**1.5** Responsibility for the overall management and coordination of tender processes conducted under the IT Initiative rested initially with the then Office of Government Information Technology, until it was transferred to the then Office of Asset Sales and IT Outsourcing (OASITO) in November 1997. In December 1998, OASITO advised the then Minister for Finance and Administration of a number of problems that had emerged in the implementation of the Initiative. OASITO advised of a need for greater clarity as to the underlying intent of the Initiative, as well as the respective roles to be played by OASITO and the agencies involved in each tender. On 22 December 1998, the Prime Minister advised all Portfolio Ministers that ‘as a general government policy, outsourcing of IT infrastructure services should proceed unless there is a compelling business case on a whole-of-government basis for not doing so’.<sup>29</sup>

**1.6** In January 1999, the then Minister for Finance and Administration issued revised guidance regarding the respective roles of OASITO and agencies in the tender processes, with the overall coordination and management role of OASITO being clarified and strengthened in some key areas, including in the conduct of the financial evaluation (see Figure 1.1). This central management of the tender processes by an agency that would not be a party to the resulting Service Agreements, together with a mandated model for the type of outsourcing arrangement that was to be sought by agencies, were key features of the implementation strategy developed for the IT Initiative.

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<sup>29</sup> ANAO, Audit Report No.9 2000-01, *Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative*, p. 43.

**Figure 1.1****Principal agency roles and responsibilities in implementing the IT Initiative**

OASITO	Agencies
<ul style="list-style-type: none"> <li>• Strategic planning, including formation of agency groups and sequencing of tenders.</li> <li>• Manage tender processes.</li> <li>• Monitor tender document quality and assist agencies to formulate requirements.</li> <li>• Develop a set of financial models; supervise the population of agency baselines; in consultation with agencies, adjust tendered prices, baselines or business case as required.</li> <li>• Joint responsibility with the DCITA for implementation of the ID framework.</li> <li>• Advise the Minister on significant proposed acquisitions, leasing programs or contracts.</li> <li>• General guidance and assistance to agencies participating in Small Agency Program.</li> <li>• Liaise with agencies after contract signature.</li> </ul>	<ul style="list-style-type: none"> <li>• Define service requirements within and subject to the required scope.</li> <li>• Develop a cost model under OASITO supervision using proforma methodology.</li> <li>• Prepare materials for tenderer due diligence.</li> <li>• Formulate and implement strategies to address human resources transition and related issues; prepare the agency for management of the contract.</li> <li>• Evaluate IT services offerings &amp; prepare reports; participate in negotiations; and determine whether negotiated outcomes meet agency service requirements.</li> <li>• Plan and manage transition of responsibility.</li> <li>• Contract management.</li> </ul>

Source: Roles and Responsibilities for Agencies and OASITO in the IT Outsourcing Initiative, January 1999

**1.7** This performance audit considered the conduct of the Health Group tender process, which was conducted under the arrangements described above. The Health Group consisted of the then Department of Health and Aged Care (DHAC)<sup>30</sup>, the Health Insurance Commission (HIC) and Medibank Private Limited (MPL). It was the fifth tender to be put to the market under the IT Initiative. The RFT was issued in November 1998, with the preferred tenderer being announced in September 1999. Since the completion of that tender, however, the IT Initiative has been the subject of a number of reviews. As a consequence, there has been substantial change made to the implementation strategy for the government's policy in regard to IT outsourcing.

## Other audits and reviews

**1.8** Australian National Audit Office (ANAO) Audit Report No.9 2000–01, *Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative*, completed in September 2000, examined the administrative and financial effectiveness of the implementation of the IT Initiative, with the focus being on the first four tenders conducted—the Cluster 3<sup>31</sup>, Department of Employment, Education, Training and Youth Affairs/ Employment National, Australian Taxation Office (ATO) and Group 5<sup>32</sup> tenders. The audit made 20 recommendations identifying opportunities for improvement in the management and ongoing implementation of the whole-of-government IT Initiative. The Department of Finance and Administration (Finance) provided a formal whole-of-government response to the audit report that agreed, or agreed with qualification, with 16 recommendations, and disagreed with four. The Health Group tender process was completed prior to the release of Audit Report No.9.

**1.9** In February 2002, Finance advised the Auditor-General of action taken by it up to 30 September 2001 on the implementation of outstanding recommendations raised by the Auditor-General in his reports to Parliament. The report was also provided to the Joint Committee of Public Accounts and Audit. It identified all 20 recommendations made in Audit Report No.9 as being implemented, including the four disagreed recommendations. Against three of

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<sup>30</sup> In the Administrative Arrangements Order of 26 November 2001, the Department of Health and Aged Care (DHAC) was renamed the Department of Health and Ageing. All references to the Department in this report will use DHAC as this was the acronym in use at the time of the Health Group tender.

<sup>31</sup> Cluster 3 consisted of the Department of Immigration and Multicultural Affairs (now Department of Immigration and Multicultural and Indigenous Affairs), Australian Electoral Commission, IP Australia, Australian Surveying and Land Information Group, Australian Government Analytical Laboratories, Ionospheric Prediction Service, Finance for Electoral Office Systems, and former Finance bureau customers, including the National Crime Authority.

<sup>32</sup> Group 5 consisted of the Department of Industry, Science and Resources (now Department of Industry, Tourism and Resources), Department of Communications, Information Technology and the Arts, Department of Transport and Regional Services, Department of the Prime Minister and Cabinet, and Australian Competition and Consumer Commission.

the disagreed recommendations, Recommendation No's 8, 12 and 14, Finance advised that its approach to its own IT outsourcing arrangements was consistent with these recommendations. Against the fourth disagreed recommendation, Recommendation No.15 (concerned with the methodology for the calculation of adjustments for required rates of return on agency assets), Finance noted that the Government had decided that responsibility for the implementation of the IT outsourcing initiative will reside with agency heads.

## **Humphry review**

**1.10** On 7 November 2000, the then Minister for Finance and Administration announced that Mr Richard Humphry AO would conduct an independent review in relation to aspects of the IT Initiative. The terms of reference for the review stated that the independent reviewer would inquire into matters relating to the Initiative, with particular emphasis on the implementation risk associated with transitioning the provision of IT infrastructure from the in-house IT operations of Commonwealth agencies to an external service provider in contracts let under the Initiative to that time.

**1.11** The report of the Humphry Review, *Review of the Whole of Government Information Technology Outsourcing Initiative*, released by the then Minister on 12 January 2001, made 10 recommendations relating to the further implementation of the Initiative. All were agreed, or agreed with qualification, by the Government. Significant changes arising from the Humphry Review were the devolution of responsibility for implementing the Initiative from OASITO to agency Chief Executives or Boards; and that decisions as to which outsourcing model to adopt are to be taken by agency Chief Executives or Boards in accordance with their responsibilities under the *Financial Management and Accountability Act 1997* (FMA Act) and *Commonwealth Authorities and Companies Act 1997* (CAC Act). In July 2001, OASITO was re-named the Office of Asset Sales and Commercial Support (OASACS) to reflect its revised functions. Subsequently, in the Administrative Arrangements Order of 26 November 2001, OASACS was abolished and its functions absorbed by Finance. In discussing the activities undertaken in the Health Group tender, this report refers to OASITO, as it was known at the time.

## **Senate inquiry into the IT Initiative**

**1.12** On 30 November 2000, the Chairman of the Senate Finance and Public Administration References Committee (the Senate Committee) announced an inquiry into the Government's Information Technology Outsourcing Initiative. The inquiry was completed in August 2001, with the Senate Committee making

22 recommendations directed at improving the conduct of future IT outsourcing activities within the Australian Public Service (APS).

**1.13** The Senate Committee noted that, during the course of the inquiry, serious questions were raised about the probity of the Health Group tender, particularly the unauthorised disclosure of pricing information to a tenderer and the acceptance of a tender lodged after the required time.<sup>33</sup> A specific public hearing into the probity issues arising out of that tender was conducted on 19 June 2001. Those issues had also been the subjects of considerable scrutiny since late 1999 at various Senate Estimates public hearings.

**1.14** The Senate Committee tabled three reports in the course of its inquiry—an Interim Report, *Accountability in a Commercial Environment—Emerging Issues*, tabled in April 2001; a second interim report, *Accountability Issues—Two Case Studies*, tabled in June 2001, which considered the probity issues associated with the Health Group tender in some detail; and a final report, *Re-booting the IT agenda in the Australian Public Service*, tabled in August 2001. On each occasion, at least one minority report was also tabled.

**1.15** A concern expressed by the Senate Committee in each of its reports related to difficulties experienced by it in obtaining timely access to relevant documentation and advice from agencies. The Senate Committee had particular concerns for its capacity to inquire into the probity issues arising out of the Health Group tender. These related particularly to its requests for access to the full versions of the Health Group evaluation reports<sup>34</sup>, and to legal and probity advice received by OASITO. The Senate Committee reported in its June 2001 second interim report that it believed it had not had adequate access to key

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<sup>33</sup> Senate Finance and Public Administration References Committee, Inquiry into the Government's Information Technology Outsourcing Initiative, *Accountability Issues: Two Case Studies*, June 2001, p. 32.

<sup>34</sup> A 26 March 2001 Senate Order for the production of documents allowed for requested evaluation reports, including those for the Health Group tender, to have commercially sensitive information blanked out, with the reasons for such claims also being provided. In its June 2001 second interim report (p. 15), the Senate Committee noted that the expurgated reports provided to it on 4 April 2001 were mere shells and of only limited value for the purpose of the inquiry. On 22 May 2001, the Senate Committee resolved to issue an order under Standing Order 25(15) for OASITO to provide the full evaluation reports relating to the Health Group, which it agreed to receive *in-camera*. The then Minister for Finance and Administration advised the Senate Committee that, having regard to legal advice, he had directed the Chief Executive of OASITO not to provide the specific documents requested on the ground of public interest immunity except in the form already provided to the Senate. On 8 June 2001, the Chair of the Senate Committee wrote to the Minister asking that he reconsider that decision. The Chair explained that, during the course of the inquiry, serious questions had been raised about the integrity of the Health Group tendering process which the Senate Committee had been unable to resolve, and that the information contained in the requested evaluation reports could be fundamental to its investigation. On 15 June 2001, the Minister advised the Chair of the Senate Committee that he had taken note of the reasons given for requesting the material, and that he had sought and received further legal advice and awaited Departmental advice. On 5 July 2001, the Minister advised the Senate Committee Chair that, based on legal advice received, he had concluded that the public interest grounds for not releasing the information requested remained.

documents and had not received clear, full and accurate information during its hearings that would enable it to make an informed decision on these numerous important issues about the tendering process for the Health Group.<sup>35</sup> The Senate Committee reported it had not been able to resolve these matters to its satisfaction and that, based on its experiences to that time in the inquiry, it was not confident that it would be able to obtain unfettered access to all documents relevant to those matters to reach an informed conclusion.<sup>36</sup>

**1.16** The Minority Report to the Senate Committee's second interim report noted that it was significant that, despite the fact that the contract for the Health Group was signed on 6 December 1999, neither of the two unsuccessful parties have embarked upon a course of legal action. The Minority Report noted that this would seem to indicate that each of them is satisfied that they were not disadvantaged; that they were treated fairly; and that the tender process was conducted with absolute probity.<sup>37</sup>

**1.17** On 21 June 2001, the Senate Committee Chair wrote to the Auditor-General requesting that he conduct an audit of the circumstances surrounding the unauthorised disclosure of tender information during the Health Group IT outsourcing process. The Chair advised the Auditor-General that the Senate Committee's request arose from its concerns about the processes that followed the disclosure, including the acceptance of a late tender offer.<sup>38</sup> On 28 June 2001, the Auditor-General wrote to the Chair advising that, in light of the Senate Committee's request, he had decided to undertake a performance audit of aspects of the Health Group IT outsourcing process as a public interest issue.<sup>39</sup>

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<sup>35</sup> Senate Finance and Public Administration References Committee, Inquiry into the Government's Information Technology Outsourcing Initiative, op. cit., p. 31.

<sup>36</sup> *ibid.*, p. 32.

<sup>37</sup> Senate Finance and Public Administration References Committee, Inquiry into the Government's Information Technology Outsourcing Initiative, Minority Report, *ibid.*, p. 57.

<sup>38</sup> ANAO had planned to conduct a performance audit of the Health Group tender process in 2001-02, but had advised the Committee on 17 May 2001 that, in light of the extensive audit of earlier IT outsourcing contracts and the significant changes subsequently made to the implementation strategy for the IT Initiative following the Humphry Review, it had been decided not to proceed with the audit. The Committee reported in its June 2001 second interim report (p. 17) that this was a matter of concern to it because a serious flaw in the tender process for that group, which it had expected to be examined by the ANAO as part of a wider audit, would now not be subjected to an independent audit.

<sup>39</sup> The August 2001 final report on the Committee's inquiry noted that, in light of that decision, it had agreed not to persist with its order of 22 May for the production of the unexpurgated versions of the Health Group evaluation reports, but nonetheless reserved the right, as a committee of the Parliament with the power to send for persons or documents, to do so at any time in the future.; Senate Finance and Public Administration References Committee, Final Report on the Government's Information Technology Outsourcing Initiative, *Re-booting the IT agenda in the Australian Public Service*, August 2001, p. 5.



## Finance internal audit review

**1.18** In July 2001, at the request of the then Minister for Finance and Administration, Finance instructed its Internal Audit Unit to conduct a review of the 1999 Health Group IT Outsourcing Process.<sup>40</sup> The Minister's request followed information that came to the attention of Finance and the Minister in June 2001 regarding the nature of the sign-offs that had been provided in respect to the Health Group tender by the Legal Adviser and the Probity Auditor. That information arose in the course of deliberations regarding the Senate Committee's requests for the Health Group evaluation reports (see paragraphs 4.111 to 4.121).

**1.19** The internal audit review commenced in July 2001 and was expected to take approximately four weeks to complete. An Interim Report was provided to the then Minister on 27 September 2001, which identified potential concerns about the conduct of the Health Group tender relating to: probity, release of confidential tender information on 28 July 1999, acceptance of the late tender on 2 August 1999, and communication with the Minister for Finance and Administration. In providing the Interim Report to the Minister, Finance noted that the review had not yet been completed as a result of a lack of documentation being provided by OASACS. A copy of the final report of the internal audit review, dated 9 July 2002, was provided to ANAO on 16 July 2002, after the proposed ANAO audit report had been provided to relevant parties for comment.

**1.20** The internal audit review was intended to provide the then Secretary of Finance and Administration and the then Minister with an assessment of the Health Group process employed by OASITO.<sup>41</sup> It was to include consideration of the risk management, probity and commercial aspects of the process.

**1.21** The internal audit review was conducted as an agreed-upon procedures engagement, rather than an audit or review engagement. Under Australian Auditing Standard *AUS 106*, an agreed-upon procedures engagement is one where the auditor's objective is to issue a report of factual findings to those parties that have agreed to the procedures to be performed, in which no conclusion is communicated and therefore no assurance is expressed.<sup>42</sup>

<sup>40</sup> Internal audit and related services provided under the contract between Finance and the external firm that operates its Internal Audit Unit would generally relate to services provided internally to Finance. As OASACS was a separate executive agency within the Finance and Administration portfolio, the conduct of this review required its agreement.

<sup>41</sup> It was also intended to: '...make recommendations (to the extent practical and relevant given that the Health IT Outsourcing Initiative is complete) both in terms of conduct and documentation of the process.' The final report of the internal audit review stated that: 'Due to the termination of OASITO's role in IT Outsourcing projects, and the completion of the [*Health Group tender*] Process, we have not made any recommendations in connection with the Process.'

<sup>42</sup> This is because the auditor does not determine the nature, timing and extent of the procedures performed. In contrast, under *AUS 106*, the auditor's objective in an *Audit* is to provide a high level of assurance through the provision of relevant and reliable information and a positive expression of opinion about an accountability matter; and in a *Review engagement* it is to provide a moderate level of assurance, being a lower level of assurance than that provided by an audit, through the provision of relevant and reliable information and a statement of negative assurance.



## Scope limitations

### 1.22 The report of the internal audit review noted the following scope limitations:

Our engagement was undertaken in accordance with applicable Australian Auditing Standards (specifically AUS 904 'Engagements to Perform Agreed-Upon Procedures'). In this regard, and in accordance with our instructions, Internal Audit has not performed a separate risk assessment to determine the scope and focus of this review, but rather is performing procedures specifically as requested by Finance in response to instructions from the Minister.

This review is limited to the conduct of certain procedures...We (Internal Audit Unit) limit our responsibility to the conduct of these procedures and drawing the findings to the attention of management...

The scope of our work has necessarily been limited due to the volume of information retained by OASITO in connection with the Process....It was agreed with Finance management that not all of these files would be reviewed by Internal Audit...Furthermore, it was agreed with Finance management that Internal Audit would not be responsible for the consideration of electronic files and e-mail records (including the diskette on which Confidential Pricing Information was sent to tenderers).

The scope of our work has also necessarily been limited to the documentation that OASITO was able to provide to Internal Audit on specific matters, as requested by Internal Audit. Due to the volume of documentation noted above, OASITO was requested to provide relevant documentation in connection with the specific procedures within our scope. In certain circumstances, OASITO was unable to provide requested documentation to Internal Audit (either due to inability to locate the documentation, or due to the fact that the documentation was not retained). To the extent that such documentation was not (or could not be) provided, this has necessarily limited the extent to which the agreed-upon procedures could be completed. In instances where this has significantly affected our procedures, we have noted this in the body of the report.

We have not been asked to and therefore we have not evaluated the merits of any decision made by OASITO, the Agencies, or any Committee or evaluation team that considered the tenders in the Health Group IT Outsourcing Initiative. This appropriately was a decision of the relevant stakeholders acting through the Evaluation and Steering Committees. This project was limited to a review of the process applied by OASITO in co-ordinating the tender process.

The review scope did not include the review of the conduct of services performed by professional advisers to OASITO (or specific decisions made by relevant parties) that form part of the decision by relevant parties on the appropriate course of action in the Health Group IT Outsourcing Initiative. However, we have been asked to consider whether *appropriate* advice was sought by OASITO during the course of the Process, and that appropriate sign-offs were obtained. Accordingly, we have limited our procedures to this extent, and have not sought to re-consider the substance of specific advice or opinions.

In these circumstances, we have necessarily relied upon management representations from OASITO and its professional advisers. To validate such representations would have required a significant amount of further work, if possible, and as agreed with Finance, unless we identified information to lead us to believe that such representations were incorrect, we agreed not to explore the basis for such representations...

In accordance with the agreed procedures for this review, we have not consulted with the Agencies, the Minister's Office, the advisers to the Process (except for [*the Legal Adviser, the ID consultant and the Probity Auditor*]), the tenderers involved in the tender process, or the Senate Finance and Public Administration Reference Committee in connection with the Process. Similarly, this review represents a review of the Process as applied by OASITO, and has not considered the actions or activities of the Agencies (or any other agencies) or the Minister's Office except to the extent that such actions are embodied in the processes, decisions, actions and outcomes of the competitive tender process. In addition, we have not consulted with certain former OASITO representatives who may have been key to the Process. In particular in this regard, we have not consulted with [*the former OASITO officer*] who was Chief Executive Officer of OASITO from September to November 1999 and was Chair of the Steering Committee with responsibility for the Process during this period.

**1.23** Consistent with the agreed-upon procedures nature of the engagement and identified scope limitations, the final report of the internal audit review stated that:

As we have not reviewed all documentation connected with the Process, and have not held discussions with all participants in the Process, we do not, as part of this review, conclude on the probity of the Health Group tender process.

**1.24** In that context, the internal audit review presented its overall findings as set out in Figure 1.2.

**Figure 1.2****Summary findings of internal audit agreed-upon procedures review**

We do note that, based on the evidence currently available to us, none of the findings in this report are sufficient individually or collectively to suggest that the procurement outcome was inappropriate.

Specifically in connection with the relatively well-publicised inadvertent release of information and the late receipt of tenders, we believe that although they presented significant probity exposures, OASITO managed them in a manner that was not unreasonable. Although in both cases, we believe that there were other steps that (with the benefit of hindsight) OASITO could have taken to improve its management of these issues, nevertheless we do not believe that these significantly compromised the probity of the Process.

However, our procedures have revealed some opportunities for improvement regarding the probity structures surrounding the Process.

1. We do not believe that the merging of probity adviser and probity auditor roles was in accordance with current better practice. The separation of these roles is an important element of maintaining the independence of the Probity Audit function. We do note that the prominence of the separation of these roles is much greater today than it was in 1998, but believe that future processes should endeavour to keep these roles separate.
2. We do not believe that milestone sign-off, as was applied in this Process for both the probity auditor and the legal adviser, provided OASITO with as strong assurance as an overall sign-off over the entire process would have. Furthermore we note that, in the case of the probity adviser, one of the milestone sign-offs was in fact not received. We believe that a more rigorous probity structure includes an overall sign-off on the probity of the process, and in case of specific significant probity issues (such as the inadvertent release of information to tenderers and the late acceptance of tender or re-pricing documentation) specific sign-off on the management of these issues (which would include the cumulative impact of these various probity issues on the overall probity of the process). Although this does not call into question the overall probity of the Process, we believe that OASITO could have obtained greater benefit (and better demonstration of the probity of the Process) with an overall sign-off.

3. Due to the varied definitions of probity, as are applied in different jurisdictions and in different processes, we believe that OASITO could have benefited from a more rigorous definition of the requirements against which the probity auditor was providing assurance. This would have allowed both OASITO, and other users of the sign-offs received from the probity auditor (including the Minister), to more readily understand what assurance was being provided by the probity auditor.
4. We believe that OASITO could have improved its documentation of all correspondence and liaison with tenderers throughout the process (including the minuting of all meetings) to better demonstrate the transparency with which the Process was conducted.
5. We also believe that OASITO could have improved the manner in which it maintained the records supporting the Process, to more readily facilitate subsequent access to specific documentation regarding the Process. This is particularly relevant given the scrutiny to which the Process has been subjected.
6. We note that there were opportunities for refinement of OASITO's communication with the Minister, including better explanation of the potential implications of the merging of probity auditor and adviser roles, references to sign-offs that either were not received or not available for review, and certain errors in Ministerial briefing documentation.

Source: Department of Finance and Administration Internal Audit Unit, Review of the Health Group IT Outsourcing Process Applied by The Office of Asset Sales and IT Outsourcing ('OASITO')—Agreed-Upon Procedures Report, 9 July 2002, Executive Summary, pp. 9–10.

## Audit approach

**1.25** Pursuant to the Senate Committee's request and the Auditor-General's response to the Committee, the objective of this performance audit was to examine and report on the selection of the preferred tenderer in the Health Group IT outsourcing process. In particular, the audit examined the circumstances surrounding OASITO's administration of the:

- disclosure to a tenderer of information provided by other tenderers;
- subsequent acceptance of a late re-pricing offer from a tenderer; and
- advice to the decision-maker leading to the selection of the preferred tenderer.

**1.26** The audit focused particularly on assessing the administrative processes undertaken in the selection of the preferred tenderer for the Health Group. Audit emphasis was placed on the management of the probity aspects of the tender process, particularly in regard to events that occurred between June 1999, when the tenderers provided their penultimate pricing, and the selection of the preferred tenderer in September 1999.

**1.27** The audit scope did not include a review of the implementation of the Health Group contracts; the management of those contracts by the relevant agencies; nor of the performance of the successful tenderer in the delivery of services since the awarding of the contracts.

**1.28** One of the parties to the tender, MPL, is a Government Business Enterprise (GBE) and was a voluntary participant in the Health Group. MPL was not included in the consideration of the savings projected to accrue to the Health Group from outsourcing, as it is not a budget-funded agency. It was responsible for conducting its own negotiations with tenderers. Under the *Auditor-General's Act 1997*, the Auditor-General may conduct a performance audit of a Commonwealth authority that is a GBE if the responsible Minister, the Finance Minister or the Joint Committee of Public Accounts and Audit request the audit.<sup>43</sup> As no such request was made or sought in this instance, the audit scope did not include consideration of the internal decision-making processes undertaken by MPL in regard to its voluntary participation in the Health Group tender nor its selection of a preferred tenderer for the delivery of its tendered IT services.

**1.29** The objective of an audit engagement is to provide a high level of assurance through the provision of relevant and reliable information and a positive expression of opinion about an accountability matter (see footnote 42 at paragraph 1.21). In contrast to an agreed-upon procedures engagement, the scope of the work performed for an audit remains the responsibility of the auditor. The nature, timing and extent of the procedures performed are those determined as necessary by the auditor to provide sufficient appropriate audit evidence to enable reasonable conclusions to be drawn. Consistent with that, the audit procedures undertaken by ANAO in the course of this performance audit necessarily represented a more expansive level of inquiry than that conducted under the Finance internal audit agreed-upon procedures engagement.

**1.30** The conclusions reached in this audit report are necessarily based on the available documentation, advice received in discussions with participants in the tender process, and comments received from relevant parties on the proposed report or relevant extracts.

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<sup>43</sup> Under the Act, the Auditor-General may also ask a responsible Minister, the Finance Minister or the Joint Committee of Public Accounts and Audit to make a particular request to conduct a performance audit of a Commonwealth authority that is a GBE.

**1.31** ANAO's fieldwork was undertaken between August 2001 and January 2002. The approach taken in the audit was to review the documentation relating to the Health Group tender held by OASACS; DHAC; the HIC; Finance; the Legal Adviser to the IT Initiative; and some documentation made available by the Probity Auditor to the IT Initiative. An important element of the documentation created in regard to the conduct of the tender was e-mail traffic between OASITO, Group agencies, and tenderers. However, in February 2002, Finance advised ANAO that computer tapes holding e-mail traffic for the period of the tender process in 1999 were overwritten and may not be available for review. In March 2002, Finance advised that retrieval of records possibly not overwritten from that period of time would be likely to involve some considerable cost and take some time. As a result, ANAO did not review those records and was therefore not able to form a view regarding the completeness of the e-mail records that were available for review in hard-copy form.<sup>44</sup>

**1.31** Interviews were held with 35 participants in the Health Group tender, including individuals from each of the tenderers; officers of the former OASITO; the then Secretary of DHAC; the Managing Director of the HIC; members of the Options, Steering and Evaluation Committees, including both agency representatives and independent industry members; the Legal Adviser to the Initiative; and the Probity Auditor to the Initiative. In this report, agencies are referred to using the title applicable at the time the tender process was conducted during 1999.

**1.32** ANAO engaged the Australian Government Solicitor (AGS) to provide legal advice on a number of matters, including in regard to good practice in the management of probity issues in competitive tenders; the legal standing of draft advices; procedural fairness matters; and the appropriate protocol for examining a computer floppy disk on which confidential information was provided to a tenderer, IBM Global Services Australia (IBM GSA), in the course of the Health Group tender. ANAO also engaged the Defence Signals Directorate (DSD) to undertake expert examination of the computer floppy disk provided to IBM GSA. This quite detailed approach to the audit was considered necessary in view of the issues involved in responding to the Senate Committee's request.

**1.33** The audit was conducted in accordance with ANAO Auditing Standards and at a cost to the ANAO of \$350 000.

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<sup>44</sup> Australian Auditing Standard *AUS 806* states that the objective of a performance audit is to enable the auditor to express an opinion whether, in all material respects, all or part of an entity's operations have been carried out economically, efficiently and/or effectively. Any limitations on the scope of the auditor's work, and the reasons for the limitation, are required to be described in the audit report.

## 2.Tender Evaluation Process

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*This chapter outlines the tender process undertaken for the selection of the preferred tenderer to the Health Group.*

### Health Group formation

**2.1** DHAC is a budget-funded Commonwealth department required to comply with the FMA Act. The HIC is a Commonwealth authority established pursuant to the *Health Insurance Commission Act 1973* (HIC Act), which must also comply with the requirements of the CAC Act. The HIC receives funding from DHAC under an Output Pricing Agreement (OPA) for Medicare and other services. The Secretary of the Department is also a Commissioner of the HIC.

**2.2** Following the announcement in April 1997 of the clustering strategy that was to be adopted in implementing the IT Initiative, DHAC proposed that it and the HIC be grouped in order to form a cluster that met the Health portfolio's objectives for its businesses. Those businesses were expected to undergo substantial change through information management reform in the sector. On that basis, it was agreed that a Health Group would be formed comprising DHAC and the HIC.

**2.3** Medibank Private was established as a private health insurance fund in 1976, operating as the commercial arm of the HIC, with the HIC providing it with IT services. The *Health Insurance Commission (Reform and Separation of Functions) Act 1997* required full separation of Medibank Private from the HIC, including separation of IT infrastructure. On 1 May 1998, Medibank Private Limited (MPL) separated from the HIC and was established as a public company under the Corporations Law wholly owned by the Commonwealth. The separation arrangements provided for a transition period in which the HIC would continue to provide IT services to MPL under a transitional contract, the Technology Services Agreement (TSA). The TSA imposed a range of obligations on the HIC to provide services to MPL until March 2000, and to assist with transition to a new provider for a period beyond that of up to 12 months.

**2.4** In April 1997, the Government decided that, due to competitive neutrality considerations arising from the GBE-like nature of Medibank Private (as it was then), it was to be excluded from the IT Initiative. However, during development of the Health Group RFT in 1998, OASITO approached MPL regarding possible involvement in the tender. The rationale was that IT infrastructure being used to provide IT services to MPL under arrangement with the HIC was to be included in the outsourcing tender process. On 31 August 1998, OASITO wrote to the Chairman of the MPL Board inviting MPL to participate in the Health



Group. OASITO advised the then Minister for Finance and Administration that MPL provided formal notification of its intention to participate on 23 November 1998. OASITO further advised that, in its view, there was merit in MPL's participation on the grounds that it facilitated placing it on a commercial footing earlier than envisaged, and would accelerate the decoupling of MPL and the HIC if suitable tenders were received.

**2.5** DHAC subsequently expressed concern about competitive neutrality issues arising from MPL's participation in the Health Group. However, following negotiations between the parties, a basis for MPL's participation was agreed and set out in the *Principles Underpinning MPL's Participation in the Health Group Competitive Tendering Process*. These included a requirement that the RFT be structured to ensure competitive neutrality was achieved.

**2.6** In Audit Report No.9 2000–01, ANAO found that, within the policy context, there were areas in which the structure of agency groupings could be enhanced to better support agency business requirements, including in terms of the relative size, business-focus, funding arrangements and security requirements of grouped agencies.<sup>45</sup> ANAO also found that overall performance is likely to be enhanced where strategies are complementary and action is mutually supportive of required outcomes.<sup>46</sup> In that context, it was beneficial that the Health Group agencies had common interests in the delivery of health portfolio business strategies.

**2.7** However, the combination of entities with such different legal and commercial obligations and incentives into a single competitive tender complicated the conduct of the tender, particularly the decision-making framework. The role of OASITO in managing the tender process also led to concerns being expressed at various points by the independent Boards of both the HIC and MPL regarding the lack of control, on their part, over the process.

## **Legal obligations of the HIC**

**2.8** The Prime Minister's letter of December 1998 advised all Portfolio Ministers that, as a general government policy, outsourcing of IT infrastructure services should proceed unless there was a compelling business case on a whole-of-government basis for not doing so. In January 1999, the then Minister for Finance and Administration advised Portfolio Ministers that this was a policy

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<sup>45</sup> Audit Report No.9, op. cit., p. 65.

<sup>46</sup> *ibid.*



of the Commonwealth for the purposes of Regulation 9(a) of the FMA Act<sup>47</sup> and applied to all budget-funded agencies within their portfolio. The Minister also advised that agency heads and boards would be accountable under the CAC or FMA Acts, or relevant agency specific legislation, for their agency's full compliance with the requirements of the Initiative.

**2.9** The HIC is a separate legal entity to the Commonwealth, established under the HIC Act and subject to the CAC Act. Under the CAC Act, the HIC Commissioners have duties much the same as do directors of public companies, including a requirement to make their decisions with reasonable care and diligence. To satisfy these duties, the Board of Commissioners must act in the best interests of the HIC in making their decisions about the market testing of HIC's IT infrastructure and the acceptance of OASITO's management arrangements of the Health Group tender process.

**2.10** For these reasons, the HIC Board could not assume that it would be in the best interests of the HIC to adopt, as the HIC solution, a solution meeting the needs of an FMA Act agency or group of agencies. It therefore followed that the HIC Board would not have been able to leave it solely to OASITO to make a decision as to the HIC's IT outsourcing solution. There would have had to be active consideration by the Board of a recommendation made by OASITO to assess whether it was in the best interests of the HIC.

**2.11** However, there are provisions under both the HIC and CAC Acts through which Ministers may compel conduct by the HIC. Section 8 of the HIC Act provides that the Minister for Health and Aged Care<sup>48</sup> may, by written notice, give directions to the Commission about the performance of its functions and the exercise of its powers, such direction being a disallowable instrument. In this case, no direction pursuant to section 8 was issued. Section 28 of the CAC Act provides that, after consulting with the directors of a Commonwealth authority, the responsible Minister may notify the directors in writing of general policies of the Commonwealth Government that are to apply to the authority. The directors must ensure that the policies are carried out in relation to the authority. The issuing of such a notice would provide legal certainty in regard to directors' actions in complying with the general government policy in the management of the authority.

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<sup>47</sup> Regulation 9 states that an approver must not approve a proposal to spend public money unless the approver is satisfied, after making such inquiries as are reasonable, that the proposed expenditure: (a) is in accordance with the policies of the Commonwealth, and (b) will make efficient and effective use of the public money.

<sup>48</sup> In November 2001, the Prime Minister announced that the title was changed to Minister for Health and Ageing.

**2.12** In June 1998, the Legal Adviser to the IT Initiative advised OASITO that a direction that departments and agencies must outsource their IT requirements may be a ‘general policy’ within the meaning of section 28, but that:

...we do not think that a decision that the conduct of the outsourcing processes should be under Government management would be a ‘policy’ in the relevant sense: rather it would be a matter of administration. We therefore do not think it would be open to the responsible Minister under section 28 to give a notification to the HIC as to the administrative means by which it was to comply with an outsourcing policy. Instead it would be a notification as to how the Government wished the HIC to carry out the administrative acts involved in outsourcing its requirements. In our view, that is a matter for the HIC (subject only to directions under section 8J of the HIC Act).

**2.13** In his January 1999 letter, the then Minister for Finance and Administration advised Portfolio Ministers that, where necessary, he may seek their cooperation in formally notifying the general policy on IT outsourcing to CAC Act agencies and to other agencies under relevant legislation. Although the potential for such a notice to be issued to the HIC was contemplated at various stages leading up to the release of the Health Group RFT, a notice under section 28 of the CAC Act requiring the HIC to comply with the general policy on IT outsourcing was not issued to the HIC at the time of the tender process.<sup>49</sup>

### *HIC Board indemnity*

**2.14** In August 1998, the Steering Committee formed to manage the Health Group tender process was advised that the HIC Board was concerned to ensure that specific independent advice was available to it to answer questions regarding the completeness of the RFT, the probity of the process, and whether it met the HIC’s business needs. OASITO indicated that the HIC Board had full access to advice from OASITO and advisers engaged for the IT Initiative; and that, together with advice from the Commission itself, this should meet the requirements of the Board. The HIC representatives on the Steering Committee indicated that

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<sup>49</sup> In June 2000, the Government agreed to the issuing of a Notice of General Government Policy under section 28 of the CAC Act on the IT Outsourcing Initiative to CAC bodies involved in the Initiative. On 8 September 2000, the then Minister for Health and Aged Care provided a draft Notice to the HIC Board of Commissioners of a general policy of the Commonwealth Government relating to the implementation of the Government’s IT Infrastructure Initiative by the HIC as a member of Health Group. The Minister advised the HIC that the Government had decided to issue the Notice to CAC bodies participating in the Initiative following a request to clarify the Government’s policy. The HIC was advised that the Notices would give directors or their equivalent in CAC bodies power to make decisions on behalf of their respective bodies to outsource their IT infrastructure in accordance with the Government’s policy and to participate in the Initiative, including industry development matters. The Commission was requested to provide any views it may have on the draft Notice. On 9 October 2000, the Chairperson of the HIC advised the Minister that the Commission had no objection or difficulty with the Minister notifying it of the general policies of the Commonwealth Government set out in the proposed Notice.

the Board may not be satisfied with this arrangement. HIC also raised the possibility of a full indemnity for Board members as an alternative option to Board access to independent advice. OASITO indicated that it could consider this matter if necessary.

**2.15** In October 1998, the Managing Director of the HIC advised OASITO that the Commissioners believed that they needed to seek independent advice to ensure they were fulfilling their obligations as HIC Commissioners in regard to their participation in the Health Group. OASITO was advised that, as none of the Commissioners had a background in IT, and in order to make the necessary critical judgements about IT outsourcing, the Commissioners had decided to engage a consulting firm to provide them with advice on the timing and processes associated with the creation and release of the RFT and the potential impact on the HIC of outsourcing as proposed.

**2.16** In November 1998, the consulting firm recommended that the HIC withdraw from the process then in train and instead pursue an approach to cost reduction that is tailored to the specific needs of the HIC. They reported that, at that time, the HIC met only three of six criteria for outsourcing readiness<sup>50</sup>, and that the existing process was not designed to account for the distinctive obligations of the HIC.

**2.17** The Commissioners considered the consulting firm's report on 6 November 1998. By majority, the Board agreed to a proposal by the Chairman that it advise the then Minister for Health and Aged Care that it could not agree to support the OASITO process at that time, and seek consultation and the opportunity to advise him of the Commission's position. The then Secretary of DHAC, as a member of the Board, dissented from the decision.<sup>51</sup>

**2.18** The Chairman advised the Minister of the results of the Commissioners' deliberations on 9 November 1998 and sought consultation with the Minister before making a final decision. The Chairman advised that, in summary, the Commission supported the principle of outsourcing based on advice from the consulting firm, but considered that it was not in the best interests of the HIC to

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<sup>50</sup> The consulting firm had established a series of criteria for successful outsourcing and reported that the tests of non-strategic, functional independence and operational stability were met. The criteria of clarity of objectives, business process certainty, and value were not met. The consulting firm found that, since the HIC had not addressed fundamental issues around how its business would be conducted, the test of business direction certainty in the medium term failed, which raised the risk of a poor outsourcing decision in terms of limited flexibility and a higher cost base. The consulting firm also reported that the lack of a detailed internal assessment of the potential available from outsourcing raised the likelihood that value would not be maximised for the HIC.

<sup>51</sup> The Secretary argued for the release of the RFT, noting that although he shared the concerns of the rest of the Commission in regard to its CAC Act obligations, there were four factors that provided him with some level of comfort—the scope, which the consulting firm had deemed to be appropriate; the dollars, where there was not a huge variance in the cost of the different options; the timing, where there may be options to move; and alliances.

proceed with the existing process at that time. Internal HIC documentation records that a key concern was that the HIC was pursuing major process and structural changes to improve efficiency and business performance, but was unable at that stage to specify the likely directions clearly enough to allow prudent specification in the RFT.

**2.19** Over the subsequent week, there was extensive consultation involving the HIC and its consulting firm, OASITO, the Strategic Adviser to the IT Initiative<sup>52</sup>, and the offices of the relevant Ministers, in which a range of options for resolving the issue were canvassed. The concerns discussed included whether an outsourcing option would provide sufficient flexibility for the HIC to perform its functions over the period of a contract; difficulties surrounding the TSA with MPL; treatment of the existing HIC data centre in the tender process; and a range of process issues.

**2.20** On 14 November 1998, the then Minister for Finance and Administration advised the then Minister for Health and Aged Care that he understood that the Commission may now have some doubt about whether its participation in the IT Initiative was wholly consistent with its own interests. The Minister advised that, while appreciating that the Commission's view of its own interests may on occasion diverge from the Government's view, it was nonetheless a general policy of Government that all agencies such as the HIC shall participate in the Initiative, unless the Government itself is persuaded that they should be exempted. The Minister further advised that, while he had noted the basis for the reservations expressed by the HIC, he was of the view that they were not sufficient to persuade him that the HIC should, having regard to the wider Commonwealth interest, be excluded.

**2.21** The Minister also stated that if, in the light of that Government view the Commission was still not persuaded that it should participate in its own interests, then he considered that it would be appropriate to use the provisions of the CAC Act to apply a formal policy compliance obligation to the HIC. However, the Minister also advised that, if the Commission was, on balance, prepared to set aside its concerns notwithstanding some doubts, then he considered that the Government should recognise their bona fide dilemma and assume the accountability to the Commonwealth by indemnifying the Commissioners in connection with this matter. The Minister noted that no special indemnity would be necessary if the CAC Act provisions were used, because there could then be no room for doubt about the duties of the Commissioners to give effect to the policy.<sup>53</sup>

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<sup>52</sup> See Audit Report No.9 op. cit., pp. 75–80 for discussion of the engagement and contract management processes undertaken in regard to the Strategic Adviser to the IT Initiative.

<sup>53</sup> In August 2002, the Legal Adviser advised ANAO that they had provided OASITO with further draft advice on 16 November 1998 in relation to section 28 of the CAC Act and section 8JA of the *Health Insurance Commission Act 1973*, and that the advice had also discussed the giving of indemnities.

**2.22** On 17 November 1998, a special meeting of the HIC Board resolved, in broad terms, to proceed with the OASITO-led RFT and tender process, on the basis that it was OASITO that would bear the risk of any margin in cost established by the successful tenderer. The Chairman advised the then Minister for Health and Aged Care that the decision was taken only after very careful consideration of further advice from the HIC's expert consultant and important concessions from OASITO in a number of key areas. The resolution to proceed included an acceptance by the Commissioners of the indemnities offered by the then Minister for Finance and Administration, and noted that OASITO had indicated that it would recommend to the Minister that a similar indemnity be offered in relation to the issue of the RFT. The resolution also stated that the HIC acknowledged at the outset that there would be issues on which the Commission must be satisfied prior to taking any decision to sign an outsourcing agreement. These would include, but not be limited to, legal issues (sign-off), data centre costs/concerns, and emerging business directions.

**2.23** The then Minister for Finance and Administration subsequently provided the HIC Commissioners with a Deed of Indemnity indemnifying each Commissioner to the maximum extent permitted by law, from and against all claims which from time to time may be made or instituted against or suffered or incurred by a Commissioner in or in relation to or in connection with the Commissioner's conduct in the course of the performance of the IT Initiative.<sup>54</sup>

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<sup>54</sup> Subject to specified conditions, the indemnity includes any claim arising from or in relation to or in connection with any decision, determination, resolution, statement or representation made or omitted to be made or any act performed or omitted to be performed by the HIC; and, for the purpose of the indemnity, the Deed states that it was immaterial that: (1) a claim is based on a claimed breach of a statutory, legal, equitable or other duty or obligation alleged to be owed by the Commissioner; or (2) a claim arises due to events which occurred before the date of the Deed of Indemnity. The indemnity does not apply to the extent that a claim results from: (1) a failure of the Commissioner to act honestly in his or her position as a Commissioner; or (2) the fraud, wilful default or bad faith of the Commissioner in his or her position as a Commissioner; or (3) the Commissioner having made improper use of information acquired or obtained by him or her in his or her position as a Commissioner or having made improper use of his or her position as a Commissioner, in either case so as to gain an advantage for the Commissioner or for any other person or to cause detriment to the Commonwealth or the HIC. The indemnity also does not apply to the extent that the Commissioner has not taken reasonable steps to comply with a policy or procedure notified in writing to the Commissioner by the Commonwealth where the Commonwealth has power to require compliance with such policy or procedure; or to the extent that the Commissioner recovers an amount under an insurance policy and where the Commissioner must claim under the insurance policy prior to claiming under the indemnity.

Despite this resolution, however, issues relating to the independent role of the HIC in participating in the tender process, including its capacity to engage independent expert and legal advisers, continued to arise throughout the tender.<sup>55</sup>

## **Legal obligations of MPL**

**2.24** On 22 July 1999, the Chair of the MPL Board formally raised with OASITO a significant concern of the Board in relation to its preparations for transferring its technology services needs from the HIC to a new provider under the auspices of the OASITO outsourcing process. That concern related primarily to the options available to MPL at the conclusion of the Health Group tender process. In particular, a tension existed between the option that appeared to offer the greatest short-term commercial value to MPL and those that would most conveniently accord with the Government's broader IT whole-of-Government outsourcing objectives.

**2.25** The Board's concern related to the obligations of directors and senior officers of MPL under the Corporations Law to discharge their duties with the degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation's circumstances. The Chair advised OASITO that, in the view of the directors, those duties would, in the ordinary course, preclude them from agreeing to the options that most aligned with Government policy objectives. However, the Chair advised that the directors would be prepared to adopt either of those options if the Government were prepared to provide a suitable form of protection against any later liability or loss they and relevant senior officials might otherwise incur.<sup>56</sup>

**2.26** On 4 August 1999, the Legal Adviser advised OASITO that, while acknowledging the government policy objectives that it understood were the basis for OASITO favouring giving the indemnity, it felt that it also needed to

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<sup>55</sup> On 18 March 1999, the Legal Adviser advised OASITO that conflicts of interest between the Commonwealth, HIC and MPL had arisen and would continue to arise. In this regard, the Legal Adviser noted that: '... no direction had been given to HIC to ensure that its interests are the same as the Commonwealth. We have discussed this potential for conflict of interest with OASITO a number of times previously.' The Legal Adviser further advised that under its contract with the Commonwealth, it was not to act in conflict of interest situations, and that '... HIC is not, so far as we are aware, separately represented and this is where our main concern lies.' The Legal Adviser advised ANAO in August 2002 that: 'We note that the outcome of the series of events that related to the advice of 18 March 1999 was that OASITO agreed to allow HIC to be legally represented. (OASITO had previously refused to permit the HIC to be legally represented although Health and MPL had each been permitted to have its own legal representation from the outset).'

<sup>56</sup> OASITO documentation indicates that the question of indemnities for MPL directors had been raised informally with OASITO by MPL earlier in the tender process.

caution about the potential Commonwealth exposures under the indemnities.<sup>57</sup> On 26 August 1999, OASITO advised the then Minister for Finance and Administration of the MPL request. OASITO indicated that the early separation of MPL and HIC (in terms of the then agreement between HIC and MPL for the provision of IT services) was a clear Government policy imperative and, on that basis, MPL's participation could be viewed as being in the Commonwealth's broader interests. OASITO advised that an indemnity for MPL directors would be appropriate in those circumstances. However, on 31 August 1999, the Minister informed OASITO that he was not prepared to consent to indemnities for the directors of MPL.

## Lessons for future implementation

**2.27** A number of the complexities that arose in the context of the Health Group tender highlighted factors that should be considered in the implementation of future initiatives with applicability across a variety of Commonwealth entities. In particular, the experience in that tender highlighted the need for implementation planning to consider the implications of relevant Commonwealth entities' legal status and obligations. This would assist in ensuring that the implementation strategy adopted provides legal certainty for all parties at an early stage in the process and enhances overall efficiency and effectiveness in implementing government policy.

**2.28** A number of the issues discussed above arose as a result of the adoption of an implementation strategy which incorporated, as key features, the central management of the tender process by an agency that would not be a party to the resulting Service Agreements, together with a mandated model for the type of outsourcing arrangement that was to be sought by a group of agencies. This issue was considered in the December 2000 report of the Humphry Review of the IT Initiative, which found that the Initiative's approach demonstrated the tension between the centralised approach to implementation and the legislated responsibilities of agency heads or governing boards.<sup>58</sup> That tension was evident in the conduct of the Health Group tender.

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<sup>57</sup> In the Legal Adviser's view, MPL had 'control' over its involvement in the process as it was able to remain an observer and make whatever decision it wanted in relation to the process. The Legal Adviser advised that it was therefore not clear why the Commonwealth would want to indemnify the directors of MPL in this process. The Legal Adviser also advised that: 'To this end, recent events relating to information disclosures may mean that the Commonwealth's risks under the indemnity (if given) are increased'.

<sup>58</sup> Richard Humphry AO, *Review of the Whole of Government Information Technology Outsourcing Initiative*, December 2000, p. 10.



**2.29** The report of the Humphry Review noted that, since the commencement of the IT Initiative, the Government had introduced several reforms to public administration, including the FMA Act 1997, the CAC Act 1997, the *Public Service Act 1999*, accrual budgeting and an outcomes and outputs framework, which serve to enhance agency management and accountability. The Review found that, with the maturing of the Initiative, it had identified significant risks in the transition and implementation processes of outsourcing that are primarily at the agency level. It found that these are best managed by those that have the authority and capability of managing them.<sup>59</sup> In light of the experience in the IT Initiative to that time, and subsequent enabling legislation introduced by the Government which empowers Chief Executives and Boards, the Review made a number of recommendations, including that:

- future responsibility for implementing the Initiative should be fully devolved to agency Chief Executives or Boards;
- the decision as to which outsourcing model to adopt should be taken by the agency Chief Executive or Board in accordance with their responsibilities under the FMA and CAC Acts; and
- it was no longer appropriate for OASITO to continue with its centrally managed role.<sup>60</sup>

**2.30** The Government agreed or agreed with qualification, to each of the Humphry Review recommendations.

**2.31 Finding:** A number of the complexities that arose in the context of the Health Group tender highlighted factors that should be considered in the implementation of future initiatives with applicability across a variety of Commonwealth entities. In particular, the experience in that tender highlighted the need for implementation planning to consider the implications of relevant Commonwealth entities' legal status and obligations. This would assist in ensuring that the implementation strategy adopted provides legal certainty for all parties at an early stage in the process and enhances overall efficiency and effectiveness in implementing government policy.

## Tender evaluation structure

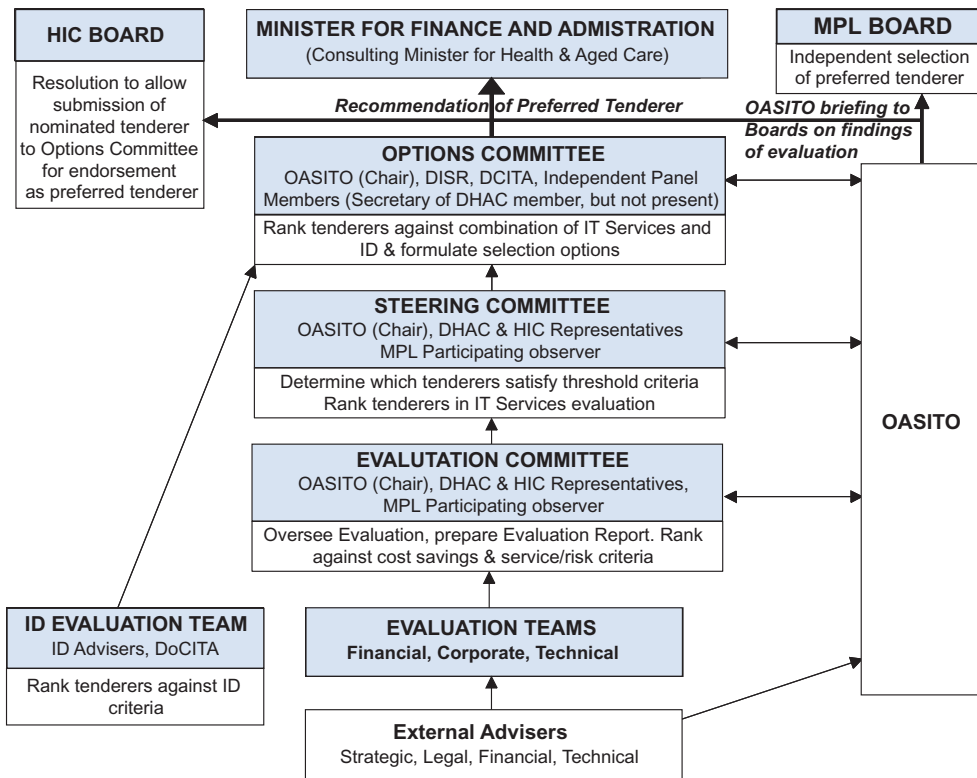
**2.32** A comprehensive tender evaluation and reporting framework was established to underpin the selection of preferred tenderer for the Health Group (see Figure 2.1). The IT&T services and industry development (ID) evaluations were conducted separately, with OASITO having an overall coordination role.

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<sup>59</sup> *ibid.*, p. 6.

<sup>60</sup> *ibid.*, pp. 6–8.



**Figure 2.1****Tender evaluation structure to preferred tenderer stage**

Source: ANAO analysis of Guide for the Evaluation of Tenders for Provision of IT&T Services- Health Group, and DHAC, HIC and OASITO documentation.

**2.33** The Evaluation Guide prepared for the tender stated that the Minister for Finance and Administration, the Minister for Communications, Information Technology and the Arts, and the Minister for Health and Aged Care would take the final decision, having regard to the options put forward by the Options Committee. However, the decision-making framework ultimately established also necessarily involved a role for the Boards of MPL and the HIC in independently assessing the outcome of the evaluation. Under the principles underpinning MPL's involvement, when a formal outsourcing decision was taken for the Group, MPL would indicate whether it wished to proceed with its own long term outsourcing contract with the Group's preferred tenderer (or another contractor), or alternatively, to remain as a HIC 'customer' under the TSA for the remaining term of that agreement. As noted above, in resolving to proceed with its participation in the Health Group tender, the HIC Board identified that there would be issues on which it would have to be satisfied prior to taking any decision to sign an outsourcing agreement.

**2.34** An Evaluation Committee was responsible for the implementation and control on a day-to-day basis of the IT&T services part of the tender evaluation. It oversaw and directed the conduct of the evaluation by specialist Financial, Technical and Corporate Evaluation Teams consisting of agency and OASITO representatives and assisted by advisers engaged by OASITO. Based on the detailed reports provided by those teams, the Evaluation Committee was responsible for preparing an IT&T Services Final Evaluation Report for review, comment and ultimate endorsement by a Steering Committee.

**2.35** The Steering Committee was responsible for managing the tender process in accordance with arrangements advised by OASITO. In the case of the IT&T Services Final Evaluation Report, the Steering Committee was responsible for determining which of the tenderers had satisfied the threshold criteria. The Evaluation Guide stated that the Committee may also rank the tenders in terms of best overall value for money as measured against the IT&T services evaluation criteria. Both Committees were chaired by OASITO, and included representatives from DHAC and the HIC. MPL could attend Committee meetings as a fully participating observer, but had no right to veto decisions or judgements of the Group as they applied to the Group outsourcing.

**2.36** A separate evaluation of tenderers' ID offerings was conducted by the Industry Development Evaluation Team (IDET), consisting of external advisers engaged by OASITO and representatives from the Department of Communications, Information Technology and the Arts (DCITA). The outcomes of the two evaluations were first combined when considered by an Options Committee comprising representatives from OASITO (again as chair), DCITA, the then Department of Industry, Science and Resources (DISR), and two invited members from industry.<sup>61</sup> The Options Committee was responsible for formulating selection options for consideration by the relevant Ministers.

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<sup>61</sup> It was normal practice in the OASITO-managed tender processes for the Group agencies not to be represented on the Options Committee. On 27 August 1999, OASITO advised the then Minister for Finance and Administration that at a recent meeting with the principals of the HIC and DHAC, the then Secretary of DHAC had requested that he be invited to participate on the Options Committee. OASITO recommended to the Minister that, given the Secretary's overall portfolio responsibilities and the 'single agency' characteristic of the Health Group, his participation in the Options Committee deliberations would be, on balance, appropriate. The Minister agreed to the request on 31 August 1999. However, the Secretary did not attend the Options Committee meeting held on 8 September 1999 at which the outcomes of the IT&T Services and ID evaluations were considered. That meeting had been rescheduled a number of times. The Secretary recorded that he was briefed on the Options Committee papers by OASITO the previous day and noted that both the IT&T services evaluation and ID evaluation on balance favoured IBM GSA, that none of the ID bids were particularly strong for the health industry per se, and there was no basis for discriminating on that score. The Secretary recorded that it was agreed that, only if the other members of the Options Committee took a different view, would there be a need for a further meeting of the Committee with all members present. The Options Committee recommended to the Minister, on 8 September 1999, that IBM GSA be selected as preferred tenderer. The recommendation was not signed by the Secretary, and made no reference to the Secretary having been formally approved as a member of the Committee, being absent from the meeting, or formally withdrawing from the Committee (see footnote 250).

## Health Group tender process

**2.37** The Health Group RFT was released on 30 November 1998. Tenders closed on 15 February 1999, with responses being received from three tenderers—IBM Global Services Australia (IBM GSA), CSC Australia Pty Limited (CSC) and EDS (Australia) Pty Ltd (EDS). The subsequent tender evaluation process was complex, lengthy and costly for all parties. The Evaluation Guide identified a timetable in which final contract negotiations were expected to conclude by 18 May 1999, depending on the number and quality of the tenders received. In the event, final contract negotiations with the successful tenderer concluded on 6 December 1999, when contracts were exchanged with IBM GSA to the value of \$351 million for the supply of IT services over 5 years to DHAC and the HIC, with options to extend for up to a further four years. MPL entered into a separate contract with IBM GSA. The key dates in the Health Group tender process are set out in Figure 2.2.

**Figure 2.2**

### Health Group IT outsourcing tender process events

Notification to Industry	23 Nov 1998
RFT Released	30 Nov 1998
Tenders closed	15 Feb 1999
Non-financial parts of tenders opened	15 Feb 1999
Financial part of tenders opened	5 March 1999
Re-pricing Number 1	21 May 1999
Re-pricing Number 2	21 June 1999
Re-pricing Number 3	2 Aug 1999
Final price clarifications	4 Aug - 1 Sept 1999
IT&T Services Final Evaluation Report endorsed by Evaluation Committee	2 Sept 1999
Errata to IT&T Services Final Evaluation Report	3 Sept 1999
IT&T Services Final Evaluation Report endorsed by Steering Committee	3 Sept 1999
Industry Development Evaluation Report	2 Sept 1999
Evaluation reports and Options Committee recommendation for preferred tenderer referred to Minister	8 Sept 1999
Steering Committee resolution regarding finalisation of savings figures	17 - 22 Sept 1999
Options Committee confirmation of recommendation	17- 22 Sept 1999
Preferred tenderer endorsed by Minister	23 Sept 1999
Contracts executed	6 Dec 1999

Source: ANAO analysis of OASITO documentation

## Evaluation criteria and rules

**2.38** The RFT established the evaluation criteria and relative priorities to be applied in determining the outcome of the tender. Those criteria, which were the same as, or similar to, those that applied to the ATO, Group 5 and Cluster 3 tenders examined by ANAO in Audit Report No.9 2000–01, were grouped into three categories:

- a) cost savings;
- b) industry development; and
- c) service and risk in relation to the performance of the services, which comprised the categories of corporate capability, commitment to service and overall risk, and technical solution.

**2.39** Cost savings and ID were identified as key Commonwealth objectives for the project. The RFT established two preconditions to the awarding of a contract. Firstly, the service and risk criteria were threshold criteria that had to be satisfied in order for the Commonwealth to consider a tenderer's proposed cost savings and ID. Secondly, the RFT stated that achievement of substantial cost savings was a precondition to the awarding of a contract, and the Commonwealth would not award a contract unless it was satisfied that the preferred tenderer would deliver a substantial and acceptable level of cost savings based on an assessment against the criteria relating to cost savings specified in the RFT.<sup>62</sup> If more than one tenderer satisfied this requirement, the Commonwealth would select the tender that, in the Commonwealth's view, offered the best combination of ID and cost savings. The Commonwealth also reserved the right to take account of service and risk considerations in determining that best combination.

**2.40** The financial evaluation was based upon three models as follows:

- Cost Model—a template provided to agencies for the identification of the baseline 'business-as-usual' costs of continuing to provide internally the services requested under the RFT;
- Price Model—provided to tenderers to prepare the detailed pricing required by platform and agency; and

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<sup>62</sup> Those criteria were the extent to which a tenderer's pricing and pricing structure would: a) enable the Commonwealth to maximise savings compared both with competing tenders and the cost to the Commonwealth of continuing to provide the services itself; b) ensure that prices for the services remain market competitive throughout the term; c) provide predictable service charges with no unanticipated price increases over time; d) provide gain-sharing arrangements such that the Commonwealth would share in substantial financial benefits from productivity gains and business process improvement; and e) provide sufficient flexibility to adapt to changing technology and business needs of the Group Agencies, including changes arising out of restructuring, strategic planning, and re-engineering projects.

- Savings Model—compared agency baseline costs with the prices proposed by each tenderer, including new or reduced costs arising as a consequence of outsourcing.

**2.41** The purpose of those models was to enable the costs associated with the two options under consideration—outsourcing the in-scope IT&T services or continuing with internal ‘business-as-usual’ delivery—to be established independently of each other. The agency cost baselines were required to be signed-off prior to the opening of tenders, with any amendments needed to ensure comparability with the services requested of tenderers being applied as transparent adjustments. A similar adjustment process applied to tenderers’ bids. A number of such adjustments were made during the Health Group tender.

**2.42** The models were then used to compare the overall costs associated with each tenderer, and to produce an assessment of the projected cash savings (or premium) for each agency and the Group overall from outsourcing the IT&T services. After the savings in agency cash outlays attributable to each tenderer were calculated, notional competitive neutrality (CN) adjustments were added to the agency cost baselines. These related to costs faced by private sector providers (and therefore reflected in their prices) that public sector agencies were not subject to. The most significant was a requirement to earn a commercial rate of return on capital. The IT&T Services Final Evaluation Report then identified projected financial savings, as well as notional post-CN savings. The savings after the application of CN are notional in that they provide a measure of savings if resource allocation distortions arising out of public ownership were eliminated.

**2.43** The RFT identified two principal phases in the tender evaluation process—the Evaluation and Clarification phase, and the Parallel Negotiations phase. Tenderers were advised that the first phase may involve presentations by some or all tenderers; visits to tenderer sites; requests to tenderers to provide written clarification of various aspects of their tenders; and discussions with some or all of the tenderers to seek further clarification of their tenders.<sup>63</sup>

**2.44** The RFT provided that, during the parallel negotiations phase, the Commonwealth may engage the finalists in detailed discussions and negotiations with the goal of maximising the benefits of the project, as measured using the evaluation criteria set out in the RFT. Tenderers were advised that, as part of this process, finalists may be asked to improve any of the technical, commercial,

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<sup>63</sup> The RFT stipulated that following this phase, the Commonwealth may, without limiting its rights under the RFT: a) select two or more finalists to continue to the next phase of the process, parallel negotiations; or b) select a single preferred tenderer for final contract negotiations without first conducting parallel negotiations.

financial, contractual and/or ID aspects of their tenders. The end of this phase was to be the selection of a preferred tenderer, subject to successfully concluding final contract negotiations.

**2.45** The RFT also stipulated that the Commonwealth may at its sole discretion add to, vary or amend the information, terms, procedures and protocols set out in the RFT. The Commonwealth reserved the right, at its sole discretion at any stage of the tender process, to change the structure and timing of the tender process and/or to change the scope of the services or other requirements of the RFT.

## **Multiple re-pricing rounds**

**2.46** Initial clarification and evaluation of tenders took place in February and March 1999.<sup>64</sup> Parallel negotiations with all three tenderers commenced in April 1999 and continued until the selection of the preferred tenderer in September 1999. Over the course of the tender, the Group agencies made a number of changes to the requirements originally specified in the RFT and tenderers were provided with multiple opportunities to revise aspects of their tenders. Subsequent to tender closure on 15 February 1999, tenderers were asked to formally submit revised pricing offers on three occasions: 21 May 1999, 21 June 1999 and 2 August 1999. Tenderers were also invited to make revisions to their technical and industry development offerings.

**2.47** It is difficult to make comparisons between the prices offered by each tenderer at different points in the tender process. This is due to a number of factors, including the changes made to the scope of services they were asked to tender for. Also, particularly in the earlier rounds, this process was used as a means of testing the pricing effects of various options in terms of service levels that could be requested. Further, many of the adjustments made to tendered prices to ensure comparability between tenders, and with the agency cost baselines, were not finalised until very late in the evaluation. As a result, the prices tendered in earlier rounds are not directly comparable to the adjusted prices used in the final financial evaluation. Nevertheless, it was clear that the

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<sup>64</sup> Tenders closed at 2.00 pm on 15 February 1999. However, opening of tenders was delayed until later that day pending finalisation and approval of the sub-criteria to be used in the evaluation. Evaluation of some aspects of tenderers' responses commenced at that time, but the financial parts were re-sealed pending agreement between OASITO and the HIC as to the HIC cost baseline. On 4 March 1999, OASITO advised the HIC that it had agreed to proceed with the financial evaluation on the basis of the HIC view of the baseline (with the option to revisit this issue during the evaluation in the form of sensitivity analysis if more information came to hand which deviated from the HIC estimate). The financial parts of the tenders were opened and evaluation commenced on 5 March 1999. However, the matter of the HIC cost baseline was raised again by OASITO later in the tender process, and in the review of savings conducted by Finance following submission of the preferred tenderer recommendation to the then Minister for Finance and Administration (see paragraphs 2.92 to 2.102 and 3.60 to 3.76).

relative positions of the tenderers in relation to the financial aspects of their bids altered considerably over the course of the re-pricing process, including in the final round.

### *First re-pricing—21 May 1999*

**2.48** There were significant disparities in the prices initially tendered in February 1999, with the difference between the highest and lowest being some \$137 million over five years. At that point, no tenderer appeared to offer savings when compared with the internal cost baselines of the HIC and DHAC. However, OASITO argued that the service levels sought in the RFT were in excess of industry standards, and of the standards already being achieved by agencies and reflected in their cost baselines.<sup>65</sup>

**2.49** On 26 March 1999, OASITO advised the Evaluation Committee of a new strategy for the Health Group. OASITO noted that it was clear from the tenders that there were some obvious mismatches and misunderstandings that necessitated further discussions with tenderers. To that end, OASITO and senior executives from the Group Agencies were to meet with tenderers in early April with a view to seeking re-priced bids against a revised scope. The Evaluation Committee agreed to tenderers being advised that parallel negotiations had commenced and that the Group was providing tenderers with the opportunity to make improvements to their offer. The Committee also agreed that tenderers' suggestions would be sought on areas of agency requirements that could be revised to provide for more cost effective pricing.<sup>66</sup>

**2.50** The information provided to tenderers on which to base a revised offer included revised statements of work for DHAC and MPL, and variations to some requirements for the HIC.<sup>67</sup> Tenderers were also asked to provide pricing against a set of 'industry standard' service levels which OASITO had developed in conjunction with an external IT consulting firm as an alternative to the service levels set out in the RFT. The HIC and MPL were not provided with an

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<sup>65</sup> This was not in general accepted by agencies, particularly the HIC. Over the course of the tender there was substantial effort applied to this issue by both OASITO and its advisers, with the HIC and its expert consultants offering a different view. On the basis of the available information, some adjustments to increase the HIC cost baseline were ultimately agreed, but they were considerably lower than OASITO had suggested were required.

<sup>66</sup> OASITO subsequently advised the then Minister for Finance and Administration that, following initial assessment of bids, it was agreed by the Health Group Steering Committee that clarification of stated requirements was necessary in order to remove inconsistencies and ambiguities across bids and, in some cases, to provide a baseline of service levels that reflected commercial standards more closely. ANAO did not evidence formal agreement by the Steering Committee to the new strategy or the comments referred to by OASITO.

<sup>67</sup> In May 1999, OASITO advised the Minister that a substantial amount of revised documentation was forwarded to bidders '...resulting in, amongst other things, the scope of work for two of the agencies involved being substantially reworked'.



opportunity to review the standard service levels prior to them being provided to tenderers. The HIC did not agree that they represented the service levels it required, or was already achieving. Ultimately, tenderers were asked to provide pricing against both the original RFT service levels and the standard service levels for the HIC and MPL, as well as a further option for the MPL of its original RFT statement of work and service levels. The option involving the standard service levels was subsequently used as the common reference point when comparing tenderers' bids.<sup>68</sup>

**2.51** Tenderers were advised on 22 April 1999 that re-pricing and any other changes or clarifications to tenders, including their technical solution and industry development offering, were required to be submitted by 5.00 pm on Friday 7 May 1999. On 5 May 1999, the OASITO chair advised the Steering Committee that one tenderer had sought an extension to 21 May 1999, and another to Monday 10 May 1999 (see paragraphs 4.24 to 4.27). The minutes of the meeting record that the Committee was advised that, following agreement by Steering Committee members out-of-session, OASITO had verbally advised all tenderers that the lodgement date had been extended to 21 May 1999.<sup>69</sup> A letter to tenderers advising of the change was endorsed by the Steering Committee on 5 May 1999 and distributed. OASITO advised the then Minister for Finance and Administration of the extension on 6 May 1999.<sup>70</sup> The written advice to tenderers confirming the extension of the deadline advised that, consistent with the terms of the RFT:

...tenderers should submit their best offers, as the Commonwealth may elect to evaluate the offers effective as of the due date without affording tenderers a further opportunity to revise them thereafter.

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<sup>68</sup> This effectively resulted in each of the three tenderers being required to submit pricing for six options, representing a total of 18 offerings that would need to be evaluated. Prior to receipt of the revised proposals on 21 May 1999, it had not been determined how the 18 offerings requested would be evaluated. On 28 May 1999, a DHAC representative on the Evaluation Committee expressed concern about the time and potential for error involved in monitoring, reviewing and updating 18 offerings. OASITO indicated that its brief required that all offerings must be evaluated and, until there was greater certainty in the numbers, no offering could be ruled out. On 31 May 1999, the Steering Committee confirmed that all 18 offerings were to be evaluated but, as simultaneous evaluation could be onerous, the evaluation teams would focus the initial evaluation on the offers against the revised Statements of Work and the OASITO standard service levels, and determine whether particular bids were sensitive to the choice of service levels. The HIC recorded that it preferred early evaluation of the bids using the original RFT service levels. The HIC agreed to the first phase evaluation against the standard service levels provided it would not be grounds for eliminating a tenderer without the HIC's concurrence or regard being given to the HIC's RFT service levels.

<sup>69</sup> The only record of those out-of-session discussions is an unsigned file note prepared by OASITO on 11 May 1999.

<sup>70</sup> OASITO advised the Minister that the Steering Committee had concluded that it would be in the Commonwealth's interest to agree to extensions in order to maximise the possibility of quality bids being lodged. OASITO further advised the Minister that the extra time allowed would provide agencies with the opportunity to establish pricing for additional service levels which they may elect to purchase.



**2.52** On 21 May 1999, all three tenderers submitted revised financial and technical offers, including pricing against both a base service level view and alternative service levels, based on the revised requirements advised by the agencies. Two tenderers slightly increased their tendered pricing. The third, CSC, significantly reduced its base offer, but attached a substantially greater price premium to the alternative service level options than did the other tenderers. IBM GSA also submitted a substantially revised ID offering.

### *Second re-pricing—21 June 1999*

**2.53** Another round of revised offers was sought from tenderers on 21 June 1999.<sup>71</sup> Following initial assessment of the 21 May offers, OASITO advised the Evaluation Committee on 4 June 1999 that:

- the Financial Team had identified a number of errors in bidder pricing and some points requiring clarification;
- tenderers would be asked to provide updated pricing responses to key financial issues papers to OASITO on 21 June 1999; and
- tenderers' updated pricing responses should incorporate any material issues identified in current bids that required rectification.

**2.54** According to the Committee minutes, the HIC members of the Evaluation Committee expressed concern about this process ...as it may enable tenderers to improve their bids'. OASITO advised the Committee that:

...all tenderers had errors in their re-priced offers and, under the evaluation and negotiation process, the Health Group would be seeking to improve the bids on a number of fronts.

**2.55** On 11 June 1999, OASITO advised the Evaluation Committee that errors in tenderers' bids were still being uncovered, and that tenderers had been advised that updated pricing which incorporated rectification of all errors must be provided to OASITO by 21 June 1999. The Evaluation Committee agreed that OASITO was to advise tenderers that they were required to provide full costings for a base service level view.<sup>72</sup>

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<sup>71</sup> While the Steering Committee was clearly aware that revised proposals had been sought for 21 June, there is no formal decision authorising a second re-pricing exercise recorded in the minutes of the Committee. Nor is there a record of OASITO formally putting to the Steering Committee that the re-pricing exercise should be undertaken.

<sup>72</sup> For all other views (or service level options), tenderers were required to provide the deltas between the base view and the other service options and, if the ranking between tenderers changed as a result of the view taken, more details may be sought from tenderers.

**2.56** OASITO also advised the Evaluation Committee that, during a pricing meeting, IBM GSA had offered to share information on its costing structures with OASITO but not with the agencies, as potential customers. To obtain greater understanding of IBM GSA's costings, and to assist with the rectification of errors in its bid, OASITO sought the Group Agencies' concurrence to its meeting with IBM GSA without the agencies. Agency representatives agreed to the meeting. The meeting discussions were not documented by OASITO. OASITO also agreed that it would provide other tenderers with a similar opportunity to have their costings examined for possible errors. ANAO could find no documentation to support whether that occurred, and if so, when.

**2.57** On 15 June 1999, the Steering Committee noted that its meeting scheduled for 28 June would consider whether a decision to shortlist from among the three tenderers should be pursued at that time. The Steering Committee agreed that shortlisting would only occur if it agreed unanimously that there was merit in deciding to shortlist. If a decision not to shortlist was taken, the Committee would examine the way forward and implications for the Health Group timetable.

**2.58** All three tenderers submitted revised technical and pricing offers on 21 June 1999.<sup>73</sup> All three lowered their tendered pricing, with IBM GSA making the most significant reduction. IBM GSA also highlighted further changes to its in-scope ID offer, with the level of small to medium enterprise (SME) participation being reduced. This was followed by the submission by it on 25 June 1999 of five additional out-of-scope ID initiatives (see paragraphs 3.102 to 3.104).

### *Third re-pricing—2 August 1999*

**2.59** A third opportunity to re-price their offers was provided to tenderers on 2 August 1999. The process leading to the decision to proceed with a further formal re-pricing, rather than completing the evaluation and parallel negotiations on the basis of the June submissions, is not clear from the available documentation.

**2.60** The leaders of the Technical, Corporate and Financial Evaluation Teams provided the Steering Committee with a report on the status of the evaluation on 28 June 1999. The Committee noted that:

- in the technical evaluation, three bids remained in contention, with a varying number of issues outstanding among the tenderers still to be clarified. A larger number of technical issues remained to be clarified/

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<sup>73</sup> One tenderer subsequently identified an error in its submission, and provided a revised offer on 24 June 1999, which slightly increased its price. The other two tenderers did not provide the requested information about pricing differentials relating to the two alternative service options with their 21 June submissions. That information was requested of them and provided subsequently.

negotiated with CSC;

- in the corporate evaluation, some significant issues remained to be resolved with each tenderer. EDS's position on the Service Agreement was closest to the Group Agencies, with the other two tenderers maintaining less attractive positions to the Group Agencies; and
- in the financial evaluation, some uncertainty remained about pricing requiring additional work to clarify some details and to add adjustments. The application of tenderer specific adjustments had the potential to change the ranking between two of the tenderers. The Financial Team leader expressed the view that his analysis of the pricing suggested there was some basis for down selection (or shortlisting) to one bidder but that there was little basis to down select to two.<sup>74</sup>

**2.61** The Financial Team Leader advised ANAO that the bidder in question was EDS, based on the higher level of certainty attaching to its pricing compared to the next closest tenderer. At this stage of the evaluation, IBM GSA was the least competitive in its pricing and in the contractual terms it was proposing. However, it was not clear that any tenderer was capable of offering savings, with the adjustments required to be made to tenderers' bids and agency cost baselines not yet agreed.

**2.62** The minutes of the 28 June 1999 Steering Committee meeting record that, following a question from the HIC on how the evaluation process could continue if a business case for proceeding could not be established, OASITO indicated that there were differing views of the HIC's internal five-year cost projections. OASITO indicated that its view was that the HIC cost model understated the likely five-year costs of performing the in-scope services as specified in the RFT, but that both views of the baseline would need to be presented for decision-making. The Steering Committee agreed that a decision to shortlist, or select a preferred tenderer, be deferred on the basis that further work needed to be done to clarify pricing uncertainty and address outstanding issues identified by the corporate and technical teams; and that OASITO would reactivate its review of the HIC cost baseline.

### *Way forward proposal*

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<sup>74</sup> These reports broadly reflected the positions put at the Evaluation Committee meeting of 25 June 1999, at which the Technical Team Leader did not consider there were major technical issues remaining with the offerings provided on 21 June 1999; the Corporate Team Leader spoke to a tabled paper that identified a number of negotiation issues and risks, none of which he considered would greatly influence a shortlisting decision; and the Finance Team Leader identified a number of issues requiring clarification and some potential adjustments. He indicated that the numbers could be refined within a week or so to provide greater clarity to assist any down selection. The Financial Team Leader also expressed his view that, with a little more confidence in the tendered pricing, there may be a case to down-select to a single vendor.

**2.63** On 6 July 1999, OASITO wrote to Steering Committee members proposing a way forward for the tender. OASITO advised that, in its view, a formal decision to continue with three bidders through parallel negotiations needed to be taken in order to bring a sense of urgency and focus to the process. OASITO's letter stated that its view had been formed having regard to the conclusions of the Evaluation Committee, and advised Steering Committee members as follows:

On 2 July, the Evaluation Committee met to review progress and consider whether shortlisting is justified. At this stage, the agencies have differing views as to the ranking of tenderers and there is no clear winner identified across the Health Group nor is there a clear third ranked offer that should be shortlisted out. The Evaluation Committee, therefore is of the view that all three bidders should be carried forward to the next phase of parallel negotiations.

**2.64** This advice appears inconsistent with the minutes of the 2 July 1999 meeting of the Evaluation Committee which recorded that, given the length of time occupied in progressing consideration of outstanding issues for each tenderer tabled by the Financial Evaluation Team, '...the Committee did not consider the potential for shortlisting tenderers'.

**2.65** In its 6 July letter, OASITO proposed that it meet with tenderers to engage in discussions regarding their bids and the elements that required significant improvement, followed by a series of further proposed meetings and activities in July and August. The schedule proposed by OASITO involved providing: a package of information to tenderers including finalisation of the service levels each agency desired to contract for; agency comments on tenderers' pricing assumptions; confirmation of the exclusion of DHAC voice services from scope; updated HIC mainframe configuration material; and a complete view of tenderer pricing including proposed adjustments. Tenderers would then be requested to provide updated pricing. The proposed schedule identified that the updated pricing would be due at 9.00 am on 2 August 1999.

**2.66** All Group Agencies agreed to OASITO's proposed way forward. However, a DHAC Steering Committee member advised OASITO on 8 July 1999 that DHAC's concurrence was subject to '...agreement that we are approaching a critical milestone/decision point on the business case for the whole process and that we must be prepared to resolve the business case issue as soon as possible'. The DHAC Committee member also advised OASITO that:

Given the review of baseline costs and assumptions process that has been agreed between OASITO and HIC, I believe the meeting of the Steering Committee scheduled for the 26 July is the final point at which it is tenable to continue the process with any or all of the vendors without a clear business case (or the clear prospect of a business case) to proceed. The danger of continuing the process in

the absence of agreement that there is the prospect of a business case has become a threat to the probity of the process itself.

**2.67** OASITO and its Strategic Adviser met with each tenderer on 9 July 1999 to brief them on the decision to proceed in parallel negotiations with all three companies. Tenderers were to be advised that they would be given an opportunity to optimise their offering and address significant issues that would prevent selection; and that any updates/adjustments to prices resulting from those discussions were to be due by 2 August. The strategy for the meetings and draft speaking notes prepared by the Strategic Adviser were discussed with the Evaluation Committee.

**2.68** Speaking notes for the meetings with EDS and CSC were not located in the documentation made available to ANAO. The speaking notes prepared for the meeting with IBM GSA indicated that it was to be advised that, at that stage, it was not acceptable as a preferred tenderer. The key points noted in respect to the IBM GSA offering were that:

- evaluation had indicated some significant deficiencies with its bid which should be addressed;
- overall, there was no business case made [*by its bid*] across the Group, by a substantial margin;
- its position on key contractual issues was well short of the ‘market position’ that had been developed under the IT Initiative; and
- its existing position raised significant risks that would weigh against it in the evaluation, with some items simply unable to be accepted by the Commonwealth.

**2.69** A letter to tenderers on 14 July 1999 confirmed earlier oral advice that Group agencies aimed to provide each tenderer with an opportunity to optimise its offering. Tenderers were advised that any refinements or adjustments to their offer would need to be provided to OASITO by 2 August 1999. Between 14 and 16 July 1999, tenderers were provided with a range of information to assist them in making the necessary corrections and adjustments to their tender.<sup>75</sup> On 28 July 1999, tenderers received a further letter from OASITO confirming the information that had been provided and giving further instructions on the submission of revised offers. That letter advised that revised offers were due by 9:00 am on Monday, 2 August 1999.

**2.70** The minutes of the Steering Committee meeting of 26 July 1999 record

<sup>75</sup> Tenderers were advised that they would be provided with a complete view of their pricing, including proposed adjustments. This was ultimately faxed to tenderers on 27 July 1999. On 28 July 1999, IBM GSA requested, and was provided with, a disk containing an electronic version of the document. The disk provided to IBM GSA by OASITO contained the pricing information for all three tenderers (disclosure event)—see Chapter 4 and the Appendix for further discussion.

that OASITO advised the Committee that it had formed the preliminary view that ‘...subject to the 2 August updated pricing, there is no case that (*sic*) on a whole of Government basis that the Health Group should not outsource its IT Infrastructure’. The HIC informed the Committee, however, that it would not be able to form a view on the business case until after the 2 August updated pricing, and not until 9 August at the earliest.

**2.71** All three tenderers submitted revised offers on 2 August 1999, with IBM GSA being late in lodging its offer on that day (see Chapter 4 and the Appendix). CSC noted that its response was offered as the final submission. In response to the revised service level and other information provided to tenderers<sup>76</sup>, IBM GSA and CSC reduced their tendered pricing from that submitted on 21 June 1999 by 18.1 per cent and 20.9 per cent respectively.<sup>77</sup> In contrast, EDS increased its tender by 2.5 per cent. IBM GSA also significantly increased the level of SME participation included in its ID offer.

**2.72** The minutes of a 6 August 1999 meeting of the IT Outsourcing Sub-Committee of the HIC Board record that the Chairman of the Sub-Committee, who was also a member of the Steering Committee, commented that, in his view:

the dramatic price drop in the latest bid round has been the result of an executive decision rather than a more refined assessment of costs and it is therefore unlikely to be reduced any further.

## **Movements in financial evaluation**

**2.73** Having regard for the revised and clarified requirements advised by Group agencies over the course of the tender evaluation process<sup>78</sup>, the net change made by tenderers to their originally tendered prices over the course of the three re-pricing rounds was a reduction of 25.2 per cent by IBM GSA, a reduction of 33.4 per cent by CSC, and an increase of 5.8 per cent by EDS (see Figure 2.3).<sup>79</sup>

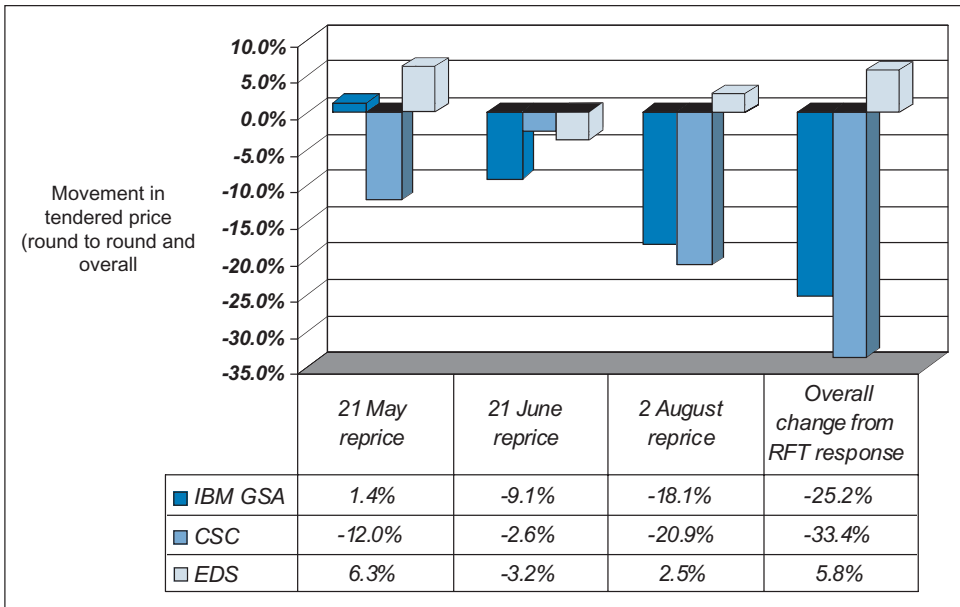
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<sup>76</sup> The price movements identified for each tenderer in the 2 August 1999 re-pricing round exclude the reduction in each tenderer's price arising from the removal from scope in the final round of DHAC voice services.

<sup>77</sup> This included the removal from both tenderers' prices of substantial provisions each had previously made for pass through postage costs associated with bulk printing for the HIC (for CSC this applied from the 21 May 1999 re-pricing round). EDS had made no such provision. On 16 July 1999, CSC was advised that this item was a cost retained by the agencies as part of the information provided to it by OASITO for the 2 August re-pricing. Excluding the effects of the removal of the bulk print postage costs, the reductions made were 11.8 per cent for IBM GSA and 8.2 per cent for CSC.

<sup>78</sup> Excluding costs associated with DHAC voice services, which were removed from scope in the final round.

<sup>79</sup> Excluding the effect of removal of bulk print pass through costs in the final round (see footnote 77), the net change made to its originally tendered price by IBM GSA was a reduction of 15.8 per cent. CSC's net change remains a reduction of 33.4 per cent as it did not include the bulk print postage costs in its originally tendered price. This saw CSC move from the least competitive financial position in the initial round of RFT responses to a marginal second ranking in the final financial evaluation, after the application of adjustments.

**Figure 2.3****Percentage movements in tendered price in each re-pricing round**

Source: ANAO analysis of tender documentation

## Re-pricing process

**2.74** It is important that agencies appreciate the probity implications arising from changes made to the requirements tenderers are asked to tender against. Probity and legal implications can arise if the original RFT requirements are amended to such an extent that it becomes essentially a re-bidding process. It is not apparent that there was the necessary level of clarity in the Health Group tender process surrounding the question as to whether each round represented a re-pricing or re-bidding process.<sup>80</sup> ANAO did not identify any evidence of OASITO obtaining probity or legal advice in respect of the decision to undertake each re-pricing round, including whether the changes made to agency requirements in respect of any of the three rounds gave rise to a re-bidding situation.

<sup>80</sup> ANAO noted that an internal OASITO minute on the late lodgement by IBM GSA of its revised offer on 2 August 1999 stated that: 'In this case, the desire not to have the latest price adjustment process seen as a formal re-bid may be part of the explanation for inconsistent referencing to the lodgement time'. The minute advised that staff would be provided with guidance to ensure that future correspondence was both consistent and clear in relation to lodgement requirements. The late lodgement is discussed in Chapter 4.



**2.75** Nor is it clear who was responsible on each occasion for the decision to seek revised offers. Based upon the available documentation, including Committee minutes, it appears to have been OASITO that determined, in the first instance, the requirement to provide tenderers with each of the opportunities to improve their bids. While the Steering and Evaluation Committees were informed of those decisions, in some instances there was not a clear record of the Committees formally agreeing to proceed to each round of revised tenders. ANAO considers that there was clear scope for the transparency of the decision-making process leading to formal revised offers being sought to have been enhanced, particularly in the later stages of the tender.

## Finalisation of tender evaluation

**2.76** The ID Evaluation Report completed on 1 September 1999 concluded that IBM GSA had the highest rated ID proposal when considered against the criteria set out in the RFT. However, the IDET also considered that both CSC's and EDS's proposals adequately met the Commonwealth's objectives.

**2.77** In respect of the IT&T services evaluation, on 5 August 1999 the Evaluation Committee agreed on an approach to finalising a number of outstanding contractual and financial issues. Responses to final clarification questions provided by tenderers resulted in final adjustments to pricing, with the last response being received on 1 September 1999. The adjustments to be applied to tenderers' prices, and therefore the outcome of the financial evaluation, were not finalised until 1 September 1999.

**2.78** The Evaluation Committee completed the Health Group IT&T Services Final Evaluation Report on 2 September 1999. That report encapsulated the findings of the Financial, Technical and Corporate Evaluation Teams. The Committee found each tenderer to be acceptable in terms of the threshold service and risk evaluation criteria. However, because IBM GSA proposed primarily an 'as-is, where-is' technical solution, it was considered to present the least migration risk. The Committee also found that there were other marginal technical advantages associated with the IBM GSA solution.

**2.79** The final price margins between all three tenderers, as reported in the financial evaluation, were small given the size of the tender. Including MPL, the total cost over the term of the Services Agreement for an IBM GSA solution was assessed as being \$5 million less than CSC, and \$13 million less than EDS. MPL did not develop a cost baseline for the purpose of calculating savings. The Evaluation Committee concluded that the savings offered to DHAC and the HIC collectively by IBM GSA and CSC were almost the same, with EDS offering about \$12 million less in savings. However, there was significant disparity in the savings offered by tenderers to individual agencies.



**2.80** The IT&T Services Final Evaluation Report found that IBM GSA offered combined net financial savings to DHAC and the HIC over five years representing two per cent of projected agency business-as-usual expenditure. Those net savings comprised a financial cost to DHAC of eight per cent over five years and financial savings to the HIC of seven per cent. Net savings, after the application of notional CN adjustments, were assessed as 9.4 per cent over the same period. The Financial Evaluation Report ranked IBM GSA first for the HIC and MPL's requirements, but third for DHAC's.

**2.81** CSC was assessed as offering slightly lower financial savings to DHAC and the HIC collectively, of 1.7 per cent of projected agency expenditure (9.1 per cent after the application of notional CN adjustments). EDS was assessed as offering DHAC and the HIC collectively increased financial costs of 1.3 per cent over five years, but savings of 6.4 per cent after CN. On an individual agency basis, CSC was assessed as offering DHAC 7.8 per cent in financial savings, while EDS was assessed as offering no savings. For the HIC, CSC was assessed as offering a financial cost over five years of 1.4 per cent, and EDS a financial cost of 1.9 per cent over the same period.<sup>81</sup>

**2.82** The Evaluation Committee concluded that the savings offered under the three tenders were sufficiently close to fall within the potential margin of uncertainty implicit in a project of this size and complexity.<sup>82</sup> In addition, differences in the pricing structure and contractual terms proposed by each tenderer could produce different financial outcomes in different scenarios over the term of the Services Agreement. Consequently, the Committee found that a case could be made to support the selection of any of the three tenderers based on purely financial considerations. Each tenderer was assessed as satisfying the RFT financial evaluation criteria.

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<sup>81</sup> In September 1999, the HIC Board agreed to the transfer of \$3 million from the HIC to DHAC under the OPA. The HIC Managing Director advised the Board that the transfer of funds had been agreed because the decision to outsource to IBM GSA, although the best result for the health portfolio, was not the best result for DHAC. The Board was also advised that Finance had deducted an efficiency dividend for IT outsourcing savings from DHAC but not from the HIC. In agreeing to the transfer of funds, the Board acknowledged that the IT outsourcing was done on a portfolio basis.

<sup>82</sup> The Financial Evaluation Report noted that the evaluation involves an inherent degree of uncertainty due to a number of factors, including that pricing for large-scale, complex IT&T outsourcing relationships involves a significant element of estimation of future agency requirements. Although tendered prices are firm for the term of the Services Agreement, there is a degree of uncertainty about how changes in agency business and technology requirements might affect the total cost of the Services over the Term of the Services Agreement; and that in the course of the evaluation, various adjustments were made to tendered prices to take account of differences in the way each tenderer structured its bid and the cost elements included in each tenderer's prices. These adjustments have a significant effect on the total cost of each tender. The report noted that these adjustments are required to ensure that bids are evaluated on a fair basis, and that, although every effort was made to ensure the accuracy and fairness of these adjustments, it should be acknowledged that they involve elements of judgement, including estimates of future costs. Therefore they introduce a further margin of uncertainty into the financial evaluation.

**2.83** Nevertheless, the Evaluation Committee noted that IBM GSA's tender had been assessed as representing slightly lower costs across the Group as a whole. The Committee also noted aspects of the CSC offer that it considered provided less service and price certainty over the term of the Services Agreement than the other tenders, and less advantageous contractual terms.

**2.84** In forming a recommendation as to the preferred tenderer, the Evaluation Committee had regard to the right reserved under the RFT to take account of service and risk considerations in determining the best combination of industry development and cost savings. Thus, although the decision was a close one, on balance the Evaluation Committee recommended that IBM GSA be designated as the preferred tenderer.

**2.85** The IT&T Services Final Evaluation Report noted that, in addition to the savings identified, there were a number of additional potential benefits that could flow from outsourcing. The opportunities noted in the report related to disaster recovery capabilities; potential for additional cost savings and operational benefits from rationalisation of the IT&T infrastructure over the term of the Agreement; potential for additional substantial savings if greater software rationalisation became possible; and opportunities in an outsourced environment for more efficient achievement of the required full separation of MPL from the HIC.

**2.86** The Steering Committee considered the Evaluation Committee's report on 3 September 1999. After an errata by the Evaluation Committee to incorporate corrections and clarifications suggested by it<sup>83</sup>, the Steering Committee agreed to a recommendation that IBM GSA be selected as the preferred tenderer based on an overall assessment against all of the relevant IT&T services evaluation criteria.

## **HIC and MPL endorsement of preferred tenderer recommendation**

**2.87** OASITO provided a presentation to the HIC Board of Commissioners on 27 August 1999 in which it outlined the status of the evaluation. According to the minutes of the meeting<sup>84</sup>, OASITO advised the Board that all bidders were technically viable and corporately capable, and that the financial assessment was the difficult part. However, OASITO believed that all bidders were now at

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<sup>83</sup> The changes requested included text clarifications and amendment of errors in the reporting of financial results. The Steering Committee agreed that the changes and clarifications it sought would not change the conclusions of the IT&T Services Final Evaluation Report.

<sup>84</sup> The minutes were signed by the Chairman and Commission Secretary. There was no record in the documentation reviewed by ANAO as to whether the minutes had been confirmed with OASITO.

or below baseline costs. OASITO also advised that the current ranking was IBM GSA ranked number one and the others line-ball. In response to a request for financial information, OASITO advised the Board that the financial figures were not final but that EDS and CSC were on the baseline with IBM below it.<sup>85</sup> OASITO also said that from an ID point of view, IBM GSA was ‘...the most defensible position from a whole of government outcome position’. It advised the Board that it expected IBM GSA to be the preferred bidder, and to be the bidder decided upon by the Minister for Finance and Administration. OASITO sought Commission approval for recommending IBM GSA as preferred tenderer.

**2.88** Following the OASITO presentation, the HIC Board agreed to a resolution that, taking account of that presentation and the draft evaluation reports submitted for its consideration, the HIC representatives on the Steering Committee be authorised to agree that IBM GSA be submitted to the Options Committee for endorsement as the preferred tenderer. The Board also resolved that, should the Options Committee not agree to endorse IBM GSA as preferred tenderer, the Commissioners reserved the right to reconsider support for the OASITO outsourcing process. The Board further resolved that, prior to any final decision being taken, OASITO should provide it with certain assurances as to the conduct of the tender process (see paragraphs 4.170 to 4.172 and 4.175)

**2.89** On 8 September 1999, MPL advised OASITO that the MPL Board had discussed the evaluation outcome. OASITO was advised that the lack of any Commonwealth indemnity given its agreement to comply with Government policy and participate in the OASITO evaluation and selection process was of concern to the Board, and that the lack of effective control that the company had over the process was discussed at some length. OASITO was advised that, ultimately, the Board agreed to endorse the MPL Steering Committee position and authorise its management to proceed with negotiation with IBM GSA on two conditions. First, the Board wished to approve any final contract negotiated with the provider prior to execution, and second, the Board wanted OASITO to provide an assurance to the Board as to the probity and rigour of the evaluation and selection process. The letter of assurance was formally provided to MPL by OASITO on 11 November 1999 (see paragraphs 4.173 to 4.175).

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<sup>85</sup> The financial evaluation outcomes as reported in the evaluation report dated 2 September 1999 were that IBM GSA and CSC offered equivalently-priced bids, followed closely by EDS, and that all fell within a range that was not in itself a material differentiating factor from a financial perspective.

## **Options Committee recommendation**

**2.90** The Options Committee met on 8 September 1999 to consider the reports of the IT&T services and ID evaluations. The Committee noted that:

- while all tenderers offered an acceptable technical solution, and tenderer pricing was very close for a transaction of this scope and scale, IBM GSA offered the highest expected level of projected savings;
- the Group Agencies had expressed a preference for IBM GSA, having regard to cost savings and service and risk considerations; and
- IBM GSA had also proposed a superior ID offering, consistent with the Commonwealth's objectives for ID as documented in the Health Group RFT.

**2.91** The Options Committee concluded that IBM GSA offered the best combination of savings and ID, also having regard to the advantages presented by its tender relative to the 'service and risk' evaluation criteria. The Committee therefore recommended that IBM GSA be selected as the preferred tenderer. The requirement in the RFT for substantial cost savings as a precondition to awarding of a contract is discussed in Chapter 3 at paragraphs 3.41 to 3.59.

## **Ministerial endorsement of preferred tenderer**

**2.92** The recommendation of the Options Committee, together with the IT&T Services and ID Evaluation Reports, were forwarded to the then Minister for Finance and Administration by OASITO on 8 September 1999. The IT&T Services Final Evaluation Report was signed off by all members of the Evaluation and Steering Committees, including the OASITO chairs of those Committees. However, OASITO advised the Minister that the Group Agencies and OASITO had been unable to agree on the savings figures due to differences over the agencies' cost projections ('primarily the HIC') and appropriate levels of contract management resourcing. OASITO advised the Minister that, as these differences did not affect the selection of the preferred tenderer, it had agreed to present the agencies' view of savings in the formal evaluation reports, while noting that OASITO had a different view. The Financial Evaluation Report noted that:

OASITO has a different view of the costs associated with outsourcing and, in the case of the HIC, the baseline cost projections for the five year evaluation period. However, this view does not affect the ranking of Tenders or the selection of a preferred Tenderer and has not therefore been pursued in this Report.

**2.93** As noted earlier, in deferring a decision to shortlist from among the tenderers, the 28 June 1999 Steering Committee meeting agreed that OASITO would reactivate its review of the HIC cost baseline. According to HIC records,

OASITO subsequently requested adjustments to increase the five-year HIC cost baseline by over \$70 million. The HIC re-engaged its external consultant to review the proposed adjustments. HIC records indicate that the net effect of the consultant's recommendations was an increase in the cost baseline of \$3 million, with the adjustments ultimately accepted by OASITO amounting to an increase of \$8 million. OASITO raised no major concerns about the DHAC cost baseline following it being signed-off prior to the tender evaluation commencing.<sup>86</sup>

**2.94** On 7 September 1999, the Managing Director of the HIC advised the then Minister for Health and Aged Care that:

The HIC believes that savings are unlikely to be achieved and the financial case for outsourcing rests on the value to the Commonwealth of the Industry Development proposal from the successful vendor. OASITO challenge the HIC baseline costs, future projections and full inclusion of costs such as redundancy payments. They therefore claim substantial savings will be made even before \$16.85 million is added to the HIC base costs for Competitive Neutrality. However, the HIC is confident that our independently assessed costs are realistic.

**2.95** In contrast, OASITO advised the then Minister for Finance and Administration that it considered the savings estimates to be conservative. OASITO considered contract management costs included by agencies were in excess of best practice, that cost projections for staff overheads were understated, and that HIC cost model figures for infrastructure costs and desktop support were understated. OASITO also noted that some potential additional savings opportunities were documented in the IT&T Services Final Evaluation Report but not reflected in the savings analysis, stating that it was difficult to attach reliable savings figures to those opportunities without detailed assessment. OASITO's view was that financial savings for the Health Group would be \$52.83 million over five years, \$82.93 million with \$30.1 million of CN adjustments taken into account (net present value (NPV) \$75.08 million based on a three per cent discount rate<sup>87</sup>). This compared to the savings identified in the Evaluation Report of \$7.39 million over five years, and \$37.49 million under CN (NPV \$33.49 million).

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<sup>86</sup> Finance advised ANAO in May 2002 that: 'Concerns about cost baselines and associated forecasting assumptions were discussed with DHAC from time to time during the evaluation process. While every effort was made to finalise cost baselines prior to tender evaluation, the addition of new information from industry about cost trends etc often obliged the parties to revisit them. Similarly, the acquisition decisions and changes to forecasts made by agencies during the evaluation period made for reassessment of cost baselines on a number of occasions.' ANAO notes that OASITO did not register concern about the DHAC baseline cost projections in its comment in the Financial Evaluation Report noted at paragraph 2.92.

<sup>87</sup> The financial evaluation calculated net present values (NPV) using a range of discount rates (three, five and eight per cent). The NPV savings figures reported to the Minister by OASITO were based on a three per cent discount rate.

**2.96** The Minister declined to endorse the recommendation for the preferred tenderer and advised OASITO that he would sign off only when agreement on savings had been achieved. The Minister instructed that, if necessary, Finance should be asked to intervene and independently establish the savings.

### *Finance review of savings*

**2.97** OASITO referred four issues to Finance for review.<sup>88</sup> On 17 September 1999, Finance reported to OASITO on its review. Finance advised that, in the time available, it was unable to provide a costing in respect to the HIC cost baseline issues relating to future PC network costs and desktop/LAN infrastructure costs for the HIC. Finance agreed with OASITO's view in regard to the contract management costs for both DHAC and the HIC, and agency staff overhead costs for DHAC, as to what should be included for evaluation purposes. Finance recommended adjustments to reduce the projected costs of contract management included in the financial evaluation for both DHAC and the HIC, and to increase the projected staff overhead costs in the DHAC cost baseline. Both adjustments had the effect of increasing the projected savings over those identified in the IT&T Services Final Evaluation Report, with a net increase of \$16.6 million in projected financial savings from \$7.39 million to \$23.99 million over five years. Post-CN savings over the same period were increased from \$37.49 million, as projected in the Evaluation Report, to \$54.09 million. The adjustments recommended by Finance increased the savings assessed against each tenderer by the same amount.

### *Steering committee re-convened*

**2.98** The Evaluation Guide identified roles for the Evaluation, Steering and Options Committees in forming recommendations on the selection of preferred tenderer on the basis of evaluation reports prepared by the Evaluation Committee and IDET. The revised savings arising from the Finance review were not referred to the Evaluation Committee that had prepared and signed-off on the IT&T Services Final Evaluation Report, including the financial evaluation. The Steering Committee agreed to a supplementary resolution which stated that, having regard to: (a) views expressed in the evaluation report concerning possible additional savings from this outsourcing; and (b) the report from Finance, the

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<sup>88</sup> OASITO had advised the Minister that its revised savings were based on a view that: the Group Agencies had included contract management costs that were in excess of best practice; the staff overhead costs included in the agency cost baselines should be calculated using the formula used by Finance for Health portfolio budget funding rather than the lower actual projections used; the desktop/LAN infrastructure costs for the HIC cost model should be recalculated; and the HIC estimate of costs of supporting a new PC/LAN network did not allow sufficient resources to support a fully functioning PC network as specified in the RFT.

Steering Committee agreed that the expected value of savings from the Health Group information technology infrastructure outsourcing contract should be expressed as 'at least \$53.9 million over the first 5 years'.<sup>89</sup>

**2.99** The Steering Committee members signed the supplementary resolution, proposed on 17 September 1999, over the period to 22 September 1999 after sighting advice on the issue from the Probity Auditor and the Legal Adviser (see paragraphs 3.60 to 3.76).

### *Options Committee confirmation*

**2.100** Between 17 and 22 September 1999, the members of the Options Committee endorsed a second resolution entitled 'Confirmation of Recommendation of the Options Committee' dated 17 September 1999. It stated that subsequent to its recommendation regarding the preferred tenderer on 8 September 1999, the Committee had been advised of revisions to Health Group savings figures based on a review of various cost model issues by Finance. It also stated that the Committee noted the resolution of the Steering Committee regarding the revised savings figures. ANAO notes that the Steering Committee resolution was not endorsed by the DHAC members until 22 September 1999. The Options Committee confirmation stated that the Committee agreed that:

- the revised savings figures did not change the recommended outcome of the tender process; and
- IBM GSA should be confirmed as the recommended tenderer for the project.

### *Ministerial endorsement*

**2.101** The resolutions of the Steering and Options Committees regarding the revised savings figures were referred to the then Minister for Finance and Administration by OASITO on 22 September 1999 with a recommendation that the Minister endorse the Options Committee's recommendation to select IBM GSA as preferred tenderer as previously recommended. OASITO advised the Minister that:

In considering this supplementary advice on savings you should note that it does not affect the information previously provided and on which your decision on the preferred tenderer should be based. Legal advice counsels that you should not now weigh this supplementary advice in your decision on the preferred tenderer. It is not germane.

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<sup>89</sup> The report provided to OASITO by Finance, and forwarded to the Minister, identified the revised savings as \$54.09million. The reason for the adjustment to \$53.9 million was not identified by OASITO in its 22 September 1999 brief to the Minister advising of the revised savings position.



**2.102** The Minister endorsed the recommendation that IBM GSA be selected as preferred tenderer on 23 September 1999, announcing total savings over five years in the order of \$54 million.

**2.103 Finding:** The Health Group tender evaluation process was complex, lengthy and costly for all parties. There were significant disparities in the prices initially tendered in February 1999, with the difference between the highest and lowest tender being some \$137 million over five years. At that point, no tenderer appeared to offer savings when compared with the internal cost baselines of the HIC and DHAC. However, OASITO argued that the service levels sought in the RFT were in excess of industry standards, and of the standards already being achieved by agencies and reflected in their cost baselines.

**2.104** Over the course of the tender, the Group agencies made a number of changes to the requirements originally specified in the RFT and tenderers were provided with multiple opportunities to revise aspects of their tenders. Subsequent to tender closure on 15 February 1999, tenderers were asked to formally submit revised pricing offers on three occasions: 21 May 1999, 21 June 1999 and 2 August 1999. Tenderers were also invited to make revisions to their technical and ID offerings.

**2.105** It is difficult to make comparisons between the prices offered by each tenderer at different points in the tender process. This is due to a number of factors, including the changes made to the scope of services they were asked to tender for. Also, particularly in the earlier rounds, this process was used as a means of testing the pricing effects of various options in terms of service levels that could be requested. Further, many of the adjustments made to tendered prices to ensure comparability between tenders, and with the agency cost baselines, were not finalised until very late in the evaluation. As a result, the prices tendered in earlier rounds are not directly comparable to the adjusted prices used in the final financial evaluation. Nevertheless, it was clear that the relative positions of the tenderers in relation to the financial aspects of their bids altered considerably over the course of the re-pricing process, including in the final round.

**2.106** Having regard for the revised and clarified requirements advised by Group agencies over the course of the tender evaluation process, the net change made by tenderers to their originally tendered prices over the course of the three re-pricing rounds was a reduction of 25.2 per cent by IBM GSA, a reduction of 33.4 per cent by CSC, and an increase of 5.8 per cent by EDS.<sup>90</sup>

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<sup>90</sup> Excluding costs associated with DHAC voice services, which were removed from scope in the final round.



**2.107** It is not apparent that there was the necessary level of clarity in the Health Group tender process surrounding the question as to whether each round represented a re-pricing or re-bidding process. ANAO did not find any evidence of OASITO obtaining probity or legal advice in respect of the decision to undertake each re-pricing round, including whether the changes made to agency requirements in respect of any of the three rounds gave rise to a re-bidding situation.

**2.108** Nor is it clear who was responsible on each occasion for the decision to seek revised offers. Based upon the available documentation, including Committee minutes, it appears to have been OASITO that determined, in the first instance, the requirement to provide tenderers with each of the opportunities to improve their bids. While the Steering and Evaluation Committees were informed of those decisions, in some instances there was not a clear record of the Committees formally agreeing to proceed to each round of revised tenders. ANAO considers that there was clear scope for the transparency of the decision-making process leading to formal revised offers being sought to have been enhanced, particularly in the later stages of the tender.

**2.109** The ID Evaluation Report completed on 1 September 1999 concluded that IBM GSA had the highest rated ID proposal when considered against the criteria set out in the RFT. However, the IDET also considered that both CSC's and EDS's proposals adequately met the Commonwealth's objectives.

**2.110** The Evaluation Committee completed the Health Group IT&T Services Final Evaluation Report on 2 September 1999. The Committee found each tenderer to be acceptable in terms of the threshold service and risk evaluation criteria. However, because IBM GSA proposed primarily an 'as-is, where-is' technical solution, it was considered to present the least migration risk. The Committee also found that there were other marginal technical advantages associated with the IBM GSA solution.

**2.111** The IT&T Services Final Evaluation Report found that IBM GSA offered combined net financial savings to DHAC and the HIC over five years representing two per cent of projected agency business-as-usual expenditure. Those net savings comprised a financial cost to DHAC of eight per cent over five years and financial savings to the HIC of seven per cent. Net savings, after the application of notional competitive neutrality adjustments, were assessed as 9.4 per cent over the same period. The Financial Evaluation Report ranked IBM GSA first for the HIC and MPL's requirements, but third for DHAC's.

**2.112** The Evaluation Committee concluded that the savings offered under the three tenders were sufficiently close to fall within the potential margin of uncertainty implicit in a project of this size and complexity. In addition, differences in the pricing structure and contractual terms proposed by each tenderer could produce different financial outcomes in different scenarios over the term of the Services Agreement. Consequently, the Committee found that a case could be made to support the selection of any of the three tenderers based on purely financial considerations. Each tenderer was assessed as satisfying the RFT financial evaluation criteria.

**2.113** In forming a recommendation as to the preferred tenderer, the Evaluation Committee had regard to the right reserved under the RFT to take account of service and risk considerations in determining the best combination of industry development and cost savings. Thus, although the decision was a close one, on balance the Evaluation Committee recommended that IBM GSA be designated as the preferred tenderer. The Steering Committee considered the Evaluation Committee's report on 3 September 1999. After an errata by the Evaluation Committee to incorporate corrections and clarifications suggested by it, the Steering Committee agreed to a recommendation that IBM GSA be selected as the preferred tenderer based on an overall assessment against all of the relevant IT&T services evaluation criteria.

**2.114** The Options Committee concluded that IBM GSA offered the best combination of savings and ID, also having regard to the advantages presented by its tender relative to the 'service and risk' evaluation criteria. The Committee therefore recommended on 8 September 1999 that IBM GSA be selected as the preferred tenderer.

**2.115** In forwarding the Options Committee's recommendation to the Minister, OASITO advised that its view was that financial savings for the Health Group would be \$52.83 million over five years, \$82.93 million with \$30.1 million of CN adjustments taken into account (NPV \$75.08 million based on a three per cent discount rate). This compared to the savings identified in the IT&T Services Final Evaluation Report of \$7.39 million over five years, and \$37.49 million under CN (NPV \$33.49 million). The Minister declined to endorse the recommendation for the preferred tenderer and advised OASITO that he would sign off only when agreement on savings had been achieved. The Minister instructed that, if necessary, Finance should be asked to intervene and independently establish the savings. Adjustments recommended by Finance had the effect of increasing the projected savings over those identified in the IT&T Services Final Evaluation Report, with a net increase of \$16.6 million in projected financial savings from \$7.39 million to \$23.99 million over five years. Post-CN savings over the same period were increased from \$37.49 million, as projected in the Evaluation Report, to \$54.09 million.

**2.116** The revised savings arising from the Finance review were not referred to the Evaluation Committee that had prepared and signed-off on the IT&T Services Evaluation Report, including the financial evaluation. The Steering Committee agreed that the expected value of savings from the Health Group information technology infrastructure outsourcing contract should be expressed as 'at least \$53.9 million over the first 5 years'. A confirmation of its earlier recommendation, endorsed by the Options Committee, stated that it agreed that the revised savings figures did not change the recommended outcome of the tender process, and that IBM GSA should be confirmed as the recommended tenderer for the project. The Minister endorsed the recommendation that IBM GSA be selected as preferred tenderer on 23 September 1999, announcing total savings over five years in the order of \$54 million.

## 3. Application of Evaluation Criteria

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*This chapter discusses the assessment of tenders against the evaluation criteria set out in the RFT.*

### Background

**3.1** Good administrative practice involves determining the basis on which the winning tenderer will be selected before the tender documentation is issued, and devising evaluation criteria that will provide a suitable methodology for distinguishing between tenders. As a result, the tender documents released to potential tenderers establish the basis for the Commonwealth to determine the outcome of a tender process. The assessment of each tenderer, and any decision to award a contract as a result of the tender, should reflect a proper evaluation of the requirements contained in the RFT, including documented consideration of all evaluation criteria and the satisfaction of identified preconditions. The quantitative and qualitative elements taken into account in assessing whether those criteria have been met, or in determining whether it is still necessary for a particular criterion to be achieved, should be clearly identified in the formal evaluation documentation and advice provided to the decision-maker. The advantage of following good administrative practice in conducting a tender evaluation is in enhancing efficiency and the ability to demonstrate openly how the process was conducted so as to substantiate and defend the decision made, and promote confidence in the process from all stakeholders.

**3.2** As noted in Chapter 2, the Health Group IT&T Services Final Evaluation Report, completed by the Evaluation Committee on 2 September 1999, encapsulated the findings of the Financial, Technical and Corporate Evaluation Teams against the evaluation criteria relating to cost savings and service and risk identified in the Health Group RFT. The ID Evaluation Report set out the findings of the ID Evaluation Team against the ID evaluation criteria. ANAO identified aspects of the methodology for the assessment of tenderers against the identified evaluation criteria that could have been improved.

### Financial evaluation

**3.3** The evaluation criteria set out in the RFT provided that the financial evaluation would play a central role in determining the outcome of the tender. The Financial Evaluation Report completed by the Financial Evaluation Team noted that the adjustments made to tenderers' bids were significant and markedly influenced the financial outcome. In light of the close margin between each of the tenderers, and the modest financial savings identified, it was important that

the process for applying adjustments to tenderers' pricing and agency cost baselines ensured accuracy and completeness. ANAO identified areas for improvement in this regard in the Health Group tender, relating to the methodologies applied in calculating adjustments in respect of end-of-term assets and obligations, and to the processes followed more generally for reconciling all adjustments applied in the financial evaluation.

## **End-of-term adjustments methodology**

**3.4** Audit Report No.9 2000–01 examined the methodology employed in the Cluster 3, Group 5 and ATO tenders to determine the direct financial savings projected to be realised by the relevant agencies through the change to outsourcing. ANAO also examined the methodology for calculating the notional CN adjustments to agency costs. ANAO found that the methodology applied in respect of both aspects of the financial evaluation had changed over the course of the IT Initiative. The whole-of-government response to Audit Report No.9 provided by Finance disagreed with the recommendations made in that report in respect to the financial evaluation methodologies applied in the tender evaluations reviewed (see paragraphs 7.8 to 7.80 of Audit Report No.9 2000–01).

**3.5** In regard to the identification of financial savings, Audit Report No.9 found that the methodology adopted in those tenders did not capture all of the relevant values and costs. In calculating the costs associated with the business-as-usual side of the business case, the methodology did not include the residual value of agency assets that provided service potential after the end of the evaluation period. As a result, ANAO found that the true financial value to the Commonwealth of entering into the outsourcing arrangements was not revealed by the cash financial evaluations undertaken.<sup>91</sup>

**3.6** In calculating the costs associated with a decision to outsource, Audit Report No.9 found that the methodology did not appropriately capture the costs arising from the Commonwealth's obligations in respect to the assets expected to be used by tenderers in delivering the services. In the case of the Cluster 3, Group 5 and ATO tenders, that obligation was to keep the external service provider (ESP) 'whole' in respect of its capital investment in assets dedicated to the provision of the contracted services. That is, where the contract is terminated or expires or services are removed from scope and the ESP cannot redeploy the equipment, the Commonwealth has agreed to pay any shortfall between the net book value (NBV) of the equipment and the proceeds from its sale, or fair market value (FMV). ANAO concluded that the economic substance of those transactions was that the Commonwealth bears the ownership risk, and considered that the

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<sup>91</sup> Audit Report No.9, op. cit., pp. 152–156.

leases reviewed in those tenders constituted finance leases. The whole-of-government response provided by Finance disagreed with that conclusion. That response and an ANAO comment on the classification of finance and operating leases is included in Audit Report No.9 at paragraphs 7.27 to 7.29.

**3.7** Audit Report No.9 found that the Commonwealth exposure arises from the probable financial costs of technical obsolescence of IT assets and diminished service potential, which are not borne by the successful tenderers. This economic cost will generally apply in some form in the scenarios likely to arise at the end of the five-year contract term. ANAO found that omitting this adjustment distorted the evaluation, as the Commonwealth's exposures under the outsourcing option were not fully captured in the financial evaluation report.<sup>92</sup>

**3.8** As a result of these factors, ANAO found that the financial evaluation methodology applied in the tenders examined in that audit did not provide the relevant Ministers with analysis that comprehensively identified the Commonwealth's financial position in respect of each of the options under consideration.<sup>93</sup> In Audit Report No.9, ANAO estimated adjustments to the financial savings identified in the financial evaluations for the three tender processes reviewed to include: an estimate of the difference between the projected NBV and FMV of each tenderer's dedicated assets at the end of the evaluation period as a cost of outsourcing in recognition of the Commonwealth's contractual obligation<sup>94</sup>; and an estimate of the residual value or FMV of agency assets projected to be on-hand at the end of the evaluation period under the business-as-usual scenario.

**3.9** Audit Report No.9 also noted that in July 1999, after completion of the ATO and Group 5 tender evaluations, OASITO obtained written advice regarding the financial evaluation methodology to be applied in subsequent tenders.<sup>95</sup> In April 2000, OASITO advised ANAO that:

Difficulties surrounding end of term issues have been acknowledged by OASITO for some time. Last year, OASITO instructed [*an accounting firm*] to develop a methodology that would eliminate the need for assumptions about the sourcing decision for future periods. Our hope was that such a methodology would allow us to avoid the lengthy debates that surrounded this issue in the Group 5 and ATO processes. To that end, [*the accounting firm*] recommended the 'position of equivalence' methodology. You raised concerns with that approach and so,

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<sup>92</sup> *ibid.*, p. 164.

<sup>93</sup> *ibid.*, pp. 166–171.

<sup>94</sup> In the case of Cluster 3, ANAO found that the methodology applied had overstated that obligation. Accordingly, adjustments estimated by ANAO in respect of this Commonwealth obligation resulted in a slight increase in the financial savings estimated in the financial evaluation for that Cluster from outsourcing (*ibid.*, pp. 162–164).

<sup>95</sup> The advice was provided by the accounting firm that had provided OASITO with earlier oral advice, which OASITO had relied upon in amending the financial evaluation methodology for the Group 5 and ATO tenders to omit the consideration of end-of-period assets that had been included in the earlier Cluster 3 tender (*ibid.*, pp. 167–170).

following discussions with ANAO, [*the accounting firm*] has developed a further approach which addresses specific future sourcing scenarios. That approach is consistent with the position of equivalence approach, but breaks the analysis down into specific scenarios, each of which can be modelled and presented separately. OASITO believes that either approach would provide a sound basis for the financial evaluation. However, in order to give the decision maker maximum transparency, for future evaluations we intend to adopt the ‘scenario sensitivity analysis’ approach.<sup>96</sup>

**3.10** Audit Report No.9, released subsequent to the completion of the Health Group tender process, noted that ANAO continued to have major concerns in respect to the financial evaluation methodologies adopted by OASITO, and the capacity of those methodologies to provide a complete and reliable analysis of the value accruing to the Commonwealth from IT outsourcing.<sup>97</sup>

**3.11** No further OASITO-managed tenders were completed between OASITO’s April 2000 advice to ANAO and the Humphry Review in December 2000. Therefore, no tender evaluations appear to have been completed using the ‘scenario sensitivity analysis’ proposed by OASITO in that advice. However, ANAO noted in Audit Report No.9 that it understood that a revised financial evaluation methodology was applied by OASITO in the Health Group tender, and that ANAO would consider the revised methodology in the context of a planned performance audit of that tender scheduled for 2000–01.<sup>98</sup> Although not the primary focus of this performance audit, ANAO examined the financial evaluation methodology applied to the Health Group tender. The following sections identify aspects of the methodology that could have been improved in order to enhance the reliability of the financial evaluation.

## Methodologies used in Health Group tender

**3.12** The methodology to be employed in the Health Group financial evaluation in calculating adjustments in respect of end-of-term assets and obligations was not finalised until very late in the tender evaluation. This was a factor that made comparisons between tenderers’ financial positions over the course of the tender difficult. Ultimately, two different methodologies were used by the HIC and DHAC evaluation teams in the one tender process.<sup>99</sup>

<sup>96</sup> Audit Report No. 9, op. cit., p. 170.

<sup>97</sup> *ibid.*

<sup>98</sup> As noted in Chapter 1, prior to the receipt of the request from the Senate Finance and Public Administration References Committee to examine the Health Group tender, ANAO had decided not to proceed with the planned audit in light of the extensive audit of earlier IT outsourcing contracts and the significant changes subsequently made to the implementation strategy for the IT Initiative following the Humphry Review.

<sup>99</sup> MPL did not include an end-of-term adjustment in its financial evaluation. Tenderers identified little or nothing in the way of end-of-term assets dedicated to the provision of services to MPL. MPL did not seek to quantify savings from outsourcing to one of the tenderers, and given the nature of the in-scope services and its existing outsourced-provider arrangements with the HIC, MPL did not project assets to be on-hand at the end of the evaluation period under a business-as-usual case.



**3.13** The Health Group RFT required tenderers to confirm that at the end of the term, Group Agencies would have an option to purchase, or assume the lease on, the tenderers' equipment substantially dedicated to the provision of the services, such option to be at FMV. Instead, all three tenderers based their initial tenders on a requirement that the agencies would purchase the dedicated assets at NBV.

**3.14** In each of the tender processes reviewed in Audit Report No.9 2000–01, the equipment leasing arrangements proposed by each tenderer at the time of the financial evaluation were comparable. Each clearly identified that the Commonwealth would be required to assume the capital risk on dedicated assets. In each case, the final contractual arrangements with the successful tenderer, which ANAO considered to represent finance leases<sup>100</sup>, were consistent with the information available at the time of the financial evaluation.

**3.15** In the Health Group tender, the obligation to keep each tenderer whole, in respect of their capital investment in dedicated equipment where the lease was terminated for convenience, remained in the proposed contractual terms and conditions, including in the final executed contract with the successful tenderer, IBM GSA. However, two of the tenderers, including IBM GSA, also proposed alternative underlying leasing structures or vehicles. The IT&T Services Final Evaluation Report noted that the terms of the proposed equipment leases had been finalised with neither tenderer at the time of the selection of preferred tenderer in September 1999.

**3.16** The equipment leasing arrangements entered into with IBM GSA were not finalised until December 1999, in the case of the HIC, and early 2000 in the case of DHAC. ANAO subsequently formed the view that the equipment leases under both the DHAC and HIC IT&T Services Agreements represent operating leases. Significant terms and conditions on which that assessment was based were introduced into the contractual arrangements subsequent to the completion of the financial evaluation.

**3.17** However, in reviewing the methodology applied in the financial evaluation completed in September 1999, ANAO has had regard for the information that would reasonably have been available at that time. Although some parties appear to have had an expectation that the leases would ultimately be operating leases, a comprehensive assessment was not made at the time of the financial evaluation as to whether the leasing structures proposed by each of the tenderers represented finance or operating lease arrangements. In the event, in contrast to the methodology applied in tenders completed earlier in 1999 and reviewed by

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<sup>100</sup> Other factors considered in the classification of the leases included technological obsolescence, the nature of the asset and end of contract commitments.



ANAO in Audit Report No.9<sup>101</sup>, the methodologies applied by both the HIC and DHAC financial evaluation teams included, as a cost against each tenderer, the difference between the estimated NBV and FMV of the dedicated assets the tenderer expected to have on hand at the end of the five-year evaluation period. That treatment is consistent with costing the tenderers' proposals as representing finance leases.<sup>102</sup>

**3.18** Having regard to the information available at the time of the evaluation as to the nature of the equipment leasing arrangements being proposed, ANAO has not, as part of this audit, sought to re-visit the question of whether those adjustments were appropriate in the case of each tenderer's contractual proposals.<sup>103</sup>

### *'Position of equivalence' methodology*

**3.19** For the bulk of the tender process, the financial evaluation included as a cost against each tenderer the full NBV of the assets each expected to have on hand at the end of the five-year evaluation period, as identified in their tendered prices. At the Evaluation Committee meeting of 5 August 1999 (just after the close of the third re-pricing round), OASITO advised that an external consulting firm had recently provided it with advice on the 'position of equivalence' methodology for the treatment of assets at the end of the term. The HIC Financial Evaluation Team subsequently adopted that methodology in calculating the end-of-term adjustments to be applied in respect of assets and obligations for services to the HIC.<sup>104</sup> In August 2002, the consulting firm advised ANAO that:

The scope of our advice to OASITO was specific in its scope and subject to a number of limitations. Specifically advice was not provided on any accounting or taxation impacts and we were not made aware of what further adjustments may be made by OASITO to account for Competitive Neutrality considerations or other factors in application of our methodology to making final procurement choices. As part of this scope we relied entirely on OASITO to source the detailed assumptions and data that was used to undertake any comparative analysis of the tenders.

<sup>101</sup> Australian Taxation Office (contract executed March 1999), and Group 5 (contract executed April 1999).

<sup>102</sup> In May 2002, Finance referred ANAO to the advice on the subject of finance versus operating leases provided by OASITO to ANAO which was included in Audit Report No.9 op. cit., pp. 156–162.

<sup>103</sup> As noted, leasing terms and conditions negotiated with IBM GSA after the evaluation had been completed were an important consideration in ANAO ultimately forming the view that the equipment leases under the DHAC and HIC IT&T Services Agreements represented operating leases.

<sup>104</sup> In August 2002, the consulting firm advised ANAO that: 'We provided a range of advice to OASITO between June 1999 and June 2000. We are not specifically aware of what advice OASITO relied upon in making its tender assessments or what ... written/verbal advice they have passed on to ANAO for the performance review.' ANAO notes that the advice from the external consulting firm provided to the Health Group agencies by OASITO on 5 August 1999 was dated 5 August 1999.

**3.20** The ‘position of equivalence’ methodology applied in respect of the HIC involved an assumed wind-up of both the outsourcing contract, and the in-scope HIC IT services operations, at the end of the five-year evaluation period. It included recognition of the costs arising from a Commonwealth obligation to meet any difference between the estimated NBV and FMV of each tenderer’s dedicated assets at the end of year 5, which were added to each tenderer’s prices. It also assumed that under the business-as-usual side of the business case, at the end of the evaluation period the HIC held neither any IT assets nor associated liabilities. The projected FMV at the end of the five-year evaluation period of the HIC’s assets under continued internal IT service provision was recognised in the evaluation, as was subsequently recommended by ANAO in Audit Report No.9 2000–01.<sup>105</sup> Under the position of equivalence methodology, this value was offset by also applying to the business-as-usual case the costs associated with winding up the HIC’s internal IT operations. These were the costs associated with the in-scope staff being given voluntary redundancies, and existing equipment or maintenance leases being terminated and paid out.<sup>106</sup>

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<sup>105</sup> In August 2002, the consulting firm advised ANAO that: ‘We were advised by OASITO that any deficiencies/surpluses of NBV over FMV for the IT Assets would be paid/received by the agency to a terminating outsource vendor. As we previously advised this difference would, irrespective of the procurement option chosen at Year 0, impact the agency by the same amount from an economic perspective at Year 5. Any delayed realisation of this impact past Year 5 under a BAU arrangement would not diminish the requirement for the cost/benefit to be included in the BAU Year 5 analysis. In other words the loss or gain should be realised on a mark to market basis for both BAU and Outsourcing options. This approach may differ from other accounting treatments of these issues.’ ANAO notes that the approach recommended in Audit Report No.9 was for the residual value of agency assets under the business-as-usual case to be recognised at the end of the evaluation period as the estimated FMV of those assets. This incorporates recognition of the estimated loss/gain to the agency of the market value of those assets compared to the historic purchase costs that were incorporated in the cash outlays identified over the evaluation period (Audit Report No.9, op. cit., pp. 152–155).

<sup>106</sup> The logic underpinning this methodology appears to have been that, in order to recognise within the evaluation period the market value of the agencies’ residual assets under the business-as-usual side of the business case, or the costs associated with the agencies’ obligations in respect of the ESP’s assets under outsourcing, an assumption must be made as to the conditions under which assets and liabilities could be ‘cashed out’. That is, a sale of agency assets occurred and therefore internal IT operations ceased, or the outsourcing contract was wound up and the assets sold.

**3.21** The consulting firm's advice to OASITO stated that this position of equivalence for each of the options was necessary to ensure that the analysis term could end at five years, and to provide a common denominator for each option at the end of that term. The consulting firm advised OASITO that, by taking this approach, the decision about whether to retain or outsource the IT assets at the beginning of the 6<sup>th</sup> year became academic as the agency was assumed to be starting from a position where it could decide to do what was to its best advantage, regardless of which option it chose during the first 5 years. In August 2002, the consulting firm advised ANAO that:

While the initial Outsourcing contract term was 5 years, we were advised by OASITO that the evaluation period should consider the long term economic consequences of choosing between the two procurement options.

OASITO advised that [it was] unable to ascribe any relative probability to the range of post Year 5 procurement scenarios that may [be] chosen or what the exercise cost of each option after Year 5 may be. It was in this context that the analysis was restricted to 5 years only.

...Our methodology was designed around the fact that only 5 years of data was made available to us and OASITO wished to ensure that any procurement cost differences or procurement choice uncertainty arising after Year 5 was taken into account. Given that there were many procurement scenarios following the initial choice for the first 5 years we designed a methodology that removed any bias from the Year 0 comparative analysis. Given the scope of our brief, the position of equivalence approach was considered as the simplest way to provide an equitable evaluation between BAU [*Business as Usual*] and Outsourcing.

**3.22** The basis of comparison between the agency baseline costs and the external bidders in each tender evaluation should be the forecast annual costs and financial position of the Commonwealth arising as a consequence of the discrete options under consideration at that point in time—continuing with in-house delivery of the IT services or outsourcing them to a tenderer.

**3.23** The purpose of the financial evaluation was to provide the decision-maker with an assessment of the relative costs that would arise under each of those options. The evaluation period used in making that assessment is determined by the proposed term of any resulting service agreement should the outsourcing option be chosen. In assessing the costs associated with continued internal delivery of the IT services (the 'no-change' option), a reasonable assumption is that the agency will be a going concern. That is, it will continue to require those IT services past the evaluation period under consideration, and will continue to provide them in-house. This would encompass utilising the residual service potential of assets expected to be on hand at the end of the evaluation period.

**3.24** However, the costs and obligations arising from adopting the change to a finite outsourcing contract need to be captured within the evaluation period selected. The costs incurred as a result of a decision to outsource should be attributed to the party giving rise to those costs. For example, the staff costs from voluntary redundancies are not incurred by the agency if it continues with the business-as-usual case, and only arise as a consequence of deciding to outsource the services.

**3.25** The methodology adopted in calculating end-of-term adjustments for services to the HIC changed the initial assessment of the financial value of outsourcing at the beginning of the evaluation period under consideration by introducing an assumption that the agency would incur the costs associated with discontinuing internal service delivery of the IT services (ie outsourcing), regardless of whether the outsourcing option was chosen as a result of the current tender process or not. Finance advised ANAO in May 2002 that: 'Given the Government's clear policy statements that IT infrastructure was to be outsourced, an assumption that it would actually occur does not appear unreasonable'. In August 2002, Finance further advised that:

...the OASITO methodology operated under the policy assumption that IT infrastructure was to be moved to the private sector via outsourcing once and for all. The methodology employed was consistent with this assumption.

**3.26** In August 2002, the consulting firm advised ANAO that:

...At the time of our advice OASITO did not make us aware of any predetermined government policy positions on Outsourcing and at no point suggested that it should impact upon our comparative methodology. In our experience any policy of this nature would normally be subject to a whole of government economic benefit or value for money test. These tests are consistent with the nature of the work that we were undertaking for OASITO.

The methodology applied is not inconsistent with the assumption of the agency continuing past Year 5 as a going concern. The methodology assumes that after Year 5 that the agency continues to provide (say) health services but is free to choose the IT procurement option that is most appropriate to support that service.

...We advised OASITO that, given the likely procurement option switching costs were likely to be considerable, we expected that the two most likely scenarios were BAU [*Business as Usual*] in perpetuity or Outsourcing in perpetuity. However we were advised by OASITO that these scenarios were no more likely than those that entailed switching after Year 5.

ANAO are correct in stating that no 'wind up costs' would be incurred if BAU was chosen initially and then again at Year 6. However this procurement sequence scenario is one of many and we were asked by OASITO to assume that after Year 5 procurement choices could not be predicted at Year 0. We advised OASITO that

they should consider a range of procurement sequence scenarios such that any procurement decision after Year 5 would neither favour nor disadvantage one option over the other. We also considered as an alternative that the end of Year 5 equivalent position [was] BAU rather than Outsourcing. This approach would have unfairly penalised the Outsourcing option by incurring the wind up costs at Year 0 and then incurring the cost of reacquiring IT assets at the end of Year 5 to re-establish a BAU position. We also advised OASITO that any savings that may be derived from Outsourcing may take longer than 5 years to fully recover the initial switching cost penalty of choosing Outsourcing. Any potential further savings from Outsourcing after Year 5 was unable to be reflected in the analysis as we were restricted by OASITO to a 5 year analysis term. If the term of analysis had been extended this may have provided further opportunity for outsourcing savings to be realised in the comparative analysis. Accordingly, we adopted the chosen methodology given that it avoided all the bias and uncertainties outlined above and provided a level playing field for equitable procurement decisions after Year 5.

**3.27** The methodology applied in respect of the HIC resulted in net additional costs of \$2.4 million being identified against the business-as-usual side of the business case for the HIC, rather than a benefit of \$3.34 million, being the estimated FMV of HIC assets at the end of the evaluation period. This overstated the financial savings identified for the HIC by \$5.73 million, which represents some 78 per cent of the financial savings to the Health Group identified in the financial evaluation.

### *DHAC methodology*

**3.28** The end-of-term adjustments for DHAC were calculated using a different methodology. The difference between the estimated NBV and FMV at the end of the evaluation period of tenderers' dedicated assets for services to DHAC was added to each tenderer's bid. But the methodology used did not include the application to the business-as-usual case of the costs associated with winding-up DHAC's internal IT services as occurred under the position-of-equivalence methodology. ANAO identified no documentation of the decision-making process that led to DHAC adopting the methodology used by it. However, ANAO did note that the Financial Team Leader, a DHAC officer, advised the then Secretary of DHAC on 24 August 1999 that OASITO's view was that there should be no end-of-term adjustment for assets, but that the agencies considered that to do a fair comparison of in-house service provision and outsourcing, the NBV of tenderers' dedicated assets should be considered in the evaluation. The Financial Team Leader advised that agencies and OASITO had now agreed that a differential between the NBV and FMV of tenderers' assets should be considered in the evaluation.

**3.29** As noted, on the business-as-usual side of the business case, the methodology applied by DHAC did not include recognition of the costs associated with winding up the internal DHAC IT services. It also included no recognition of the residual value of the assets DHAC projected to hold at the end of the five-year evaluation period under continued internal service delivery. As a result, the financial savings likely to be obtained from outsourcing were overstated by the estimated FMV of DHAC assets at the end of the evaluation period. The DHAC cost model projected a NBV of assets of \$8.41 million. Applying the average FMV to NBV ratio offered by tenderers for the existing DHAC assets at the commencement of the evaluation period (43.4 per cent), ANAO estimated the FMV of DHAC assets at the end of the five-year evaluation period at \$3.65 million.

### *Estimation of FMV*

**3.30** Both of the methodologies used to calculate end-of-term adjustments involved the estimation of the FMV of tenderers' dedicated assets at the end of the initial five-year contract term. This was calculated by taking a percentage of the estimated NBV advised by each tenderer.

**3.31** As part of their tenders, tenderers were required to undertake to purchase agencies' existing in-scope assets at the commencement of the outsourcing Services Agreement. The purchase price proposed by each tenderer was applied as a reduction to the overall cost of their tender. Under both the DHAC and HIC methodologies, the FMV of each tenderer's dedicated assets at the end of year 5 was estimated by applying the same ratio of FMV to NBV provided by that tenderer's purchase price offer for the agencies' existing assets, rather than on expected realisable value at the end of year 5. ANAO does not consider that this methodology was appropriate to the circumstances.

**3.32** In the context of a competitive tender for the outsourcing of IT&T services, the purchase price offered by tenderers for existing assets does not typically represent the amount for which the assets could be exchanged between knowledgeable, willing parties in an arm's length transaction, as would normally be expected in determining FMV.<sup>107</sup> Rather, tenderers' offers represent a strategic commercial position, with many factors being taken into account. These include the relationship between the up-front purchase price and the unit rates subsequently charged for the equipment and services provided under the resulting outsourcing Agreement. As a result, tenderers offer widely varied values for existing assets that do not necessarily reflect the assets' FMV. Indeed, in the Health Group tender, one tenderer initially offered a payment for the

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<sup>107</sup> As set out in, for example, the definition of 'fair value' in Australian Accounting Standard AAS 29, *Financial Reporting by Government Departments*.

agencies' existing assets of one dollar. Ultimately, the tenderer that offered the highest initial purchase price for the agencies' assets was also assessed as having the highest-cost tender.

**3.33** The final purchase prices offered by tenderers for the HIC's existing assets ranged between about 21 and 44 per cent of the assets' NBV, and between 28 and 63 per cent for DHAC's assets. The effect of imputing these same ratios to the estimation of the FMV each tenderer would realise for its dedicated assets at the end of the contract term was that the quantum of adjustment added to each tenderer's price was distorted. The adjustment related to the agencies' obligation to pay the tenderer the difference between their dedicated assets' NBV and the proceeds of sale, or FMV. Therefore, a tenderer that offered a low purchase price at the commencement of the evaluation period compared to the NBV of agencies' existing assets had a higher adjustment added to its tender. This was because it was assumed that the tenderer would only be able to realise a similarly low FMV ratio on its own assets if they were sold at the end of the term, increasing the differential the agencies would be required to make up. The opposite effect applied to a tenderer that offered a higher purchase price for the agencies' existing assets relative to their NBV at the start of the evaluation period.

**3.34** ANAO does not consider that there is a sound basis for assuming that there would be a material difference in the ratio of NBV to FMV each tenderer's assets would realise at the end of the evaluation period when exchanged between knowledgeable, willing parties in an arm's length transaction. While tenderers were able to propose individual solutions, each was required to include in their tender minimum equipment standards, specifications, and refresh periods, thereby maintaining a comparability between the type of dedicated assets each would be expected to have on hand at the end of the evaluation period.

**3.35** ANAO calculated revised end-of-term adjustments for each tenderer using the average NBV to FMV ratio resulting from the purchase prices offered by all three for the agencies' existing assets at the start of the evaluation period. This had the effect of increasing the adjustment added to two tenderers' bids in the financial evaluation by \$0.28 million and \$3.04 million respectively, and decreasing the adjustment added to the third by \$2.16 million.

**3.36** The aggregate effect of those adjustments and the other adjustments to the treatment of end-of-term agency and tenderer assets identified by ANAO (see paragraphs 3.27 and 3.29) reduces the financial savings identified in the financial evaluation against the preferred tenderer by over \$9 million, and by some \$7 million against the second-ranked tenderer. In the context of the close outcome of the financial evaluation in the Health Group tender, movements of that nature would have changed the indicative financial rankings of the tenderers,



but would have also resulted in no tenderer offering financial savings (before the application of additional savings identified by Finance—see paragraphs 2.79 to 2.83 and 2.95 to 2.97). The net estimated adjustments would result in a cost premium to the Health Group from outsourcing, before the application of notional CN adjustments, of some \$1 million over five years, and post-CN savings of \$29 million based on the CN adjustments applied in the financial evaluation (also before the application of additional savings identified by Finance).<sup>108</sup>

**3.37** As noted in Chapter 2, the Evaluation Committee found that all tenderers fell within a financial range that was not in itself a material differentiating factor (see paragraph 2.82). While the quantum of the revisions identified here would have moved the relative financial rankings, they are not likely to have changed that assessment. However, this analysis does highlight the importance of ensuring that the financial evaluation methodology is designed to provide the decision-maker with a sound basis for selecting between tenderers and determining the outcome of the tender.

## Reconciliation of adjustments

**3.38** ANAO's review of the Financial Evaluation Report identified a number of errors and internal inconsistencies in the construction of adjustments figures within the summary and body of the Report, and its Appendices. The report of the Finance internal audit review similarly found that it could not reconcile the total adjustments within the Financial Evaluation Report to the sum of the individual adjustments listed in its Appendix. ANAO also identified errors in the calculation, or application, of adjustments.<sup>109</sup>

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<sup>108</sup> In the Health Group tender, the notional CN adjustment added to agency cost baselines in respect of a requirement for a return on capital was calculated based on a weighted average cost of capital of 12.89 per cent. This is consistent with the higher risk premiums applied in the calculation of CN rate of return adjustments in the Cluster 3, Group 5 and ATO tenders. In regard to the calculation of notional CN adjustments, Audit Report No.9 op. cit., pp.173–176 found that, given the low business risk for the external service providers associated with assets under the outsourcing Agreements reviewed in that audit, the CN rate of return adjustment applied to the agency cost baselines should have reflected a lower rate of return requirement than was the case. ANAO considers that the determination of the appropriate rate of return should have included consideration of the business risk to each tenderer associated with assets under their tender proposal.

<sup>109</sup> For example, ANAO noted apparent errors in the application of adjustments that appeared to result in the total costs against one tenderer being overstated by some \$3 million. As noted, the Evaluation Committee found that all tenderers fell within a financial range that was not in itself a material differentiating factor (see paragraph 2.82). The errors identified by ANAO are not likely to have changed that assessment.



**3.39** Many of the errors identified appear to have been the result of a last-minute rush to complete the adjustments process, particularly in respect to services to the HIC. A minute from the Financial Evaluation Team Leader to the OASITO Evaluation Coordinator on 1 September 1999 covering the provision of the Financial Evaluation Report advised that:

In respect of this report many adjustments to tenderer prices have been processed and finalised only in the last 24 hours. The numbers in this report have been developed from a summary view of those adjustment numbers provided by OASITO. This is a divergence from agreed process.

While I remain convinced that a detailed review of adjustments will support the numbers and conclusions in the report, I can't discount the possibility of change when the recently processed adjustments are finalised pursuant to the agreed process.

**3.40** On 2 September 1999, the Evaluation Committee signed off on the IT&T Services Final Evaluation Report. An errata to the report passed on 3 September following review by the Steering Committee adjusted some errors in reported numbers, but did not correct all of the errors and internal inconsistencies contained in the report. Financial consultants were engaged by OASITO to manage and reconcile the entry of financial adjustments into the Savings Model. Within the documentation available for review, ANAO could not locate a final reconciliation of the adjustments and savings assessed against each tenderer that agreed with the adjustments and final outcome shown in the Financial Evaluation Report. In August 2002, the financial consultant engaged by OASITO advised ANAO that:

...we were not required to provide final sign off in relation to the reconciliation of the savings model and in fact the final adjustments to the model were made by OASITO and [*the Strategic Adviser*] without [*our*] involvement and without [*our*] being required to provide a final reconciliation.

## Substantial cost savings precondition

**3.41** The Health Group RFT explicitly stated that 'achievement of substantial cost savings is a precondition to the award of a contract.' It was stipulated that the Commonwealth would not award a contract unless it was satisfied that the preferred tenderer would deliver a substantial and acceptable level of cost savings based on an assessment against the criteria relating to cost savings specified in the RFT.

**3.42** The Evaluation Guide for the tender stipulated that, based on the interim and final evaluation reports provided to it, the Steering Committee would determine which tenders had satisfied the threshold criteria relating to cost

savings and service risk. It could also rank the tenders in terms of best overall value for money as measured against the IT&T services evaluation criteria. The Steering Committee's findings were then to be submitted to the Options Committee, which would also consider the ID Evaluation Report in formulating selection options for consideration by Ministers.

**3.43** The manner in which the requirement for substantial cost savings was expressed meant that it was a key threshold factor to be applied in the evaluation process. However, the financial evaluation methodology did not explicitly provide for an evaluation against the cost savings precondition.

**3.44** The RFT stipulated that the assessment of a tenderer's pricing proposal would include an evaluation of the extent to which its pricing and pricing structure would enable the Commonwealth to maximise savings compared both with competing tenders and the cost to the Commonwealth of continuing to provide the services itself. Other identified criteria related to the ongoing competitiveness and flexibility of the pricing structure.<sup>110</sup>

**3.45** The sub-criteria developed to assist evaluators in forming assessments against the evaluation criteria were included as an attachment to the Evaluation Guide. The HIC proposed that the first sub-criterion to be used in assessing tenderers against the criterion relating to maximising savings should be tenderers' capacity to 'Achieve genuine, sustainable and substantial savings'. However, OASITO advised the HIC that:

While the RFT states that substantial cost savings are a precondition to the award of a contract, the evaluation criteria published in the RFT at Clause 94.1 specify that the criteria against which tenders will be evaluated will be whether the Commonwealth is able to 'maximise savings'. The word "substantial" would therefore not be included in sub-criteria.

**3.46** The sub-criterion ultimately included in the Evaluation Guide referred to achievement of genuine and sustainable savings, but omitted reference to the achievement of substantial savings. The terms 'substantial' and 'acceptable' were not specifically defined in either the RFT or the evaluation methodology. It was also not defined as to whether the assessment of substantial 'cost savings' should include consideration of notional competitive neutrality adjustments.

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<sup>110</sup> These criteria were the extent to which a tenderer's pricing structure would: ensure that prices for the services remain competitive throughout the term; provide predictable service charges with no unanticipated price increases over time; provide gain-sharing arrangements such that the Commonwealth will share in substantial financial benefits from productivity gains and business process improvement; and provide sufficient flexibility to adapt to changing technology and business needs of the Group Agencies, including changes arising out of restructuring, strategic planning, and re-engineering projects.

**3.47** OASITO also advised the HIC that RFT references must be identified for all sub-criteria, as they could only be used to evaluate tenders against requirements specified in the RFT. An RFT cross-reference was included against all cost savings sub-criteria except the one relating to the achievement of genuine and sustainable savings. That sub-criterion was cross-referenced to financial reports developed from financial models. The sub-criteria were not cross-referenced to the RFT cost savings precondition.

**3.48** The sub-criteria were finalised the day tenders closed, 15 February 1999.<sup>111</sup> That same day, the Probity Auditor provided OASITO with a sign-off confirming that he had reviewed the Evaluation Kit for the IT&T services evaluation (which included the Evaluation Guide identifying the evaluation methodology and sub-criteria). The Probity Auditor confirmed that the document was consistent with the RFT and that it had not identified any probity issues in respect of the document. No details were provided in the letter as to the work completed as a basis to the sign-off of the evaluation methodology.<sup>112</sup>

**3.49** The determination as to whether a tenderer had satisfied the precondition for substantial and acceptable savings would require a conclusion to be drawn, based upon the detailed assessments against the individual criteria. The financial criteria set out in the RFT, and associated sub-criteria, did not require a specific assessment against the concept of ‘substantial’ savings. Consequently, there needed to be some other mechanism set out in the evaluation methodology to ensure that the extent to which the RFT precondition had been satisfied was transparently considered. It does not automatically follow that savings assessed as genuine and sustainable would also be considered substantial. Equally, a tenderer could be assessed as maximising the available savings, but for those savings not to be considered substantial. However, the evaluation methodology did not identify such a mechanism, or articulate how assessments against the precondition would be made.

## **Conclusion against achievement of substantial cost savings**

**3.50** It could be expected that the Committees responsible for the evaluation would formally and specifically address in their advice and recommendations to the decision-maker whether, in their view, the cost savings precondition had been satisfied by the recommended preferred tenderer. As was discussed in Audit Report No.9 2000–01, that was not the case in the ATO and Group 5 tenders.<sup>113</sup> It was also not the case in the Health Group tender.

<sup>111</sup> The opening of tenders was delayed that day pending finalisation of the sub-criteria and Evaluation Kit.

<sup>112</sup> ANAO sighted a sign-off on the Kit provided by DHAC also on 15 February, but formal approval of the Kit and the evaluation methodology contained in it by the Evaluation Committee or Steering Committee was not recorded in the minutes of either Committee.

<sup>113</sup> Audit Report No.9., op. cit., pp. 118–125.

**3.51** The Financial Evaluation Report stated that all tenderers provided genuine and sustainable savings to the Health Group as a whole when CN was included, but that when viewed on a total cash basis excluding CN, only IBM GSA and CSC showed savings. The report did not identify whether either the post-CN or financial savings identified against each tenderer were considered to represent ‘a substantial and acceptable level of cost savings’. The report did note that no tenderer provided genuine and sustainable savings to every Health Group agency or across every platform.

**3.52** In referring the IT&T Services Final Evaluation Report to the Options Committee, the Steering Committee did not express a clear view that the precondition had been satisfied. In fact, the comments made by the Committee appeared to indicate an opinion that is inconsistent with it having formed such a view. The Steering Committee noted, inter alia, that:

- after making CN adjustments to the cost baselines, savings from all tenderers could be anticipated but were not assured; and
- the opinion of the Committee was that the outsourcing process should be accepted as capable of delivering savings to the Group, but that there is a potential that actual savings may not eventuate when measured against the cost baselines used in the financial evaluation. While regarded as real, this potential cannot be reliably quantified.

**3.53** The Steering Committee noted that, as the financial positions of the tenders were close, it had regard to both cost savings and service and risk considerations in forming its recommendation. In this regard, the Committee noted the RFT provision reserving the right to take account of service and risk considerations in determining the best combination of ID and cost savings. The Committee did not refer to the RFT precondition for substantial and acceptable savings. The Options Committee also made no reference to the precondition in its recommendation to the Minister. The revised resolutions provided by the Steering and Options Committees following the Finance review of savings similarly made no reference to the cost savings precondition.

**3.54** The minutes of the 27 August 1999 meeting of the HIC Board<sup>114</sup> record that, in response to a query from a Commissioner as to whether or not OASITO considered there were substantial savings for the HIC in outsourcing, OASITO advised that:

OASITO has taken legal advice and that advice states that it is valid to include competitive neutrality when determining savings, that the cost saving requirement can at the end of the process be ignored, and that the OASITO view will prevail. He said considering these points OASITO is comfortable the process can proceed.

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<sup>114</sup> See footnote 84.

**3.55** OASITO received faxed advice from the Legal Adviser at 9.19 am on 27 August 1999, which noted that OASITO had sought its comments on the meaning of ‘substantial cost savings’ as used in the RFT precondition clause.<sup>115</sup> The Legal Adviser advised that the term was not defined, and that its meaning needed to be considered in light of relativities between present expenditure and proposed expenditure. ANAO notes that the projected savings associated with the application of notional CN adjustments did not specifically relate to present or proposed expenditure by the agencies involved. On that basis, it is not clear that the Legal Adviser’s advice provided a clear indication as to whether CN adjustments should, or should not, be included in determining whether the cost savings precondition had been satisfied. The advice did not specifically discuss CN or CN adjustments. In August 2002, the Legal Adviser advised ANAO that: ‘We do not recall being asked to advise on CN issues. The Strategic Adviser had the prime carriage in relation to financial issues.’

**3.56** The 27 August 1999 advice to OASITO from the Legal Adviser stated that the Commonwealth needed to be satisfied that the tenderer would deliver a substantial and acceptable level of cost savings based on an assessment of the cost savings criteria in the RFT. To this end, the Legal Adviser understood that OASITO had done considerable work on defining the Group Agency cost baselines and that the Evaluation Team had reviewed the matters specified in the evaluation criteria in the RFT. The Legal Adviser further noted that:

We further understand that the savings are at least 10% over existing baselines. A level of 10% could properly be considered by the Group Agencies to be substantial.

If savings were low/lower, then the Group Agencies could amend the RFT evaluation criteria if they still wished to proceed with the outsourcing.

**3.57** OASITO advised the Minister on 8 September 1999 that the evaluation had identified financial savings of 2.2 per cent, or 11 per cent<sup>116</sup> after the inclusion of notional CN savings. On 22 September 1999, OASITO advised the Minister that the additional financial savings identified in the Finance review represented a further 4.2 per cent in savings, a total of 6.4 per cent in financial savings and 13.6 per cent in savings with notional CN adjustments.

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<sup>115</sup> OASITO joined the HIC Board meeting at 10.15 am on 27 August 1999.

<sup>116</sup> This appears to have been an error. ANAO calculated the post-CN savings as identified in the Financial Evaluation Report to represent 9.4 per cent of the reported agency baselines (see paragraph 2.80). The ANAO calculation is consistent with OASITO’s later advice to the Minister on 22 September 1999, in which it advised that the further 4.2 per cent in savings identified by the Finance review had increased post-CN savings to 13.6 per cent (which is consistent with a 4.2 per cent increase over 9.4 per cent).

**3.58** ANAO noted in Audit Report No.9 2000–01 that, in December 1998, the Prime Minister advised all Portfolio Ministers that ‘as a general Government policy, outsourcing of IT infrastructure services should proceed unless there was a compelling business case on a whole-of-Government basis for not doing so’.<sup>117</sup> As was the case with two of the tenders examined in that audit, the Health Group RFT had been issued prior to the Prime Minister’s letter. As also noted in Audit Report No.9, the timing of the December 1998 policy statement meant that it had the potential to introduce a new factor into the environment in which the tender evaluations then underway were being conducted. ANAO found that there was potential for the policy statement to be interpreted and applied in those tenders in a manner inconsistent with the selection preconditions set out in the respective RFTs.<sup>118</sup> In such circumstances, there is a heightened need for the factors considered in any decision to award a contract in respect of a tender process to be appropriately documented/recorded. This should include transparent consideration of the satisfaction of specified preconditions, including any changed conditions.

**3.59** In Audit Report No.9, ANAO considered that the transparency and accountability of the decision-making process in the ATO and Group 5 tenders would have benefited from improved documentation/recording of the respective evaluation Committees’ conclusions. This includes advice as to whether the preconditions stipulated in the RFT had been satisfied by the recommended preferred tenderer and the factors considered in reaching that conclusion.<sup>119</sup> ANAO formed a similar conclusion in respect of the conduct of the Health Group tender.

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<sup>117</sup> Audit Report No.9., op. cit., p. 121.

<sup>118</sup> *ibid.*, pp. 121–123.

<sup>119</sup> *ibid.*, p. 123.

## Consideration of revised savings by Committees

**3.60** Issues also arose in regard to the role of the various Committees in regard to the revision of savings to be announced as arising from the tender. As discussed in Chapter 2, the announced savings differed from those identified in the IT&T Services Final Evaluation Report as a result of a review conducted by Finance at the request of the then Minister for Finance and Administration before he would agree to endorsement of the preferred tenderer recommendation (see paragraphs 2.92 to 2.102). OASITO had advised the Minister on 8 September 1999 that it had a different view of the likely savings to those identified in the Evaluation Report. The increased savings arising from the Finance review were not referred back to the Evaluation Committee that had prepared and signed-off on the Evaluation Report.

**3.61** In advising DHAC and the HIC that the matter had been referred to Finance at the Minister's request, OASITO stated that it had always been concerned that the agency-developed cost baselines under-estimated the likely future cost to the agencies of continued in-house operation. As well, OASITO stated that its agreement to progress the project without further debate over cost estimates was on the basis that it would separately advise the Minister of its view of the more likely scale of the business case.

**3.62** On 15 September 1999, the then Secretary of DHAC replied that he accepted that there was room for judgement about estimates of the precise savings from outsourcing and of cost baselines under continued in-house operation, and agreed to cooperate with the review. The Secretary noted, however, that OASITO accepted the DHAC cost baseline and 'signed-off' on it; that consultants engaged by OASITO to review the agency cost baselines had also agreed the DHAC cost baseline<sup>120</sup>; and that the HIC cost baseline had also been signed off, notwithstanding OASITO's comments from time-to-time that it believed the baseline understated the most likely future cost of continued in-house operations.<sup>121</sup> The Secretary also noted that the unanimous report of the Steering Committee was based on those cost baselines.

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<sup>120</sup> Financial Advisers engaged by OASITO reconciled the completed agency cost models with the information and service requirements set out in the RFT. The documentation was reviewed from the perspective of consistency, reasonableness and accuracy, but agencies remained responsible for determining their cost baselines. In conducting each reconciliation, the Financial Advisers noted issues for review as appropriate. The Financial Evaluation Report stated that OASITO had a different view of the baseline cost projections for the five-year evaluation period for the HIC. It made no reference to OASITO having concerns about the DHAC cost baseline (see paragraph 2.92).

<sup>121</sup> See discussion of this issue at footnotes 64 and 65.



**3.63** Finance recommended adjustments to reduce the projected costs of contract management included in the financial evaluation<sup>122</sup> and to increase the projected staff overhead costs in the DHAC cost baseline.<sup>123</sup> This resulted in \$16.6 million in additional savings being identified.

**3.64** On 17 September 1999, the then Secretary of Finance convened a meeting with senior OASITO and Group Agency representatives at which the Finance report was circulated. File notes of the meeting created by DHAC and HIC representatives stated that the discussion about the report led to both agencies seeking assurances that agency budgets would not be revisited as a result of the claimed savings being agreed by them for publication. The Finance Secretary confirmed that the additional savings would not be removed from agency budgets. On this basis, the DHAC and HIC representatives agreed to the conclusions in the Finance report.<sup>124</sup>

<sup>122</sup> Estimated contract management costs were included in the financial evaluation as a cost arising from a decision to outsource. DHAC had estimated that, based on projected staffing, its contract management costs would be \$8.9 million over five years. The HIC had estimated its costs at \$15.8 million, but OASITO indicated that it considered that estimate too high and an agreement was struck to include a cost of \$10 million for evaluation purposes. The contract management costs represented 7.4 per cent and 4.5 per cent of contract value for DHAC and HIC respectively. Finance's report acknowledged that the cost of contract management is ultimately a judgement that balances risk and cost, but noted that it is an area that lends itself to benchmarking against the experience of other organisations. Finance reported that current investment in contract management had proven difficult to quantify but that there clearly is a common range of around one to five per cent of contract price, and that it is reasonable to regard three per cent as an achievable and desirable standard. Finance did not identify why, within the range it identified, it had selected three per cent as the appropriate benchmark. Finance reported that, for the purpose of calculating savings, it considered that additional amounts over the three per cent level should be regarded as discretionary investment of savings and a business decision of the agency. Applying the three per cent ratio for contract management in both DHAC and the HIC increased estimated savings by \$8.6 million over the five years.

<sup>123</sup> The DHAC cost baseline included a provision for staff overhead costs over the five-year evaluation period. DHAC considered that its analysis was a very detailed one that had captured all the relevant corporate overheads. The costs identified represented about 51 per cent of direct salary costs. However, Finance agreed with OASITO's view that this approach was inconsistent with an agreed formula operating between DHAC and Finance for funding additional staff in Budget new policy and savings. That agreement provided for overheads of 93 per cent of salary costs. The issue of consistency between projected internal cash flows identified for the purpose of enabling direct comparison with the projected cash flows under a tenderer's outsourcing proposal, and the formulae applied to costing and funding measures identified in the Budget context had not been previously raised. Applying the 93 per cent ratio increased the DHAC cost baseline, and therefore savings, by \$8 million over five years. Finance noted that the HIC had calculated these costs as approximately 63 per cent of direct salary costs in its baseline, but that there was no agreed formula between the HIC and Finance. In the absence of such an agreement and, in the time available, Finance did not propose an alternative.

<sup>124</sup> As noted at paragraph 1.2, in anticipation of savings being realised from the whole-of-Government IT Initiative, reductions were made to the forward estimates of Budget-funded agencies in the 1997-1998 Budget. If specific tender processes result in savings in excess of the Budget reductions, those savings are retained by agencies. If the tender processes result in lower savings, agencies must fund the difference internally. In transmitting the original Options Committee recommendation to the Minister, OASITO advised that the Health portfolio budget (pre-Administrative Orders changes) was reduced by \$10 million per annum. DHAC documentation suggests that the reductions to be applied to Health Group agencies were \$3 million per annum for DHAC and \$4.5 million per annum for the HIC, but that Finance had not applied the reduction to the HIC. As noted at footnote 81, under a separate agreement, the HIC contributed \$3 million per annum to DHAC under the OPA towards the cost premium incurred by DHAC under the IBM GSA contract as compared to the DHAC cost baseline.



## Supplementary resolution

**3.65** The OASITO chair of the Steering Committee proposed a draft resolution stating that, having regard to views expressed in the Evaluation Report concerning possible additional savings from this outsourcing<sup>125</sup>, and the report from Finance, the Steering Committee agreed that the expected value of savings from the Health Group information technology infrastructure outsourcing contract should be expressed as ‘at least \$53.9 million over the first 5 years’<sup>126</sup> (see paragraph 2.98). The DHAC file note of the meeting with Finance recorded that the OASITO chair undertook to obtain appropriate probity sign-offs before requesting Steering Committee members to sign the resolution.

**3.66** The Finance report and proposed resolution were formally provided to Steering Committee members by the OASITO chair later that day, 17 September 1999. The Committee members were asked to sign the resolution, or advise OASITO if they considered the Committee should meet to discuss it. OASITO advised the Steering Committee members that the Probity Auditor had approved the documentation. ANAO was not able to locate documentation of that approval in the records made available for review.

**3.67** On 20 September 1999, the Probity Auditor provided OASITO with a letter stating that he had received copies of the Finance report and the resolutions to be placed before the Steering and Options Committees confirming their previous recommendations. The Probity Auditor stated that the independent review by Finance strengthened the process and as such, he did not believe that it in any way impinged upon the probity of the process. The Probity Auditor advised that, as the Minister instigated the review, he believed that it was appropriate for the Steering and Options Committees to confirm their previous recommendations as was proposed.

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<sup>125</sup> The items identified in the evaluation report as possible additional savings did not relate to staff overhead costs in agency cost baselines or the projected costs of contract management.

<sup>126</sup> The report provided to OASITO by Finance, and forwarded to the Minister, identified the revised savings as \$54.09million. The reason for the adjustment to \$53.9 million was not identified by OASITO in its 22 September 1999 brief to the Minister advising of the revised savings position.

### *Legal Adviser advice on additional process*

**3.68** The DHAC Steering Committee representatives requested that OASITO obtain an opinion from the Legal Adviser on the additional processes associated with the Finance review of the savings identified in the financial evaluation. On 20 September 1999, OASITO sought a revised sign-off from the Legal Adviser to take into account the additional part of the process. The proposed additional part of the process would be the resolution by the Steering Committee that the expressed value of savings in the IT&T Services Final Evaluation Report should be adjusted in light of Finance's review of those figures. OASITO advised the Legal Adviser that the sign-off should address the fact that this additional work on cost baselines was not inconsistent with the published evaluation process. The Legal Adviser faxed draft advice on the issue to OASITO on 20 September 1999. In their covering facsimile, the Legal Adviser advised OASITO that:

As cost savings is an Evaluation Criteria and the cost base feeds into this calculation, we do not see how in the circumstances you can safely circumnavigate the Evaluation Committee.

**3.69** Following the giving of the draft advice, the Legal Adviser had further telephone discussions in relation to the issue with OASITO. A file note dated 20 September 1999 records a series of telephone conversations with OASITO on that day in which concern was expressed by the Legal Adviser that, if the Evaluation Report were to be amended, the procedure set out in the Evaluation Plan for finalising Evaluation Reports needed to be followed to avoid a process error. The Legal Adviser advised OASITO that the Steering Committee had no power to amend the Evaluation Report of its own volition. Rather, the Evaluation Committee would need to be reconvened to amend the Evaluation Report. According to the Legal Adviser's file note, OASITO advised that it did not want to amend the Evaluation Report; but rather wanted the Steering Committee to accept that there was a change in savings figures and that the Minister had brought about this change. OASITO advised the Legal Adviser that the evaluation phase had been completed and this statement was 'outside' the evaluation process and a separate function of the Steering Committee. According to the Legal Adviser's file note, the Legal Adviser queried the purpose of such a recommendation being signed by the Steering Committee. The file note further indicated OASITO advice that the Minister wished to estop the Steering Committee members from subsequently criticising the savings figures that the Minister intended to release in his Press Release.

**3.70** The Legal Adviser's file note concludes that OASITO was advised that, if this course of action were followed, it would be necessary:

- to check the terms and conditions of the Steering Committee's reference;
- to expressly indicate in the resolution that the savings acknowledgement had nothing to do with amending the Evaluation Report and that the Evaluation Report stood as it was; and
- for the Steering Committee to confirm that the Evaluation Report was not incorrect. If it were incorrect, the Evaluation Report would need to be rectified in accordance with the RFT process.

**3.71** The supplementary resolution, proposed by OASITO on 17 September 1999, was not amended to accord with the 20 September 1999 advice from the Legal Adviser.<sup>127</sup> Accordingly, the resolution did not confirm that the IT&T Services Final Evaluation Report was not incorrect. It did include a statement that the Steering Committee noted advice from the Chairman that OASITO, consistent with its long-standing reservation on this matter, had advised the Minister of its view that the cost base lines included in the evaluation reports had understated the expected future costs and had therefore understated expected savings.

**3.72** On 21 September 1999, the Legal Adviser and OASITO had further telephone discussions about the issue. The Legal Adviser's file note of those discussions, dated that day, states that OASITO indicated that the Minister had not actually made the decision to select the preferred tenderer. The Legal Adviser recorded advice to OASITO that, on that basis, the initial part of the evaluation was not completed in accordance with the RFT. The Legal Adviser further advised OASITO that 'this whole process was entirely unsatisfactory and that OASITO should attempt to solve these contentious issues well before trying to finalise an Evaluation Report'. The file note concludes that the Legal Adviser would now finalise their advice on the issue, but was concerned that the Minister had not yet made his decision and 'how we could know what decision he would make and what information he would consider in making that decision'. Finance advised ANAO, in May 2002, that there had been long running efforts made to resolve cost baseline issues and that:

the evaluation reports were not changed as a result of the exercise conducted by Finance to review costs. Therefore the facts on which the Minister based the selection decision did not change as a result of this exercise.

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<sup>127</sup> It is unclear from the available documentation whether some members of the Committee had already signed the resolution by the time that advice had been received by OASITO.

**3.73** The Legal Adviser faxed four advices in relation to the Steering Committee resolution to OASITO over the course of 21 September 1999, the third of which was marked draft.<sup>128</sup> The final advice provided by the Legal Adviser on 21 September 1999 noted advice from OASITO that:

- subject to the decision about the preferred tenderer being made by the Minister, the initial evaluation process established by the Health Group RFT to select a preferred tenderer was completed with the submission of the Options Committee recommendation to the Minister on 8 September 1999. The HIC Board had made its decision;
- the Steering Committee resolution was intended solely as a declaratory statement that is supplemental to the RFT process, drawing upon information that had been provided by Finance, only following the completion of that initial evaluation process;
- the resolution does not involve any change to the Evaluation Report, nor does it imply any error or incorrectness in the Evaluation Report or the preceding evaluation process. To this end, the financial evaluation report indicated that there was some disagreement about cost base lines. These baselines have now been resolved;
- the resolution has no effect on the selection of the preferred tenderer, nor on the terms on which the tenderer would be contracted;
- the purpose of the resolution is, at the request of the Minister, solely to record a consensus on the minimum level of expected savings in the light of the Finance advice;
- the Probity Auditor had been involved in considering the resolution and had signed off on the resolution to the effect that the action referred to in the resolution was sound and strengthened the process that was conducted; and
- the Steering Committee had been reconvened by phone and correspondence.

**3.74** The Legal Adviser noted further advice from OASITO that the foregoing points were understood by the Steering Committee in their consideration of the resolution. On that basis, the Legal Adviser did not see any legal process issues arising from the proposed resolution provided that the Minister did not consider or use the information in his decision about which tenderer was the preferred tenderer. As noted at paragraph 2.101, in a brief to the Minister of 22 September

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<sup>128</sup> The Legal Adviser advised ANAO in August 2002 that: '... standard procedure, as per instructions from [OAS/TO] was that all of our advices to OASITO were considered to be 'draft advices' until OASITO agreed that a final advice could be provided.'

1999, OASITO advised that the supplementary advice on savings did not affect the information previously provided on which the decision on the preferred tenderer should be based.

**3.75** On 21 September 1999, DHAC advised the then Minister for Health and Aged Care that the department had been willing to go along with the revised savings estimates:

...notwithstanding that they had not been rigorously developed—unlike the estimates developed by the Steering Committee (subject to their having no impact on agency budgets). This is because there is always scope, at the margin, for additional efficiencies over and above the factors examined by the Steering Committee.

**3.76** DHAC also advised the Minister that, irrespective of the ‘headline’ figure, an IBM GSA outcome would involve a premium (or additional cost) for DHAC of \$9.7 million over five years. Upon sighting the Legal Adviser’s final advice on the issue dated 21 September 1999 and the Probity Auditor’s advice of 20 September 1999, the DHAC representatives provided their signatures on the resolution to OASITO on 22 September 1999.

## Service and risk evaluation

**3.77** The service and risk evaluation criteria were assessed by the Technical and Corporate Evaluation Teams. Each tenderer was assessed as meeting the threshold requirements as stated in the RFT.

**3.78** The Technical Team reported that it was unable to arrive at a Group position in regard to the level of compliance and risk associated with the technical solutions. However, the DHAC, HIC and MPL Technical Teams each assessed IBM GSA as the preferred tenderer. An important differentiating factor in that assessment related to the level of migration risk that was assessed as being associated with each tenderer’s solution, particularly the location and delivery of data centre operations.

## Data centre services

**3.79** The RFT advised tenderers that, although DHAC was willing to consider other solutions, it would prefer that the contractor migrate its mainframe services from the existing Woden Data Centre (WDC) to a contractor data centre and vacate the WDC to enable DHAC to redeploy this space as general office space. The RFT also advised tenderers that the HIC operated two existing mainframe data centres both located in the ACT—the purpose-built Tuggeranong Data Centre (TDC) which comprised part of the HIC Central Office leased by the HIC from MPL; and the Deakin Data Centre (DDC) leased by the HIC from the

Commonwealth and used as its applications testing and development and disaster recovery site. The RFT provided that tenderers may, at their option, offer to take a sublease, lease or assignment of lease in any or all of the existing sites, or migrate all processing performed at the TDC and/or DDC, as appropriate, to other sites after the Handover Date.

**3.80** The RFT stated that, if they did not desire to take over the HIC's interest in the TDC or the DDC, tenderers would be responsible for any 'make-good' costs resulting from the removal off the HIC's equipment acquired by the tenderer pursuant to the Services Agreement. The RFT also stated that, in the event that the tenderer proposed migration of the services from the TDC or DDC (in the case of HIC) or from the WDC (in the case of DHAC) to other data centre(s), the Group agencies were particularly interested in understanding the provisions that the tenderer made in its transition plan to ensure that such migration was accomplished without adverse impact on the Services or on the Group agencies.

**3.81** As part of their technical solution, all three tenderers proposed to migrate DHAC's mainframe services to another site. IBM GSA and CSC proposed to retain the HIC's mainframe services at the existing data centres, with DHAC's services being migrated from the WDC to the TDC. EDS proposed to migrate the mainframe processing and disaster recovery for all Group Agencies to its data centres in Sydney. It also proposed re-locating help desk and other services interstate.

**3.82** On 13 April 1999, tenderers were provided with a clarification of the position with respect to the existing data processing facilities operated by the HIC at Tuggeranong and Deakin. Tenderers were advised that there was no requirement that the successful contractor should necessarily continue to use those data centres. Tenderers were asked to structure their bids so as to provide what each considered to be the best overall technical, commercial and operational solution that they could offer, and that, where that involved relocation from existing data centre facilities, any risks and technical considerations resulting from the relocation must be addressed. Any additional cost to the HIC of the relocation would also be taken into account in tender evaluation.

### *Migration risk*

**3.83** IBM GSA proposed a largely 'run as is' solution for the data centre operations, with the exception of relocation of DHAC's mainframe services to the TDC. This was considered by the Technical Team to be a strength as it minimised risk, but DHAC had a concern over a lack of innovation in the proposal. While CSC also offered a 'run as is' solution, the HIC Technical Team preferred, on balance, the IBM GSA solution because it involved less overall change to the HIC's operating environment. The CSC solution was considered

to offer a low to medium level of migration risk as it involved some software rationalisation and standardisation, the relocation of DHAC's mainframe and midrange services to Tuggeranong, and migration of the existing Lotus Notes implementations from Windows NT to Unix. These changes, coupled with the use of third party support personnel and the availability of sufficient skilled agency staff to transition to the service provider, resulted in the overall assessment of a medium level of risk for each agency. The EDS solution was assessed as offering a medium level of migration risk for DHAC and a medium to high level for the HIC and MPL due to its proposal to relocate mainframe, midrange, help desk and some technical services interstate.

**3.84** The Technical Team concluded that each tenderer had proposed a technically viable solution that would meet the Health Group agencies' current and anticipated service requirements. However, IBM GSA was ranked technically as the preferred tenderer because its technical solution offered a comparatively lower level of migration risk due to the lowest level of technical change proposed.

**3.85** In the IT&T Services Final Evaluation Report, the Evaluation Committee reported that, although the advantages and risks associated with each of the proposals were different, it did not consider that any one of the proposals represented a materially greater ongoing risk than the others when viewed as a whole. However, it also found that IBM GSA had proposed an essentially 'as-is, where-is' technical solution for the HIC and MPL. As a result, it considered that IBM GSA's proposal contained comparatively lower migration risk, particularly for the HIC and MPL.

**3.86** As noted earlier, the RFT requirement was that, where relocation was proposed, the Group agencies were particularly interested in understanding the provisions that the tenderer made in its transition plan to ensure that such migration was accomplished without adverse impact on the Services or on the Group agencies. In assessing this aspect of the tenders, the Evaluation Committee noted that, despite the comparatively higher migration risk presented by the EDS and CSC proposals in comparison with the IBM GSA tender, such migration risk could be satisfactorily managed.

**3.87** However, the Committee also reported it believed that, although it was not averse to accepting a bid that involved change, including the possibility of significant change to the Health Group agencies' existing arrangements, the migration risk which is necessarily inherent in such change must be justified on the basis of some financial, technical or corporate advantages offered by the tendered solution. The Evaluation Committee found that, in this instance, there were no offsetting financial, technical or corporate advantages in the other tenders that would cause the Committee to recommend another tender over the lower migration risk solution offered by IBM GSA. The speaking notes prepared



for the unsuccessful tenderer debriefing meeting with EDS on 5 October 1999 stated that the assessment of migration risk associated with its proposed moves ‘...although not a major issue, in the absence of other offsetting advantages, it was a factor in the selection decision’. Finance advised ANAO in May 2002 that: ‘...it is clear (from evaluation criteria and other RFT references) that the assessment of risk was a major factor in the evaluation’. Finance further advised that service and risk were major themes considered in all transactions arranged under the IT Outsourcing program and that a comparative assessment of risk is entirely consistent with the Evaluation Methodology.

**3.88** The available documentation indicates that the HIC had a strong preference, for strategic business reasons, for retaining the data centre operations at their existing sites. Although no weightings were identified for the evaluation criteria or sub-criteria, ANAO considers the consideration of this aspect of the tenders in the evaluation demonstrated a preference for a no change, low risk solution that tenderers offering alternative solutions had to overcome through an offsetting advantage in another aspect of their tender. In such circumstances, better practice would have been for that preference to be made clear to tenderers in the RFT and for the evaluation methodology to be designed to ensure that the application of any pre-existing preferences in the evaluation was consistent and transparent.

## Industry development evaluation

**3.89** The RFT required tenderers to propose ID commitments that related to the delivery of the IT&T services (‘in-scope commitments’). The in-scope commitments tenderers were assessed against were the level of Australian Value Add and SME involvement as a percentage of the contract value, and total employment and regional employment over the contract term. Tenderers were also requested to propose ID initiatives, if any, that they would commit to delivering during the term which did not relate to the performance of the services (‘out-of-scope initiatives’).

## ID evaluation methodology

**3.90** The evaluation methodology used in the Health Group tender to assess the ID offerings of tenderers was not finalised prior to the opening of tenders and was not signed-off by the Probity Auditor. In August 1998, the Steering Committee noted that, while Group Agencies did not expect to be members of the ID Evaluation Team (IDET), they would wish to be involved and consulted on any health IT industry development offerings. This was because agencies wanted to be involved in making assessments of offerings from a health policy and regulatory perspective, as well as from a specific IT perspective. OASITO undertook to consider this request.



**3.91** The Evaluation Guide for the IT&T services element of tenders stated that OASITO had prepared a detailed ID evaluation methodology that assessed the tenders in terms of the quality and value of their respective offerings consistent with the ID evaluation criteria in the RFT. It also stated that the Group Agencies would not be represented on the IDET, but that:

If an industry development bid includes an offering which is assessed as being specific to a particular agency's business or policies and requiring expert advice from the agency to ensure a full and proper evaluation, the Industry Development evaluation team will invite the relevant agency to provide expert advice to the Industry Development evaluation team on that offering.

**3.92** However, the ID evaluation methodology, as amended to include this provision, was not finalised prior to the receipt of tenders on 15 February 1999. The non-financial and ID parts of the tenders were opened on 15 February 1999. On 25 February 1999, the consultant managing the ID evaluation (IDET Team Leader) advised OASITO that, based on a review of the Health ID initiatives offered by tenderers in their RFT responses, it did not look as if they needed to get Group Agencies involved. The consultant advised OASITO that: 'Once we have resolved this issue, then we can get sign off on the evaluation methodology and can then progress the evaluation'.

**3.93** On 10 March 1999, the IDET Team Leader advised the OASITO Evaluation Coordinator that the issue of the extent of involvement of HIC in the evaluation of the ID offerings had not yet been resolved. The Team Leader advised that, given that one of the proposals had been drawn to the attention of the IT services evaluation team, it could ask a senior Health official to read the relevant proposal and provide comments including any clarification they considered was required of the proposal and to formally comment to IDET on it. The Team Leader noted that '...the evaluation methodology will need to be amended to reflect this. We need to resolve this issue as a matter of urgency'.

**3.94** On 12 March 1999, the IDET Team Leader emailed OASITO regarding a comment by the OASITO Evaluation Coordinator to another of the consultants involved in the ID evaluation to the effect that OASITO did not want to get a sign-off on the evaluation methodology from the Probity Auditor. The IDET Team Leader advised OASITO that, as had been mentioned in an email to the OASITO Project Coordinator prior to commencement of the evaluation, '...it is a necessary step in the process which IDET has to have approved before we can undertake an evaluation'. The IDET Team Leader suggested that the Probity Auditor be advised that it had been necessary to wait to see the bids to determine if there were any specific Health offerings in order to see if the evaluation methodology needed to be amended.

**3.95** The OASITO Evaluation Coordinator advised the IDET Team Leader that the earlier indication had been that OASITO would prefer not to refer this matter to the Probity Auditor as the bids had already been opened and it would not be appropriate to change the evaluation methodology. OASITO also indicated that the inclusion in the IT&T services evaluation guide of the paragraph relating to the participation of Group Agencies in the ID evaluation might be a sufficient indicator of the ID evaluation methodology as it involved the Group Agencies and therefore did not require a fresh sign-off from the Probity Auditor. Finance advised ANAO in May 2002 that:

The Industry Development evaluation methodology was not signed off by the Probity Auditor. However, this is of only minor relevance given that the methodology (& the matching text in the RFT) had been used in a number of other transactions. The outstanding matter preventing it being signed off at the time was the discussion occurring at that time about the extent of the group agencies' involvement in the event that health sector specific offers were received. This was later agreed and a DHAC representative reviewed some ID offering material. In other respects our understanding is that the evaluation and its methodology was the same as previous and subsequent transactions.

**3.96** On 15 March 1999, the IDET Team Leader advised the OASITO Evaluation Coordinator that the problem was that there was no evaluation methodology for ID that had been formally signed off by the Probity Auditor as being consistent with the Health Group RFT, and that OASITO had to get the Probity Auditor to sign it off as a matter of process. On 17 March 1999, the OASITO Executive Coordinator advised all parties that, to bring the debate to closure:

I am prepared not to have a formal endorsement of the criteria by the Probity Auditor at this stage, although it should have happened earlier, on the basis that they should be the same as for other projects. In future, however, I would like all criteria to be signed off BEFORE bids close.

**3.97** The ID evaluation undertaken in respect to the Health Group tender appeared to be similar in many respects to the approach taken in earlier tenders, for which the Probity Auditor had provided a sign-off, but with some specific changes to provide for the involvement of the Health Group agencies. However, a final version of the ID evaluation methodology for the Health Group tender was not available to ANAO. In June 1999, a DHAC officer was asked to examine the health-related, out-of-scope proposals submitted by tenderers as part of their ID offerings. The ID Evaluation Report stated that 'these industry development offerings were evaluated in accordance with the evaluation methodology which has previously been approved by OASITO's Probity Auditor as being consistent with the RFT.'

## Changes to tenderers' ID offerings

**3.98** The ID offerings of the three tenderers were subject to revision and alteration over the course of the evaluation period. In some cases this related to flow-on effects from changes made to technical solutions, but also related to efforts by the tenderers to improve aspects of their ID offers. The most substantial changes were made by IBM GSA, which, after an initial round of clarification questions, had been considered to provide the least favourable ID offering.

**3.99** In April 1999, EDS proposed replacing an initiative within the existing ID plan under its IT outsourcing contract with the ATO (executed on 31 March 1999) with an ID initiative from its unsuccessful Group 5 bid; and replacing an initiative in its original Health Group ID offer with the existing ATO initiative and other initiatives previously used within its Group 5 bid. On 16 April 1999, the IDET Team Leader advised OASITO that all tenderers should be offered the opportunity to revise their ID offerings so that there was no issue of EDS being advantaged in substituting offerings into the Health Group bid. The Team Leader stated '...indeed in the case of one bidder where we have an SME participation level of less than 4%, a reofferring is critical'.

**3.100** The IDET Team Leader also advised OASITO that IDET had a number of additional questions in relation to the IBM GSA offering, and that, prior to IBM GSA responding to those questions, IDET would like to have a face to face meeting with them '...to give them some very strong messages about the adequacy of their offering'. The Team Leader noted that the extent of deficiencies in the IBM GSA bid relative to the other bidders was significant, and that IDET did not require to undertake the same exercise with the other bidders. A second round of clarification questions was provided to each tenderer on 21 April 1999. IDET met with IBM GSA on 22 April 1999, but the meeting was not minuted.<sup>129</sup> In providing its responses to the second round clarification questions on 10 May 1999, IBM GSA advised that it was undergoing revisions to its ID proposal, including the number and nature of SMEs, which would be submitted as part of its re-pricing proposal on 21 May 1999.

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<sup>129</sup> An agenda prepared for the meeting listed the following items for discussion: 1) Additionality issues 2) Definitions (of Strategic Investment, and Australian Value Add) 3) SME Australian Value Add levels 4) Sanctions and 5) Other business.

**3.101** As noted in Chapter 2, tenderers were advised on 22 April 1999 that re-pricing and any other changes or clarifications to tenders, including their ID offering, were required to be submitted by 7 May 1999, later extended to 21 May 1999.<sup>130</sup> All three tenderers submitted re-priced offers that impacted on their ID offering. In submitting its revised offer, IBM GSA advised that it recognised that its previous ID proposals had not offered sufficient levels of Australian SME involvement or an appropriate range of out-of-scope initiatives to satisfy the objectives that the Government had set for its IT outsourcing program.

**3.102** A third round of ID clarification questions was put to each tenderer on 17 June 1999, together with a draft ID contract schedule for comment. Responses were due by 25 June 1999. In providing its response to the clarification questions, IBM GSA also submitted a revised ID proposal which included five additional out-of-scope initiatives not previously submitted as part of its formal ID offer (although two of the initiatives were highlighted in IBM GSA's 21 May response as other possibilities it was exploring). The additional out-of-scope initiatives were offered as an offset to a significant reduction in the level of SME involvement in the in-scope services to 12.2 per cent.

**3.103** The IDET Team Leader sought instruction from OASITO regarding the evaluation of the new initiatives. The Team Leader advised that the IDET were intending to move to negotiation of contract schedules on 6 July 1999, but that this would not be possible for IBM GSA if the initiatives put forward were allowed. The IDET Team Leader also advised OASITO that the new initiatives were still very 'raw' and needed considerable clarification, and requested:

I presume that as we are seeking to maximise the benefits to the Commonwealth, and that as the additional 5 initiatives have been offered in return for a significant decrease in SME participation in scope...we must clarify the offerings. Can you please confirm that this is correct.

**3.104** On 29 June 1999, the OASITO Project Coordinator advised the IDET Team Leader that he thought they had to clarify and evaluate the new initiatives.<sup>131</sup> The Team Leader subsequently advised that IBM GSA had not completed various

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<sup>130</sup> On 22 April 1999, the Probity Auditor advised OASITO that: '1) In respect of the Health bid evaluation, he believed that if EDS was allowed to substitute sections of their Health tender ID proposal with sections from other bids, it could result in a perception that *[it had been given]* an advantage over other bidders; and 2) This perception could be managed if the same opportunity was provided to all bidders, but that this could result in delays in the evaluation process while bidders make the required amendments'. Also on 22 April 1999, the Legal Adviser advised OASITO that there was scope to permit EDS to alter its proposal, but that any alteration must be done in accordance with the RFT process. The Legal Adviser suggested that, if OASITO wished to permit EDS to alter their proposal in advance of the parallel negotiation stage, it give all tenderers the opportunity to also amend their ID offering.

<sup>131</sup> Four of the five new initiatives were ultimately included as out-of-scope ID commitments in the DHAC Services Agreement with IBM GSA.

tables and other requests for information for both the original and new initiatives, making it difficult for IDET to negotiate with them. The OASITO Project Coordinator advised the Team Leader that ‘The key point we need to make to IBM is that I agreed with them that they would introduce any new initiatives in the form of completed contract schedules...’. There was no evidence of the acceptance of the additional initiatives being discussed with, or referred to, the Probity Auditor or the Legal Adviser. A fourth round of ID clarification questions was put to IBM GSA on 1 July 1999, with the response being provided on the due date of 9 July 1999. Negotiation meetings were subsequently held with all tenderers.

**3.105** On 20 July 1999, OASITO met with IBM Australia, one of the three joint venture partners in IBM GSA. The file note of the meeting prepared by OASITO indicates that the meeting was sought by the then recently appointed Chief Executive of IBM Australia as a courtesy call and introduction. In particular, IBM Australia was seeking feedback, in broad terms, on its performance under the IT Initiative and was keen to understand how it could improve its response to and performance within the Initiative. According to the file note, among the key messages provided by OASITO were issues relating to IBM’s stated position on ID commitments. The file note records that, in closing, IBM Australia advised that IBM was working very hard to improve its response to the Health Group tender in the key areas of price, services agreement and ID, where it was working hard to improve its SME participation.

**3.106** On 27 July 1999, OASITO met with representatives from IBM GSA and IBM Australia. The file note of the meeting prepared by OASITO states that IBM GSA requested the meeting with OASITO to discuss its ID offering<sup>132</sup> and, in particular, the proposed level of SME involvement. The IDET was not represented at the meeting. The key issues raised in regard to ID related to inclusion of a subcontractor for bulk printing, thereby increasing the SME involvement in the IBM GSA bid significantly.

**3.107** The final round of re-priced offers were submitted on 2 August 1999. As part of its revised offer, IBM GSA increased its SME participation to 20.3 per cent of the services contract value.

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<sup>132</sup> As is noted in footnote 201 in Chapter 4, IBM GSA also took the opportunity to explore other issues related to its IT&T services offer. See paragraph 4.20 and paragraphs 4.88 to 4.90 for further discussion regarding the file notes of the meetings of 20 July 1999 and 27 July 1999.

## ID evaluation outcome

**3.108** The Finance internal audit review reported that the IDET meeting of 3 August 1999 noted that IBM was ‘clearly the best proposal’. The report indicates that the minutes of the meeting reflect that the IDET agreed that the IBM GSA proposal became the best due to information provided on 2 August 1999 in the fourth re-pricing round.<sup>133</sup>

**3.109** The ID Evaluation Report stated that ID proposals were received from the three tenderers at the close of tenders on 15 February 1999, and that tenderers were also asked to provide revised ID offerings by 21 May 1999. The report made no reference to revisions to ID offers being made as part of the 21 June and 2 August 1999 re-pricing exercises, or of the submission of additional out-of-scope initiatives by IBM GSA on 25 June 1999.

**3.110** IBM GSA was identified as most preferred in terms of both in-scope and out-of-scope ID commitments. The Evaluation Report stated that the in-scope commitments offered by the three tenderers had demonstrated some differences and had emerged as a material differentiator in the outcome of the ID evaluation. The Report further stated that the key difference in the in-scope commitments was the level of Australian Value Add. IBM GSA offered a marginally higher level of SME participation and total employment over the contract term, and the highest levels of Australian Value Add and regional employment outcomes.

**3.111** The ID Evaluation Report also stated that, although the IDET was concerned that a number of IBM GSA’s initiatives did not always offer clearly defined and articulated commercial strategies, it did provide the most substantial quantitative package of out-of-scope ID. The IDET noted some weaknesses with some of the out-of-scope initiatives proposed by IBM GSA, but found that, even if those initiatives were discounted heavily, IBM GSA still offered the most substantial out-of-scope ID outcomes that were backed up by adequate financial sanctions. Overall, the IDET considered that IBM GSA had the highest rated ID offering having regard for the evaluation criteria set out in the RFT. However, the IDET also considered that both of the other tenderers’ offerings adequately met the Commonwealth’s objectives.

**3.112 Finding:** The Health Group IT&T Services Final Evaluation Report, completed by the Evaluation Committee on 2 September 1999, encapsulated the findings of the Financial, Technical and Corporate Evaluation Teams against the evaluation criteria relating to cost savings and service and risk identified in the Health Group RFT. The ID Evaluation Report set out the findings of the ID Evaluation Team against the ID evaluation criteria. ANAO identified aspects of the methodology for the assessment of tenderers against the identified evaluation criteria that could have been improved.

<sup>133</sup> The minutes of the 3 August 1999 IDET meeting could not be located for review by ANAO.



**3.113** In respect to the financial evaluation, ANAO identified areas for improvement relating to the methodologies applied in calculating adjustments in respect of end-of-term assets and obligations, and to the processes followed more generally for reconciling all adjustments applied in the financial evaluation.

**3.114** The methodology to be employed in the Health Group financial evaluation in calculating adjustments in respect of end-of-term assets and obligations was not finalised until very late in the tender evaluation. This was a factor that made comparisons between tenderers' financial positions over the course of the tender difficult. Ultimately, two different methodologies were used by the HIC and DHAC evaluation teams in the one tender process. ANAO identified issues with both methodologies.

**3.115** The aggregate effect of adjustments identified by ANAO in respect of end-of-term agency and tenderer assets reduces the financial savings identified in the financial evaluation against the preferred tenderer by over \$9 million, and by some \$7 million against the second-ranked tenderer. In the context of the close outcome of the financial evaluation in the Health Group tender, movements of that nature would have changed the indicative financial rankings of the tenderers, but would also result in no tenderer offering financial savings (before the application of additional savings identified by Finance). The net estimated adjustments would result in a cost premium to the Health Group from outsourcing, before the application of notional CN adjustments, of some \$1 million over five years, and post-CN savings of \$29 million based on the CN adjustments applied in the financial evaluation (also before the application of additional savings identified by Finance).

**3.116** ANAO's review of the Financial Evaluation Report prepared by the Financial Evaluation Team identified a number of errors and internal inconsistencies in the construction of adjustments figures within the summary and body of the Report, and its Appendices. ANAO also identified errors in the calculation or application of adjustments. Many of the errors identified appear to have been the result of a last-minute rush to complete the adjustments process, particularly in respect to services to the HIC. Financial consultants were engaged by OASITO to manage and reconcile the entry of financial adjustments into the Savings Model. Within the documentation available for review, ANAO could not locate a final reconciliation of the adjustments and savings assessed against each tenderer that agreed with the adjustments and final outcome shown in the Financial Evaluation Report. In August 2002, the financial consultant engaged by OASITO advised ANAO that:

...we were not required to provide final sign off in relation to the reconciliation of the savings model and in fact the final adjustments to the model were made by OASITO and [the Strategic Adviser] without [our] involvement and without [our] being required to provide a final reconciliation.



**3.117** The Health Group RFT explicitly stated that ‘achievement of substantial cost savings is a precondition to the award of a contract’. It was stipulated that the Commonwealth would not award a contract unless it were satisfied that the preferred tenderer would deliver a substantial and acceptable level of cost savings based on an assessment against the criteria relating to cost savings specified in the RFT. The financial evaluation methodology did not explicitly provide for an evaluation against the cost savings precondition. In Audit Report No.9 2000–01, ANAO considered that the transparency and accountability of the decision-making process in the ATO and Group 5 tenders would have benefited from improved documentation/recording of the respective evaluation Committees’ conclusions; and advice as to whether the preconditions stipulated in the RFT had been satisfied by the recommended preferred tenderer, and the factors considered in reaching that conclusion. ANAO formed a similar conclusion in respect to the conduct of the Health Group tender.

**3.118** The service and risk evaluation criteria were assessed by the Technical and Corporate Evaluation Teams. Each tenderer was assessed as meeting the threshold requirements as stated in the RFT. The Technical Team reported that it was unable to arrive at a Group position in regard to the level of compliance and risk associated with the technical solutions. However, the DHAC, HIC and MPL Technical Teams each assessed IBM GSA as the preferred tenderer. An important differentiating factor in that assessment related to the level of migration risk that was assessed as being associated with each tenderer’s solution, particularly the location and delivery of data centre operations.

**3.119** As part of their technical solution, all three tenderers proposed to migrate DHAC’s mainframe services to another site. IBM GSA and CSC proposed to retain the HIC’s mainframe services at the existing data centres, with DHAC’s services being migrated to the HIC site. EDS proposed to migrate the mainframe processing and disaster recovery for all Group Agencies to its data centres in Sydney. It also proposed re-locating help desk and other services interstate.

**3.120** In assessing tenderers’ proposed solutions for the provision of data centre services, the Evaluation Committee stated that the migration risk that is necessarily inherent in any change must be justified on the basis of some financial, technical or corporate advantages offered by the tendered solution. The available documentation indicates that the HIC had a strong preference, for strategic business reasons, for retaining the data centre operations at their existing sites. Although no weightings were identified for the evaluation criteria or sub-criteria, the consideration of this aspect of the tenders in the

evaluation demonstrated a preference for a no change, low risk solution that tenderers offering alternative solutions had to overcome through an offsetting advantage in another aspect of their tender. In such circumstances, better practice would have been for that preference to be made clear to tenderers in the RFT and for the evaluation methodology to be designed to ensure that the application of any pre-existing preferences in the evaluation was consistent and transparent.

**3.121** The evaluation methodology used in the Health Group tender to assess the ID offerings of tenderers was not finalised prior to the opening of tenders and was not signed-off by the Probity Auditor. The ID Evaluation Report stated that the industry development offerings were evaluated in accordance with the evaluation methodology which had previously been approved by OASITO's Probity Auditor as being consistent with the RFT.

**3.122** The ID offerings of the three tenderers were subject to revision and alteration over the course of the evaluation period. In some cases this related to flow-on effects from changes made to technical solutions, but also related to efforts by the tenderers to improve aspects of their ID offers. The most substantial changes were made by IBM GSA, which, after an initial round of clarification questions, had been considered to provide the least favourable ID offering.

**3.123** The ID Evaluation Report stated that ID proposals were received from the three tenderers at the close of tenders on 15 February 1999, and that tenderers were also asked to provide revised ID offerings by 21 May 1999. The report made no reference to revisions to ID offers that were made as part of the 21 June 1999 and 2 August 1999 re-pricing exercises, or of the submission of additional out-of-scope initiatives by IBM GSA on 25 June 1999. IBM GSA was identified as most preferred in terms of both in-scope and out-of-scope ID commitments.

## 4. Probity Management

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*This chapter examines the probity management aspects of the Health Group tender process, particularly as it related to the transparency of decision-making and the maintenance of an appropriate management trail.*

### Introduction

**4.1** Probity and accountability are fundamental tenets for the proper conduct of competitive tender processes by Commonwealth agencies. Within government, the word ‘probity’ is often used in a general sense to mean ‘good process’<sup>134</sup>, with the underlying concern being to ensure that no potential or actual tenderer is commercially advantaged or disadvantaged by the process undertaken. Accountability is the obligation to be able to explain or account for the way the tender process was conducted. If confidence in government purchasing is to be maintained it is important that tenders are conducted in a manner that promotes not only the reality but also the perception that due process was properly observed. This requires that the process be conducted ethically, honestly and transparently, with all significant actions and decisions being documented in a manner that ensures they are capable of subsequent review, if necessary.

**4.2** These concepts are reflected in the core principles that Commonwealth agencies are required to observe in the conduct of competitive tenders, including value for money, open and effective competition, ethics and fair dealing, and accountability and reporting. These principles have been reflected in successive versions of the Commonwealth Procurement Guidelines (CPGs)<sup>135</sup>, as well as the *Public Service Act 1999*, which specifies the values and code of conduct required to be demonstrated by all members of the APS.

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<sup>134</sup> Department of Treasury and Finance, Victoria, *Probity Guidelines for Government Tendering Projects in Victoria*, 2001.

<sup>135</sup> The CPGs are issued by the Minister for Finance and Administration under Regulation 7(1) of the Financial Management and Accountability Regulations. They apply to the procurement of all property and services, including outsourcing or contracting out activities. By outlining the fundamental policies and principles that underpin procurement, they articulate the expectations on officials, or agents conducting procurement on behalf of the Commonwealth, in the design, conduct and management of all aspects of Government procurement. The CPGs in operation at the time of the Health Group tender stipulated a number of core principles which underpinned the procurement activities of government agencies, including: value for money; open and effective competition; ethics and fair dealing; and accountability and reporting. The most recent edition of the CPGs, released on 12 February 2002, states that value for money is the core principle governing Commonwealth procurement and is underpinned by four supporting principles: efficiency and effectiveness; accountability and transparency; ethics; and industry development.

**4.3** The South Australian Auditor-General observed in a November 2000 report that procedural regularity is important for a government in that it must at all times adopt high standards and principles in the conduct of its commercial dealings. The Auditor-General commented that:

Government must, by its example, present itself as a model for others in the market place to emulate ie there are ‘moral exemplar’ expectations and requirements placed upon a government.<sup>136</sup>

**4.4** The need to ensure that the requirements of probity, or good process, are satisfied in an open and transparent manner has been the subject of increased focus in recent years.<sup>137</sup> Both the Victorian and Tasmanian governments have issued probity guidelines in recent years. Although issued subsequent to the conduct of the Health Group tender, ANAO has drawn upon those guidelines to assist in identifying examples of good practice that may have been beneficial in that tender process. The probity guidelines for the Victorian Government, issued by the Victorian Department of Treasury and Finance in 2001, note that the broad objectives of the probity process for all stakeholders should be to:

- ensure conformity to processes;
- provide accountability;
- ensure that the interests of tenderers are protected by an equitable process;
- ensure that all bids will be assessed against the same criteria;
- preserve public and tenderer confidence in government processes; and
- improve defensibility of decisions to potential legal challenge.<sup>138</sup>

## Probity management in the Health Group tender

**4.5** The framework put in place to manage the probity aspects of the Health Group tender exhibited a number of elements of good practice. Probity protocols were developed to guide the conduct of all parties; agency personnel involved in the evaluation were required to identify potential conflicts of interest; legal and probity advice was obtained in regard to various issues that arose; physical

<sup>136</sup> South Australian Auditor-General, *Electricity Businesses Disposal Process in South Australia: Arrangements for the Disposal of ETSA Utilities Pty Ltd and ETSA Power Pty Ltd: Some Audit Observations*, November 2000, para 1.2.7.

<sup>137</sup> For example, recent decisions by the Federal Court in *Hughes Aircraft Systems International v. AirServices Australia* and *J. S. McMillan Pty Limited, Pirie Printers Holdings Pty Limited and Imsep Pty Limited v. Commonwealth of Australia* highlighted the requirement for Commonwealth agencies to have practices in place to ensure that the tender process is properly managed and accords procedural fairness to all tenderers if potential legal liability is to be avoided, or at least minimised.

<sup>138</sup> Department of Treasury and Finance, Victoria, op. cit.

and information security arrangements were put in place for the conduct of the evaluation; and sign-offs were obtained from expert advisers and committee members.

**4.6** However, issues arose in the course of the Health Group tender that had the potential to compromise the probity of that process, or to at least give rise to a perception that it may have been or had been compromised. These included OASITO inadvertently sending a tenderer, IBM GSA, confidential pricing information relating to other tenderers (disclosure event—see the Appendix) and the subsequent late lodgement of a revised pricing offer by the same tenderer (see the Appendix). The tender process also saw substantial change in financial rankings following the fourth and final pricing round<sup>139</sup> (see Chapter 2) and revision to savings identified by the evaluation following a review by Finance (see Chapter 3).<sup>140</sup>

**4.7** In examining the circumstances surrounding the specific events referred to by the Senate Committee in its request to the Auditor-General for an audit to be undertaken (see paragraph 1.17), ANAO also became aware of perceptions held by some participants in the tender process that there may have been extraneous communication with one or more tenderers by personnel from one or more Commonwealth agencies or their advisers. Having regard to these issues, ANAO examined the extent to which the general management of the probity aspects of the Health Group tender adequately promoted transparent and accountable decision-making consistent with government and parliamentary expectations. Finance advised ANAO in May 2002 that:

OASITO's role in managing the whole of government Initiative required that organisation to consult with interested parties constantly about upcoming tender processes, performance under existing contracts and related topics...Agencies may have perceived this regular contact as 'extraneous communication' but it did not create a problem for the process.

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<sup>139</sup> Throughout the course of the tender process each tenderer made changes to their bid prices, and the relative positions of the tenderers in relation to the financial aspects of their bids altered considerably. Pricing varied during the tender evaluation period (see Chapter 2).

<sup>140</sup> Finance advised ANAO in May 2002 that: '...the final resolution of agency cost baseline issues by Finance ...was the culmination of a long period of debate between OASITO and the group agencies about current costs and forecast costs if IT infrastructure was to remain in-house. These discussions had no bearing on the selection of the successful tenderer'. This review was completed by Finance prior to the decision in relation to the successful tenderer.

**4.8** ANAO identified shortfalls in good practice in a number of areas of the probity management process for this significant government contract. Some aspects of the shortfalls related to the unique tender management structure that existed under the IT Initiative until the Government's endorsement of the recommendations of the Humphry Review of December 2000. The problems identified primarily relate to:

- inadequate documentation of the tender process, including communications with tenderers;
- lack of transparency of the consideration of all relevant options, risks and information in the management of probity issues; and
- the adequacy of the information available to the decision-maker on probity issues, of the role of the probity expert engaged for the tender process, and of the scope and nature of sign-offs provided by external advisers.

## Documenting the tender process

**4.9** The CPGs acknowledge that fundamental to all Commonwealth procurement is that it is sufficiently transparent to allow the Government, Parliament, and the public to have the utmost confidence in the procurement process and that Chief Executives and agencies are meeting their obligations to promote the efficient, effective and ethical use of resources as stated in section 44 of the FMA Act.<sup>141</sup> Accurate record keeping is an integral component of ensuring transparency and evidencing accountability.<sup>142</sup>

**4.10** The Victorian Government probity guidelines identify the establishment of clear trails of documentation, both paper and electronic, as one of the common issues in any tendering exercise about which managers and probity auditors should be particularly vigilant. The guidelines note that, despite pressing deadlines, it is essential that key discussions, data and decisions are documented and filed in a form which allows those undertaking subsequent reviews of the tendering process to understand clearly how, why and when the key decisions were made.<sup>143</sup>

<sup>141</sup> Minister for Finance and Administration, *Commonwealth Procurement Guidelines and Best Practice Guidance*, February 2002, p. 5.

<sup>142</sup> Queensland Department of Public Works, *Better Purchasing Guide: Probity and Accountability in Purchasing*, July 2000, p. 8.

<sup>143</sup> Department of Treasury and Finance, Victoria, op. cit.

**4.11** It is particularly important that, in spite of the urgency or haste with which they might occur, the deliberations and actions undertaken in response to any significant unexpected events be adequately documented for adequate accountability, including management information purposes. ANAO's capacity to examine the management of the probity aspects of the Health Group tender was limited by deficiencies in the contemporaneous records made. In a number of areas, the recollections of individuals were the only means of establishing important elements of the sequence of events. The report of Finance's internal audit review of the Health Group tender process similarly noted that:

In certain circumstances, OASITO was unable to provide requested documentation to Internal Audit (either due to inability to locate the documentation, or due to the fact that the documentation was not retained). To the extent that such documentation was not (or could not be) provided, this has necessarily limited the extent to which the agreed-upon procedures could be completed.

## **Inadequate documentation**

**4.12** The documentation maintained by OASITO in respect to its management of both the disclosure event of 28 July 1999 and the subsequent late lodgement on 2 August 1999 involving the same tenderer does not provide a sufficiently comprehensive account of all relevant actions relating to these significant probity issues. Adequate records were not consistently maintained of significant discussions that occurred, nor of some of the key decisions taken and their underlying rationale.

**4.13** An unsigned Note for File was OASITO's formal record of the events of 28 July 1999 relating to the cause of the disclosure of confidential information to IBM GSA, the discovery that the event had occurred, and the initial response by OASITO to managing it. It purported to record conversations in which the preparer was not a participant, but was not countersigned or otherwise verified by those who were.<sup>144</sup> It did not adequately record the timing and sequencing of the events described. In particular, neither the time at which OASITO received initial advice from IBM GSA as to the contents of the disk, or of when OASITO physically retrieved it, was recorded. As a result, it was not possible for ANAO to accurately assess the promptness with which OASITO was informed of the disk's contents by IBM GSA, or the period of time for which the tenderer had the disk in its possession on that day.

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<sup>144</sup> Finance advised ANAO in May 2002 that: '...The record would have been more complete had the note been signed but it is not uncommon for a person to be asked to document details advised to them by a more senior officer'.



**4.14** OASITO has stated that the Legal Adviser, the Probity Auditor and the Office of the then Minister for Finance and Administration were each contacted on 28 July 1999.<sup>145</sup> However, within the material made available for review, ANAO was unable to locate records retained by OASITO of the time, participants and content of any of its meetings or discussions about the disclosure event with the Probity Auditor, the Legal Adviser, the Secretary of DHAC, the Managing Directors of the HIC and MPL<sup>146</sup>, or with the Minister's Office. ANAO was also informed that OASITO did not maintain records of any conversations with IBM GSA on 2 August 1999 regarding the late lodgement of its revised offer on that day.

**4.15** OASITO did prepare Notes for File of two meetings held on 30 July 1999 at which the Chief Executive Officers (CEOs) of EDS and CSC were advised of the disclosure event (see paragraphs 4.35 to 4.36 and paragraphs 9 to 11 of the Appendix). The Probity Auditor attended both meetings and co-signed the Notes for File.<sup>147</sup> ANAO engaged AGS to provide advice on the adequacy of those notes as a record of the discussions from a probity perspective. AGS advised that the notes were generally well prepared in that they listed the attendees, the subject of the meeting, and provided for the signature of OASITO staff and the Probity Auditor. In that regard, AGS considered that a reasonable level of probity had been achieved. However, AGS also noted that both of the Notes for File used broad statements to summarise the conveying of complex and potentially vital information. Consequently, it is not possible to confirm what detail was conveyed to both tenderers, or that the same details were conveyed to both. AGS advised ANAO that, to improve the probity aspects of the Notes for File, more detail as to the exact nature of information conveyed to tenderers should be expressed.

<sup>145</sup> Senate Finance and Public Administration Legislation Committee *Hansard*, 8 February 2000, p. 216.

<sup>146</sup> Finance advised ANAO in May 2002 that: 'The briefings to the heads of the group agencies...were based on the letters signed by the Chief Executive of OASITO setting out the events surrounding the disclosure and subsequent remedial actions. The letters were delivered by hand given the sensitivity of the issue and also to provide the opportunity for those executives to ask questions about the letters. Details of the relevant events are recorded in notes for file and in a chronology of the events provided to the ANAO.' ANAO notes that no contemporaneous notes for file or other records prepared by OASITO to record the date, time, participants or content of its meetings with agency heads on the disclosure issue were provided to ANAO for review.

<sup>147</sup> In July 2002, the Probity Auditor advised ANAO that: 'At the meeting with the CEO's we took our own notes. We then ensured that the Note for File prepared by OASITO was in accordance with those notes. We then signed the note to evidence our concurrence, which we believe was an acceptable approach to the preparation of a minute of the meeting.'

**4.16** Neither tenderer was asked to verify or comment on the accuracy of the Notes for File as a record of the meeting proceedings, and neither provided any written advice or confirmation to OASITO as to their understanding of the outcome of the meetings. AGS noted that this is of added importance as both Notes contain quotes in inverted commas from the tenderer representatives. AGS advised ANAO that, giving each tenderer the opportunity to review the Note for File and then sign (and date) that they were happy it was an accurate record of the meeting proceedings, would also have improved the probity aspects of those records. This may be done after the Note has been prepared and later sent to the tenderer for approval. AGS advised that the date, time and duration of the meeting should also be recorded. The Notes for File prepared by OASITO only recorded the date.

**4.17** Written advice to the Minister about the disclosure event and subsequent actions taken by OASITO was prepared on 30 July 1999.<sup>148</sup> However, there is no documented advice to the Minister of the late lodgement by IBM GSA following the disclosure event<sup>149</sup>, nor of the substantial price movements that occurred in that final re-pricing round.

### *Records of communication with tenderers*

**4.18** The issue of communication with tenderers was an area of some ongoing focus in the conduct of the Health Group tender process. It is apparent from contemporaneous documentation and subsequent discussions with ANAO that not all parties were confident that they were aware of all communication that occurred between tenderers, OASITO, its advisers and/or Group Agency representatives, or that the content of that communication had been properly recorded. The likelihood of such perceptions arising was increased by environmental factors, including perceived preferences for particular tenderers and the dual role played by OASITO in managing both the whole of Government IT Outsourcing Initiative and each tender process. The approach taken to documenting contact with tenderers did not assist in removing such perceptions.

**4.19** A coherent record of all meetings and conversations with each tenderer involving tender evaluation teams, OASITO or its advisers, and/or Group Agency representatives was not kept during the tender evaluation phase. The Evaluation Guide for the Health Group stipulated that OASITO evaluation support staff would maintain a number of paper files, including tender files containing all correspondence or other records of contact with a tenderer; and a

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<sup>148</sup> OASITO could not provide ANAO with a copy of the Briefing endorsed by the Minister or his office as having been received.

<sup>149</sup> Finance advised ANAO in May 2002 that: 'The acceptance or rejection of late tenders is clearly within the bounds of the authority of OASITO executives having responsibility for management of the Health Group tender process'.

Contact Register, containing copies of correspondence and records of other contacts over all vendors and other agencies, stored in date/time of handling by the Team members. However, a Contact Register was not maintained. The individual tenderer files did not contain all correspondence and contact with that tenderer. Negotiation and clarification meetings with tenderers were not generally minuted, although the Legal Adviser advised ANAO in August 2002 that negotiations with tenderers in relation to the terms and conditions of the Services Agreement were documented and provided to all Group Agencies. Due to the ad-hoc structure of the available records, it was not possible for ANAO to conclude whether all contact with tenderers had been properly recorded for accountability purposes.

**4.20** In August 1998, the HIC Steering Committee representatives requested that OASITO provide Group Agencies with records of material discussions with industry that related to the Health Group. OASITO indicated to the Steering Committee that Health Group specific discussions did not generally occur, but it was agreed that OASITO would advise Group Agencies of material issues that arose from discussion with industry which were relevant to the Health Group.<sup>150</sup> However, the Steering Committee does not appear to have been informed of all such meetings or issues. For example, in advising the Minister of the disclosure event, OASITO pointed to a file note it had made of a meeting between itself and IBM Australia on 20 July 1999 as confirmation that IBM GSA had indicated the intention to substantially reduce its pricing for the Health Group tender prior to the disclosure event occurring. Yet there is no evidence of that meeting, nor the matters discussed, having been reported to the Steering Committee. Similarly, there is no evidence of meetings between OASITO and IBM GSA on 16 February 1999 and 27 July 1999, which included discussion of the financial, technical and corporate aspects of its Health Group offer, being reported to the Steering Committee.<sup>151</sup>

**4.21** As part of its wider responsibilities for implementing the IT Initiative, OASITO met with various IT industry firms during the Health Group tender. From the limited documentation available, ANAO was not able to determine whether all meetings with industry participants at which the Health Group tender was discussed were adequately documented by OASITO for that tender process. To ensure transparency of communication with tenderers, it would have been prudent for OASITO to maintain a comprehensive record of all meetings with industry participants, cross-referenced to individual tender processes.

<sup>150</sup> In April 1999, Group Agency Evaluation Committee representatives again expressed concern that OASITO was having discussions with tenderers without the participation of Group Agencies and requested that future discussions involve them. The Committee minutes record that the OASITO Project Coordinator (who also chaired the Committee) indicated that involving Group Agencies in all discussions with tenderers would slow the process, but he was willing to do so if Group Agencies wanted this.

<sup>151</sup> See paragraphs 3.105 to 3.106 and 4.88 to 4.90 for further discussion regarding the file notes of the meetings of 20 July 1999 and 27 July 1999.

**4.22** Transparency and confidence in the tender process would also have been enhanced through improved procedures for managing and recording contact with tenderers. Finance advised ANAO in May 2002 that the Probity Auditor had a role in reviewing, and sometimes producing, protocols and procedures governing management of the tender process and also provided briefings to those involved in the process. However, the schedule of services for the Probity Auditor did not require assessment or certification of procedures adopted for the general management of the tender process, including communication with tenderers.<sup>152</sup>

**4.23** This contrasts with good practice as outlined in, for example, the 2001 Victorian Government probity guidelines which state that it should be part of the probity auditor's brief to certify that procedures for the provision of information to bidders have been established and adhered to.<sup>153</sup> This includes procedures for contact points, recording meetings and telephone conversations, approving correspondence, filing, verification of data provided to tenderers, and procedures to ensure that other contact<sup>154</sup> is handled in a way which affords all bidders the same opportunity to acquire information about the tender process. As the Victorian guidelines note<sup>155</sup>, taken together, such processes should minimise the risks of discriminatory conduct and of disputes with bidders, not least by allowing the Government to demonstrate that it has taken all reasonable steps to ensure that all bidders are provided with the same opportunities to gain information. The Legal Adviser advised ANAO in August 2002 that: '...this also represents normal process in Commonwealth tenders. [We] had no involvement in developing the Probity Auditor's brief.'

### *Recording of requests for extension of lodgement times*

**4.24** Two tenderers requested extensions to the 7 May 1999 lodgement date for the first re-pricing round. IBM GSA sought an extension to 21 May, and CSC sought an extension to Monday, 10 May (see paragraph 2.51). Both requests appear to have been made orally, with no evidence in the documentation held by OASITO of written requests having been received. It is also not clear from the available documentation when the request for an extension was formally received from IBM GSA.

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<sup>152</sup> The Legal Adviser advised ANAO in August 2002 that they had no involvement in the industry briefings and no role in the procedures for managing and recording contact with industry participants in the IT outsourcing process.

<sup>153</sup> Department of Treasury and Finance, Victoria, op. cit.

<sup>154</sup> Including site visits, data rooms, briefing sessions, clarification meetings and other direct contact with bidders.

<sup>155</sup> Department of Treasury and Finance, Victoria, op. cit.

**4.25** On 3 May 1999, the Legal Adviser provided OASITO with written advice on whether the Commonwealth was permitted under the terms of the RFT to extend the deadline to 21 May as had been requested by one of the tenderers. The Legal Adviser advised OASITO that, in their view, the proposed extension time should be offered to all tenderers. The request for a short extension to 10 May was apparently received from CSC the following day.<sup>156</sup>

**4.26** On 6 May 1999, OASITO advised the Minister that, in addition to legal advice, the advice to tenderers extending the due date was prepared after consultation with the Strategic Adviser and the Probity Auditor. ANAO did not sight documentation of discussions with, or advice provided by, the Strategic Adviser or the Probity Auditor on the extension of the lodgement date.

**4.27** Transparency of process requires the nature and timing of all important interactions between tenderers and Commonwealth representatives to be properly documented and consistently recorded. This requirement also applies to expert advice obtained in regard to those interactions. ANAO considers that the transparency of the process for the extension of the lodgement date for the first re-pricing round would have been improved by OASITO requiring all requests for extensions to lodgement times to be made in writing; and by making contemporaneous records of all oral interactions with tenderers about those requests and of any discussions held with expert advisers. The Legal Adviser advised ANAO in August 2002 that they agreed with these comments.

### *Procedures for dissemination of information*

**4.28** The need for sound procedures in regard to managing and recording the dissemination of information to tenderers was further highlighted by the disclosure event. OASITO was responsible for managing all communication to, and from, tenderers. In this instance, OASITO made no contemporaneous record, prior to providing IBM GSA with the disk, of:

- receiving a request from IBM GSA for an electronic version of the document previously faxed to it;
- the request by an OASITO officer of a member of the evaluation team for an electronic copy of the document, including the nature of that request;
- a disk containing confidential tenderer information being removed from the secure Evaluation Centre;

<sup>156</sup> An OASITO file note dated 11 May 1999 of out-of-session discussions by Steering Committee members about the extension request records that the request for an extension from Friday to Monday was made by the other tenderer, CSC, on 4 May 1999. ANAO identified no other documentation of that request being received by OASITO.

- the identity and contents of the document contained on the disk; or
- a disk containing pricing information being provided to a tenderer.<sup>157</sup>

**4.29** No correspondence was prepared to accompany the disk. There was no examination made of the disk's contents prior to it being handed over to the tenderer. Nor was a hardcopy of the electronic document contained on the disk produced or retained at that time as a record of the information provided. In August 2002, the Legal Adviser advised ANAO that their advice was not sought as to whether release of the disk was appropriate or what procedural steps should accompany the release.

**4.30** The process errors that occurred in regard to the disclosure event highlighted the need for clear and effective procedures for the storage, copying and dissemination of confidential tender information.<sup>158</sup> Following that event, OASITO recognised the need to improve its information management processes and, on 2 August 1999, introduced revised interim procedures for the dissemination of hardcopy and electronic information to tenderers or agencies. In particular, those procedures stipulated that no financially sensitive information was to be transmitted electronically or on removable media (for example, floppy disks).

**4.31** OASITO also engaged the Probity Auditor to review OASITO's operating procedures for the handling and security of tenderer information and communications with tenderers. The Probity Auditor's report of 7 August 1999 found that there was limited detailed documentation in existence which specified the overall security requirements for tender or asset sales documentation.<sup>159</sup> It noted that the level of security maintained appeared to have been developed through custom and practice, which in the main provided an adequate level of

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<sup>157</sup> Finance advised ANAO in May 2002 that: '[This paragraph] appears to suggest that the disclosure event was somehow related to inadequacies in documentation. This was not the case. The process for having the Evaluation Team's interpretation of pricing viewed and confirmed for accuracy by the bidders was well understood by all those involved. The variable that caused the problem was the accession to the (not unreasonable) request for a soft copy of the data sent by facsimile'. ANAO notes that following sound procedures for recording the contents of information provided to IBM GSA in electronic form, prior to the disk being handed over, would have been of considerable assistance in enabling OASITO to avoid the possibility of the disclosure of information relating to other tenderers (see paragraph 4.29).

<sup>158</sup> The Victorian Government's probity guidelines acknowledge the importance of the physical security of documents and information to bidders' confidence in fully participating in Government tenders. The Guidelines note that the incorrect release of information could cause a tender process to be aborted and the process recommenced in a manner affording equity to all parties. On that basis, the guidelines note that agencies should therefore establish clear security procedures for handling tender-related documents (Department of Treasury and Finance, Victoria, op. cit.).

<sup>159</sup> The report found that the documentation in respect of the administrative arrangements of the evaluation process of IT outsourcing projects was very detailed, and of a high standard with clearly defined operating procedures required to be followed to ensure consistency in approach through the evaluation process. The Probity Auditor also found, however, that those procedures were maintained at the evaluation level and not necessarily applied to the management process.

protection, but was open to error with potentially severe consequences. The Probity Auditor strongly recommended that the procedures necessary for maintaining security of information within OASITO, both hard copy and electronically based, be more comprehensively documented and promulgated as standard operating procedures (SOPs). The Probity Auditor agreed to formulate a set of SOPs for OASITO, providing recommendations in February 2000. Finance advised ANAO in May 2002 that the Probity Auditor assessed:

...procedures across OASITO in the sense of whole of agency operational arrangements rather than each tender process. The examination did not delve into the arrangements in place for each project—such as the process guidance information in place for the various IT Outsourcing projects. As part of control measures for management of the tender process, OASITO generally reviewed all material produced by Evaluation Teams prior to provision to bidders. This was the case for the pricing material faxed to bidders. The diskette was to only contain that previously cleared material.

## Transparent consideration of relevant information, risks and options

**4.32** In any tender there is always the possibility that, despite the best endeavours of those involved, actions, errors or omissions may arise that result in a breach of probity requirements. The essential question to be addressed when a probity error occurs is whether the process can continue while still ensuring all tenderers receive, and are perceived to receive, fair and equal treatment. It is important that, in making that assessment, the consideration of all relevant information, risks and options is transparent and documented as a basis for any conclusions reached. From a probity perspective, the process by which such conclusions are reached can be seen to be as important as the conclusions themselves. In this regard, AGS advised ANAO that:

There is always a possibility of a challenge to a tender process by a disgruntled tenderer and in that case it is imperative that the Commonwealth can demonstrate that decisions were only made on the basis of a credible level of assurance that the recommendations were free from the taint caused by a lack of probity.<sup>160</sup>

<sup>160</sup> In August 2002, the Legal Adviser advised ANAO that they agreed with the comments in this paragraph. ANAO notes that neither of the two unsuccessful parties has embarked upon a course of legal action arising from the Health Group IT Outsourcing tender process.



## Consideration of disclosure event

**4.33** The provision to IBM GSA on 28 July 1999 of a document containing other tenderers' pricing was a very significant probity error of the type that could lead to the termination of a tender process. Officers of the former OASITO interviewed by ANAO advised that a variety of options, including the potential need to terminate the tender, were considered in the forum of internal discussions. However, those deliberations were not documented.<sup>161</sup>

**4.34** OASITO sought advice from the Legal Adviser and the Probity Auditor in regard to the disclosure event. In February 2000, OASITO advised the Senate Finance and Public Administration Legislation Committee that the management of the event, including the consultation with the agency heads and other tenderers in the process, was conducted in accordance with the advice from both the Probity Auditor and Legal Advisers engaged for the initiative.<sup>162</sup>

**4.35** In advice dated 29 July 1999 the Probity Auditor stated the view that OASITO had little option but to inform the other tenderers of the process violation and await their response. The Probity Auditor recommended that OASITO be provided with a Statutory Declaration by IBM GSA. The advice noted that the Probity Auditor did not believe that it would be appropriate to extend the 9.00 am 2 August 1999 lodgement time for the next round of pricing re-bids (sic) (see paragraphs 4.82 to 4.85). Advice from the Legal Adviser dated 30 July 1999 also recommended that OASITO inform the other tenderers of the event and the actions taken and then, depending upon the responses of those entities, consider further action in the process, including whether to proceed with the process or not.

**4.36** OASITO, along with the Probity Auditor, met with the CEOs of the other two tenderers on 30 July 1999 (see paragraphs 4.15 to 4.16 and paragraphs 9 to 11 of the Appendix). In such circumstances, it is good practice to prepare, with the assistance of expert advisers, scripts or speaking notes to ensure all tenderers are provided with the same information.<sup>163</sup> OASITO prepared no scripts or speaking notes for the meetings with the tenderers. The Legal Adviser was not asked to be present, or to provide advice on the conduct or recording of the

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<sup>161</sup> In August 2002, the Legal Adviser advised ANAO that: 'We are unaware of what transpired in the internal discussions.'

<sup>162</sup> Senate Finance and Public Administration Legislation Committee *Hansard*, 8 February 2000, p. 215.

<sup>163</sup> In that regard, a normal part of the OASITO process was to obtain legal clearance from the Legal Adviser on written questions prior to their being provided to tenderers as part of the clarification process.

meetings.<sup>164</sup> Whilst the Probity Auditor was present at the meetings, any advice he may have been provided in regard to the conduct or recording of the meetings was not documented. Finance advised ANAO, in May 2002, that a meeting was held in the office of the Probity Auditor on 30 July 1999 and that statements to be made to the bidders about the disclosure and remediation actions were agreed then.

**4.37** The Probity Auditor's written advice of 29 July 1999 stated that he concurred with advice from the Legal Adviser dated 29 July 1999. The advice sighted by the Probity Auditor was a draft of the signed legal advice provided on 30 July 1999, which included additional comments and recommendations with implications for the probity of the process. These related to a discussion of the specific sources of potential disadvantage to the other two tenderers arising from the disclosure, and a recommendation that the Group Agencies be informed about the disclosure.<sup>165</sup> The Probity Auditor's advice did not identify that the legal advice he was concurring with was in draft form. There is no evidence that the Probity Auditor sighted the final legal advice.<sup>166</sup> There is no documented consideration by the Probity Auditor as to whether the Group Agencies, including the relevant Committees, should be informed of the disclosure event from a probity perspective. Nor is there evidence of OASITO seeking such advice from the Probity Auditor (see paragraphs 4.79 and 4.150 to 4.160).

### *Oral requests and instructions*

**4.38** Based upon the available documentation, all requests by OASITO for advice from both the Legal Adviser and the Probity Auditor regarding the disclosure event were oral.<sup>167</sup> Oral requests to advisers for advice are not

<sup>164</sup> In August 2002, the Legal Adviser advised ANAO that: '[We were] not asked to prepare scripts or give other advice in relation to the meetings with [the other two tenderers]... [We] confirm(s) that [we were] not asked to be present at the meetings with [the other two tenderers] or to provide advice on the conduct or recording of the meetings. [We were] made aware that the meetings occurred, after the meetings were held...The meetings with [the other two tenderers] took place on 30 July 1999. [Our] signed advice was provided on 30 July 1999. However, an earlier draft of the advice had been provided on 29 July 1999. It (like the signed final) recommended that [the other two tenderers] be briefed...[We] had also verbally recommended to OASITO on 28 July 1999 that [the other two tenderers] be briefed.'

<sup>165</sup> In August 2002, the Legal Adviser advised ANAO that: '...[we] had also verbally expressed concern to OASITO on 28 July 1999 about the proposal not to advise the Group Agencies. OASITO advised [us] that it would inform Group Agencies.'

<sup>166</sup> Finance advised ANAO in May 2002 that: '...it would have been entirely appropriate for the Probity Auditor to provide advice on this sort of issue alone as this was his contracted role. OASITO provided the draft advice in an endeavour to ensure the advice provided was timely and as comprehensive as possible'. In August 2002, the Legal Adviser advised ANAO that: 'OASITO did not tend to involve the Probity Auditor and Legal Adviser together. Rather, it was OASITO's practice to involve us separately. The Strategic Adviser was involved in devising strategy and provided the linkage between advisers.'

<sup>167</sup> The Legal Adviser advised ANAO in August 2002 that: 'On the evening of 28 July 1999, OASITO faxed [us] a draft letter to IBM for comment. The draft letter related to the disclosure event. However, it is correct that all requests from OASITO to [us] for advice in relation to the disclosure event were verbal.'

uncommon, but it is sound practice to document those requests and, particularly for significant issues, follow them up with written instructions. There was no record retained by OASITO of its conversations with either the Legal Adviser or the Probity Auditor in relation to the disclosure event, the instructions provided about the event and the nature of the advice sought by OASITO, nor of the options discussed with either party.<sup>168</sup>

**4.39** The need for agencies' instructions to expert advisers to be appropriately recorded was highlighted in the course of the Senate Committee's inquiry. In May 2001, in the context of compiling answers to questions from the Senate Committee taken on notice, OASITO orally requested that the Legal Adviser provide it with copies of the legal sign-offs and advice provided for the Health Group tender. On 4 June 2001, the Legal Adviser provided OASITO with copies of various advices and sign-offs, accompanied by a covering letter marked draft. The draft letter included a statement that, in relation to their 30 July 1999 advice on the disclosure event, '...please note that we were advised that termination of the RFT process was not an option. This principle guided the structure of the legal advice'.

**4.40** That statement was omitted from the final version of the letter, which was provided to OASITO on 20 June 2001, but dated 4 June 2001.<sup>169</sup> As noted above, the Legal Adviser's 30 July 1999 advice included a comment that, depending upon the responses of the other tenderers, OASITO would need to consider further action, including whether to proceed with the process or not. However, in a telephone conversation with an OASITO officer on 15 June 2001, and in discussions with ANAO in November 2001, the Legal Adviser confirmed that their advice had been prepared under the belief that OASITO had instructed that termination of the process was not an option. ANAO observed handwritten notes in papers held by the Legal Adviser which indicated that, on two occasions, the Legal Adviser raised in telephone conversations with OASITO the prospect of considering termination of the tender and was advised by OASITO officers that they did not want to terminate. In August 2002, the Legal Adviser provided ANAO with the following comments in respect of this paragraph:

Noted and agreed. The procedure established by OASITO was that [*our*] advice was provided initially as a draft (whether labelled as a draft or not) until OASITO asked us to finalise the advice. Changes would normally be made to draft advices—in discussion with OASITO or the Strategic Adviser—prior to OASITO

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<sup>168</sup> Finance advised ANAO in May 2002 that: '...the fact that conversations and verbal requests for advice were made to probity and legal consultants is evidenced by the provision of advice within a short period of those calls being made. There is little room for doubt that the calls were made or about the nature of the requests given the nature of the events that occurred and the advice provided'. The Probity Auditor provided ANAO with an electronic copy of one file note of a meeting with OASITO on 29 July 1999 at which the disclosure event was discussed.

<sup>169</sup> See also paragraphs 4.112 to 4.116 for further discussion of the Legal Adviser's draft letter of 4 June 2001.

instructing us to finalise advices. In this case the warning statement in the draft had brought to OASITO the issue of concern and was not included in the final advice. We have not altered our view that the advice about termination options was given.

**4.41** OASITO's record of the conversation of 15 June 2001 records that it indicated to the Legal Adviser that it did not agree that it had given instructions that termination was not an option.<sup>170</sup> Officers of the former OASITO advised ANAO in similar terms. The precise nature of the oral instructions provided to the Legal Adviser by OASITO cannot be identified from the available documentation.

**4.42** The question as to whether the tender was compromised by the disclosure event to the extent that it should be terminated was clearly of particular significance to the appropriate consideration and resolution of this major probity issue. Yet, uncertainty and differing views remain about the extent to which the Legal Adviser was empowered to consider that question in framing their legal advice on the issue.<sup>171</sup>

### *Opportunities for further inquiry*

**4.43** Assurances that the disclosed pricing information had not been examined, or retained, were provided by relevant IBM GSA personnel through contemporaneous Statutory Declarations made following the disclosure event on 28 July 1999. Those assurances were confirmed in subsequent interviews with ANAO during the latter half of 2001. In advising the other two tenderers of the disclosure event, OASITO provided the Statutory Declaration received to that time to the bidders for their review. OASITO advised each tenderer that it was OASITO's intention to proceed with the tender process.

**4.44** Based upon available documentation and oral advice provided in discussions with ANAO, OASITO and the Probity Auditor relied extensively upon the assurances contained in the Statutory Declarations to conclude that the tender process could continue.<sup>172</sup> AGS advised ANAO that, in these circumstances, Statutory Declarations provide a reliable record of a contemporaneous note by the witness as to what happened.<sup>172</sup> ANAO considers

<sup>169</sup> In August 2002, the Legal Adviser queried this comment as the discussion on 15 June 2001 had been with an OASITO officer who was not involved in the Health outsourcing.

<sup>170</sup> In August 2002, the Legal Adviser advised ANAO that: 'We confirm that [our] file notes represent our understanding of our instructions.'

<sup>171</sup> The Statutory Declarations signed by the six IBM GSA employees were all made pursuant to the *Oaths Act 1900* (NSW).

<sup>172</sup> However AGS further advised that, generally speaking, the Statutory Declarations would not be sufficient evidence of what occurred for the purposes of any legal action relating to the tender process. If legal action were taken, further affidavits would have to be sworn and the witnesses would have to be available for cross-examination in order for the testimony to be used.

that there were other inquiries that could reasonably have been undertaken in order to improve the capacity to demonstrate that all relevant information had been considered in forming conclusions about the disclosure event.<sup>174</sup>

**4.45** The Probity Auditor's advice of 29 July 1999 stated that the probity implications of the disclosure event had been examined, but did not detail the nature of those implications or the inquiries undertaken. In July 2002, the Probity Auditor advised ANAO that:

We did make independent inquiries of both IBM GSA and the OASITO officers involved by interview and telephone immediately following the disclosure. We confirmed that the advice provided to us by OASITO and IBM GSA accorded with the facts as presented to us. In addition we examined the sealed envelope holding the disk.

**4.46** The Statutory Declarations did not provide a complete and reconcilable picture of the timing and sequencing of events. During the latter half of 2001, ANAO held discussions with the IBM GSA declarants in an attempt to clarify events, but minor gaps, discrepancies and anomalies remained. This was due in part to the considerable time that had elapsed since the events in question and inconsistencies in individuals' recollections of events that occurred in mid-1999. For example, ANAO was not able to clearly establish who within the company had sighted the original fax from OASITO, considered by IBM GSA to be illegible; who had originated the request for an electronic copy; the terms of the request to OASITO for a replacement copy; or the period that elapsed between the company identifying the contents of the document on the disk and its notification to OASITO. Other inconsistencies were identified regarding whether particular conversations occurred or not. ANAO was also unable to resolve whether the company ever received a complete version of the information it was originally intended to receive in order to participate in a meeting at 3.00 pm on the day of the disclosure.<sup>175</sup>

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<sup>174</sup> Further inquiry conducted by ANAO included, for example, discussions with IBM GSA employees to clarify and supplement the various accounts of events presented in the Statutory Declarations, examination of the disk provided to IBM GSA in error, and inquiry into IBM GSA's internal approval processes for tender submissions.

<sup>175</sup> Available records were patchy, but seem to indicate that this meeting proceeded.

**4.47** Based on an examination of the disk by the Defence Signals Directorate (DSD)<sup>176</sup> and audit observations, ANAO identified a more significant discrepancy between the events described in the Statutory Declaration of the IBM GSA employee who opened the pricing document, and the properties of the document contained on the disk. This related to an inconsistency between the nature of the information that, based on examination of the disk, would have been first observed by the IBM GSA employee upon opening the document, and the sequence of actions described in the relevant Statutory Declaration.

**4.48** Against this background, ANAO was unable to fully reconcile the events. This was in large part due to differing recollections given the significant period of time that had elapsed since the events in question. A more comprehensive examination of the disk and its contents at the time of the event, together with analysis of the complete set of Statutory Declarations, would have been of benefit in ensuring that a comprehensive, unambiguous and transparent record of the event was retained. In particular, the capacity to clarify any anomalies would have been significantly greater at the time.

**4.49** Another area in which further inquiries could reasonably have been made to enhance the capacity to demonstrate that the disclosure event had not resulted in competitive advantage related to establishing when the pricing lodged by IBM GSA on 2 August had been substantially finalised. However, no inquiries were made by those concerned in this regard (see paragraphs 4.91 to 4.95).

### *No report on disclosure event*

**4.50** The advice of both the Probity Auditor and the Legal Adviser referred to the need for OASITO to consider the responses of the other tenderers in then determining further action in the process, including whether to proceed with the process or not. The CEOs of EDS and CSC were advised of the disclosure event on 30 July 1999; the last of the Statutory Declarations provided by IBM GSA officers was received by OASITO on 4 August 1999; and the agency heads were advised between 4 and 5 August 1999.

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<sup>176</sup> The 28 July 1999 OASITO Note for File records that a check of the disk on its return found that it contained the pricing details of the bids from the other two tenderers, and that it was then sealed in an envelope. In September 2001, ANAO engaged DSD to undertake expert examination of the disk. DSD's examination confirmed that it contained an Excel spreadsheet comprising three worksheets labelled with the names of the tendering companies. Each worksheet contained the pricing information that had been faxed to that tenderer on 27 July 1999. Examination by DSD identified that the document had last been printed and modified (or saved) at 6.50 pm and 7.03pm respectively on 27 July 1999, the day before the disk was provided to IBMGSA. The document had been last accessed on 28 July 1999, and was copied to the disk at 10.47 am on 28 July 1999. These facts coincide with the broad events as described by OASITO and IBM GSA. It is not possible to determine from the document or disk whether the document was copied.



**4.51** As noted earlier, the Probity Auditor co-signed Notes for File prepared by OASITO as a record of the meetings with the tenderer CEOs.<sup>177</sup> The only comment attributed to the Probity Auditor was a suggestion that it was appropriate that 2 August 1999 be retained as the closing date for lodgement of any refinements to offers (see paragraphs 4.82 to 4.85). AGS advised ANAO that, while observing that the file notes record some comments made by the Probity Auditor:

We suggest, however, that it would have been appropriate in the circumstances to obtain written probity advice as to what had occurred and what further steps should be taken. If it was considered outside the probity auditor's role to provide such advice then this could have been sought from a probity adviser, if one was appointed to the project, or the legal adviser to the project.

**4.52** Neither the Probity Auditor nor the Legal Adviser provided any further written advice or comments specifically relating to the resolution of the disclosure event, having regard to the actions taken following their initial advice (provided on 29 July 1999 and 30 July 1999 respectively). Also, neither provided a specific sign-off on the management of the disclosure event. In July 2002, the Probity Auditor advised ANAO that a request to provide any additional sign-offs or further written advice in respect of the disclosure event was never made by OASITO. The Legal Adviser similarly advised ANAO that no request was made by OASITO for the Legal Adviser to provide further advice or a specific sign-off on the disclosure event or to be involved in the briefing of tenderers or the Agencies. Better practice was subsequently followed by OASITO in respect to a probity issue that arose in the Group 1 tender process in May 2000. In that case, following a request from OASITO for a probity audit of the issue, the Probity Auditor prepared a full report setting out the scope of inquiries undertaken and the conclusions reached. The report was subsequently provided to the then Minister for Finance and Administration.

**4.53** It was not until 3 September 1999 that the Probity Auditor's sign-off on the Health Group evaluation process was provided to OASITO. The tender process had continued in the meanwhile. The sign-off stated that the Probity Auditor was not aware of unresolved probity issues or concerns, and made no reference to specific probity issues considered or inquiries undertaken. ANAO considers that a probity report of the type prepared in relation to the Group 1 tender, available at the time of a probity event, provides transparency and timely closure on the issue. In the absence of such a report, a clear accountability trail was not maintained of a decision being formally taken by an appropriately

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<sup>177</sup> See footnote 147.



authorised entity that the tender should continue after the disclosure event, and the basis for that conclusion. In July 2002, the Probity Auditor advised ANAO that:

As there were no unresolved probity issues or concerns we formed the view that to provide additional detail may have unnecessarily caused incorrect concerns regarding the probity of the process. We believe that there was no lack of transparency.

**4.54** In September 2002, the previous Minister for Finance and Administration advised ANAO that:

When the disc containing all three bids was delivered to IBM GSA in error my reaction on being informed directly by OASITO was to cancel the tender. I could not see that a tender process with integrity could continue. I conveyed this view to OASITO and I requested two things. Firstly, that all parties associated with the tender be informed of the potential breach of confidentiality and their views obtained. Secondly, that the Probity Auditor be immediately informed and that all subsequent dealings on this issue be in the presence of the Probity Auditor so that a separate audit report could be prepared on this issue to underpin either cancelling the Health tender or proceeding with the concurrence of all parties.

At the conclusion of the tender I was both disappointed and annoyed at the limited role of the Probity Auditor and the absence of a separate report on this issue.

## Consideration of late lodgement

**4.55** Where a tenderer lodges a tender after the closing time advised to all tenderers, the opportunity for commercial advantage may arise.<sup>178</sup> The Victorian Government probity guidelines acknowledge the importance of tender closing deadlines to the probity of tender processes, noting that:

Adherence to tender closing deadlines is of great importance in maintaining the integrity of the tendering process. Bidders can be seen to obtain an unfair advantage if they are permitted to have more time to prepare bids.<sup>179</sup>

<sup>178</sup> Such advantage may arise simply from having additional time to prepare the response, or may also occur in other circumstances such as where:

- there is potential for information from tenders that were lodged on time to be disseminated prior to the lodging of the late tender; or
- the late tenderer has obtained additional information late in the process of developing its tender and is seeking an opportunity to incorporate that information into its tender.

<sup>179</sup> Department of Treasury and Finance, Victoria, op. cit.

**4.56** For this reason, the RFT issued to tenderers will typically advise that late tenders may not be accepted. Equally, however, there may be good grounds for accepting late tenders. It is common, therefore, for the Commonwealth to reserve the discretion to accept tenders lodged after the advertised closing time.<sup>180</sup> However, even where there are good grounds for accepting a late tender, it is important that due process is seen to be followed. AGS advised ANAO that, given the tension between the possibility of prejudicing tenderers by admitting a late tender that was compiled using an unfair benefit of extra time and possibly information, and excluding a tender that could be quite attractive to the Commonwealth, it is imperative that the discretion to admit a late tender is exercised with due care and fully documented. Finance advised ANAO in May 2002 that:

The Commonwealth does not prescribe a position on treatment of late tenders. OASITO managed the process of dealing with late tenders in accord with its own accountabilities on quite a number of occasions. We are aware of a large number of instances of late tender lodgement in procurement transactions—and acceptance of those late tenders once assessments have been made that no material advantage was gained by the party submitting its offer late.

**4.57** AGS further advised ANAO that, before the issue of a late lodgement could be resolved, the full circumstances should be known. These issues are usually resolved by obtaining a statement from the person lodging the late tender as to the reasons for it being late, and from the person taking receipt of the tender as to the time it was lodged and any other pertinent circumstances (such as any statement made at the time it was being lodged as to why it was late). It would also include obtaining probity and legal advice regarding acceptance of the late tender.

**4.58** IBM GSA was late in lodging its revised offer on 2 August 1999. The offer was accepted into the evaluation (see the Appendix for details). However, the approach taken by OASITO to documenting the late lodgement and its management of the issue diminished its capacity to demonstrate that all relevant information was considered before the offer was accepted into the evaluation.

### *Acceptance of the late offer*

**4.59** The issue of whether the late offer should be accepted into the evaluation was considered internally by OASITO. The Evaluation Guide stated that, if a tender was received after the deadline declared in the RFT, the issue would be

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<sup>180</sup> The Victorian probity guidelines state that where an RFT contains a clear rule (such as a deadline), it should be applied strictly. The guidelines note that, if the Government envisages circumstances in which it may wish to tolerate minor errors or variances from its bidding rules, it should include appropriately explicit provisions to that effect in the RFT (Department of Treasury and Finance, Victoria, op. cit.).

referred to OASITO's Project Coordinator. The Guide set down no procedures or guidelines for determining whether a late bid could be accepted or who would exercise that authority.<sup>181</sup>

**4.60** ANAO was informed that an OASITO officer contacted IBM GSA by telephone when it was realised that IBM GSA had not lodged its revised offer by the 9.00 am closing time. OASITO made no record of the time, content or participants in conversations it may have had with the tenderer about the issue, or of any instructions or directions it may have given regarding the lodgement of the late offer. However, a file note prepared by the Probity Auditor's representative present for the tender opening recorded that, between 9.05 am and 9.30 am, the OASITO Project Coordinator advised her that IBM GSA had informed OASITO by telephone that IBM GSA thought the closure time was 5.00 pm.

**4.61** At 9.30 am, the Probity Auditor's representative requested that the two bids received on time be held unopened. IBM GSA lodged its revised offer in two parts over the course of 2 August, the first at 12.02 pm and the second at 2.35 pm. At 2.55 pm, all tenders were opened together. The Evaluation Guide provided that:

Once the time for lodging tenders has closed and all expected tenders have been received, the Evaluation Support Staff will register the tenders. If a decision has been made to accept a late tender, tenders will not be opened until all tenders have been received. *[emphasis added]*

**4.62** Given the rules set down in the Evaluation Guide, the actions taken left open the interpretation that a decision or assumption that the IBM GSA offer would be accepted had been formed and communicated within OASITO by 9.30 am.<sup>182</sup> If this were not the case, it is not clear why the two bids that had been lodged on time were not registered and opened in the normal course. ANAO received conflicting advice regarding this matter from participants in the process. The approach taken in the Health Group tender contrasts with the practice set out in, say, the Defence Procurement Policy Manual which stipulates that late offers are to be opened and registered separately from those received by closing time and should be clearly marked as late offers.<sup>183</sup>

<sup>181</sup> In contrast, the Defence Procurement Policy Manual explicitly states that the Liability Approver will determine whether to exclude a late tender from further consideration or not.

<sup>182</sup> In August 2002, the Legal Adviser advised ANAO that: 'We are not aware whether OASITO had made a decision by this time. Advice from [us] was requested on 2 August 1999 and verbal advice was provided at that time.'

<sup>183</sup> Department of Defence, *Defence Procurement Policy Manual*, section 5, Chapter 1, Evaluation of Offers.

**4.63** An internal OASITO minute recommending that the Chief Executive note the intention, subject to his views, to accept the late offer was dated 2 August 1999 and signed as noted by the Chief Executive on the same day. The Chief Executive inserted a handwritten note on the minute that stated: ‘This confirms my verbal agreement given prior to action being taken’. Neither the time of the verbal agreement nor the actions referred to are recorded.<sup>184</sup>

### *Legal advice*

**4.64** The 2 August 1999 internal minute stated that advice from the Legal Adviser that the late offer could be accepted under the RFT was attached. Records held by the Legal Adviser show that OASITO discussed with the Legal Adviser OASITO’s capacity to accept the late offer in telephone conversations on 2 August 1999. In August 2002, the Legal Adviser confirmed to ANAO that the ability to accept the late tender was discussed with OASITO on 2 August 1999. The Legal Adviser’s written advice to OASITO concluded that, on the basis of the information provided and the discretions reserved by the Commonwealth under the RFT, OASITO and the Group Members may consider the revised but, late, IBM GSA material in this case. However, written advice on the matter, dated 3 August 1999, was first faxed to OASITO by the Legal Adviser at 9.21 am on 3 August 1999. The same written advice, but dated 2 August 1999, was then faxed by the Legal Adviser at 10.09 am on 3 August 1999. In August 2002, the Legal Adviser advised ANAO that: ‘OASITO had requested that the written advice be dated 2 August (as [*this was the date*] when the oral advice was provided).’

**4.65** On that basis, it is apparent that OASITO was acting on oral advice from the Legal Adviser in accepting the late lodgement on 2 August 1999.<sup>185</sup> Acting on initial oral advice that is subsequently confirmed in writing is not unusual. However, the records prepared to document the actions taken should reflect that that was actually the case.

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<sup>184</sup> The minute is ambiguous as to who within OASITO was exercising the discretion to admit the late tender. That is, the Chief Executive did not ‘approve’ a recommendation that it be admitted, but merely ‘noted’ a recommendation by the Executive Coordinator that ‘we intend to allow the information to be accepted....’.

<sup>185</sup> In August 2002, the Legal Adviser advised ANAO that: ‘[I] did not know when OASITO made a decision to accept the late information provided by IBM GSA. It could have been sometime on 2 August ... or 3 August or some other time.’

## *Probity advice*

**4.66** The Evaluation Guide made no reference to a probity auditor or the role that a probity auditor would play in the tender process. In this regard, AGS advised ANAO that the issue raised in considering whether to admit a late tender to evaluation is a probity issue, and that:

The Project Coordinator would be expected to identify that a probity issue existed and refer the issue to the probity adviser for advice. It is usual to obtain probity sign off in relation to admission of late tenderers even where the tenders are lodged only a few minutes after the deadline. As with other probity issues, it would be expected that the probity adviser would report on the implications of the probity issue for the evaluation process and the options for their resolution...

**4.67** ANAO noted an earlier incidence in the Health Group tender in which consideration of the admissibility of tender material provided after the lodgement closure was conducted in a manner that accorded with the good practice identified by AGS. The matter was referred to the Probity Auditor for advice after being raised in the context of the Steering Committee's consideration of evaluation progress.<sup>186</sup> The Probity Auditor's subsequent advice that the material could be accepted was formally recorded in the minutes of the Steering Committee.<sup>187</sup>

**4.68** In contrast, while the 2 August 1999 tender opening process was managed under the control of a representative of the Probity Auditor, OASITO did not formally refer the issue of whether the late offer received on that day should be accepted to the Probity Auditor. The file note prepared by the Probity Auditor's representative recorded that she spoke to the OASITO Executive Coordinator and requested that the latter prepare a file note stating that he had considered the late bid by IBM GSA and was prepared to accept it.<sup>188</sup> In July 2002, the Probity Auditor advised ANAO that the representative of the Probity Auditor did contact her manager by telephone during this process. However, there is no written advice from the Probity Auditor (who was overseas at the time), nor from his representatives, regarding the probity aspects of accepting the late offer from IBM GSA following the disclosure event, either before or after the decision to

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<sup>186</sup> During the Financial Team Leader's report to the Committee on progress in evaluating the re-priced bids lodged on 21 May 1999, it was indicated that one of the tenderers had responded erroneously to the RFT version of a part of the required material, rather than the revised version distributed to tenderers as part of the re-pricing material. The Steering Committee directed that the Probity Auditor's advice be sought on the acceptance of this material after submission of re-priced offers.

<sup>187</sup> The Probity Auditor had advised that: 'whilst [*the tenderer*] have in reality put in a non-conforming tender I believe it would be appropriate in the circumstances to obtain clarification of the outstanding material'. He further advised that the late material could be accepted into the evaluation as it did not affect price, and was therefore a clarification issue permitted by the RFT.

<sup>188</sup> See paragraphs 4.60 and 4.162 for further discussion regarding the file note prepared by the Probity Auditor's representative.

accept it had been made. OASITO made no record of having received such advice orally. There was also no record of the Legal Adviser's advice on the issue having been provided to the Probity Auditor.<sup>189</sup> As with the disclosure, there is no specific reference to the late lodgement in the sign-off provided by the Probity Auditor at the conclusion of the evaluation process, some five weeks after the decision to accept the late offer had been made.

### *Reason for late lodgement*

**4.69** The importance of following rigorous processes for even very minor instances of late lodgement was acknowledged by OASITO in the earlier Group 5 tender process, which was examined by ANAO in Audit Report No.9 2000–01. On that occasion, a tender was receipted two minutes after the due deadline. This was observed by another tenderer. OASITO subsequently advised the then Minister for Finance and Administration that:

in order to follow due process and to protect ourselves against any future claim by *[the other tenderer]*, we have in consultation with *[the Legal Adviser]* and the Probity Auditor, written to *[the late tenderer]* asking them to show good reason as to why we should accept the late bid.

**4.70** However, that approach was not taken in regard to the late bid received from IBM GSA. There was no written request to IBM GSA for an explanation. The covering letter for the first part of its revised offer lodged at 12.02 pm on 2 August 1999 stated that:

IBM GSA were working to provide all the information requested by the deadline of the close of business today. In the rush late last week we missed the change in deadline to 9AM this morning.

**4.71** ANAO notes that the nomination of the 9.00 am closing time in OASITO's 28 July 1999 letter to tenderers did not represent a change in deadline. Rather, it represented the first advice to tenderers of a specific closing time for the previously advised due date (see paragraph 2.69 and paragraphs 16 to 17 of the Appendix). It appears unusual for a tenderer to a major tender of this nature to rely upon an assumption about a closing time for the lodgement of tender material.<sup>190</sup> The cover letter provided by IBM GSA with the final part of its offer lodged on 2 August made no reference to the late lodgement or the earlier cover letter. However, it did state that the amended offer was being submitted in response to OASITO's letters of 14, 16 and 28 July. This appears at odds with the earlier statement that the closing time advised in the 28 July letter had been overlooked.

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<sup>189</sup> In August 2002, the Legal Adviser advised ANAO that: 'We do not know what transpired between OASITO and the Probity Auditor.'

<sup>190</sup> Previous experience in the course of the tender had been not wholly consistent in that regard. The two previous re-pricing exercises had closed at 5.00 pm on the due date, but the original RFT response closed at 2.00 pm.

**4.72** In advising OASITO as to whether the late bid could be accepted, the Legal Adviser concluded that, whilst the statement regarding a 9.00 am closing time on 2 August was clear in the 28 July letter, ‘...there are some arguments that the correspondence may have led to some confusion in each of the Tenderers.’ In August 2002, the Legal Adviser advised ANAO that this was because OASITO’s previous letter to tenderers (14 July 1999) had not specified an exact time for lodgement but had variously referred to the information being lodged ‘on 2 August’ or ‘by 2 August’. This was noted in the Legal Adviser’s written advice to OASITO. The Legal Adviser advised ANAO that: ‘IBM GSA’s statement [was] consistent with them having focused on the 14 July letter.’<sup>191</sup>

**4.73** Both other tenderers lodged their offers by 9.00 am. Each indicated in discussions with ANAO that, from their perspective, there had been no ambiguity as to the closing time.

**4.74** As noted at paragraph 4.62, the actions taken in respect to the late lodgement by IBM GSA leave open to interpretation important aspects of the management of that event by OASITO. In the circumstances, it would have been prudent for the documentation of OASITO’s deliberations of the issue to have more fully reflected the timing of the actual decision to accept the late offer into the evaluation, and the nature and form of information available at that time to support that decision. In August 2002, the Legal Adviser advised ANAO that they agreed with this comment.

## Price movements

**4.75** Each tenderer made various changes to their prices, and other aspects of their bids, over the course of the tender. Two of the three tenderers made significantly greater changes than the other, both having initially tendered relatively high costs. Those same two tenderers, IBM GSA and CSC, also both made substantial price reductions in their final bids on 2 August 1999. ANAO notes, however, that the third tenderer, which had been the most competitive initially, slightly increased its price in the final round in response to the material provided to tenderers. These movements resulted in changes in the final competitive positions of the tenderers, with the final margins being small (see paragraphs 2.48, 2.52, 2.58, 2.71 to 2.73, 2.79 to 2.83 and Figure 2.3).

<sup>191</sup> The Legal Adviser’s 2 August 1999 advice to OASITO on the late lodgement suggested that: ‘...for all future correspondence, the timeframes be clearly specified, and that references be made to deadlines and timeframes and the rules of the RFT, so as to ensure that all Tenderers are aware that the Commonwealth is serious about timeframes and deadlines in the process.’



**4.76** Movements in tenderers' offerings over the course of an extended tender process are to be expected in commercial negotiations. As long as all tenderers are provided with the same opportunities, movements are not, in themselves, cause for particular concern. Indeed, the desire to obtain more competitive bids was clearly a significant driver behind the approach taken to the parallel negotiations phase in the Health Group tender, with multiple changes being made to agency requirements over three re-pricing rounds.<sup>192</sup>

**4.77** However, the substantial size of the price reductions made by two of the tenderers after three previous opportunities could give rise to perceptions about the extent of robustness of the process. In those circumstances, the nature of the price movements made by each tenderer should be examined in order to be assured that they were explainable in the context of the preceding negotiations and the new or revised information on which re-priced bids were sought. ANAO identified documentation of analysis of the tender having been undertaken by the Financial Evaluation Team to identify where price movements had occurred compared to the previous round of pricing, and the drivers behind those movements. However, analysis was not undertaken in the context of the probity of the process, and no documented conclusions were provided in that regard. ANAO notes that the Financial Evaluation Team, responsible for review of the financial elements of the bids, was not made aware of the disclosure event during the evaluation process and therefore was not in a position to perform the analysis in the knowledge of that probity exposure. As neither the Evaluation Committee nor Steering Committee were aware, as a Committee, of the disclosure event, the price movements were also not examined by them in that context (see paragraphs 4.90 and 4.163).<sup>193</sup>

## **Consideration of cumulative effect**

**4.78** A single occurrence which has the potential to impinge on the probity of the process may not always give rise to perceptions that due process was not properly followed. However, the risk of such perceptions arising is likely to

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<sup>192</sup> As noted in Chapter 2, in undertaking such processes, it is important that agencies appreciate the probity implications arising from the changes made to the requirements tenderers are asked to tender against (see paragraph 2.74).

<sup>193</sup> In August 2002, the Legal Adviser advised ANAO that: 'We were not advised of pricing changes. As a general concept—the Legal Adviser was not involved in any consideration of financial issues... Similarly, we do not know if the Probity Auditor was aware of these movements. [*We were*] also unaware until towards the end of the process, when the issue arose at a meeting with Agencies that all members of the Evaluation and Steering Committees did not know about the disclosure event.'

increase where subsequent issues arise over the course of a tender, particularly if they involve the same tenderer. This was the case in the Health Group tender, given the sequence of events involving IBM GSA.<sup>194</sup>

**4.79** The then Secretary of DHAC alluded to concerns about potential cumulative effects in a file note prepared on 8 October 1999 to record his involvement in the management of the disclosure event over the period 5-6 August 1999 (see paragraphs 4.150 to 4.160). The file note records that the Secretary expressed extreme concern to OASITO about the disclosure matter, but also raised a number of other concerns about the process ‘...including the surprising changes in the IBM and CSC bids and the lateness of IBM’s latest bid...’. In referring the Options Committee recommendation for preferred tenderer to the Minister on 8 September 1999, OASITO noted that the Secretary had also expressed some concern about issues arising from the close margins in the bids, coupled with perceptions of the benefits of incumbency. In August 2002, the Legal Adviser advised ANAO that: ‘We were not aware of nor asked to advise on these concerns.’

**4.80** In such circumstances, it is important not only to deal with the individual events on their merits, but also for their cumulative effect to be openly considered. Ensuring there is close consideration of possible relationships between individual occurrences does not imply improper behaviour by any party. Rather, it provides a transparent basis for concluding that the probity of the process has been maintained. In the interests of all parties, not least the successful tenderer, it is important to ensure that the awarding of a government contract is not subject to the taint of perceptions or suspicions that due process may not have been observed. It is important that those undertaking the tender remain alert to all aspects of the tender that could have implications for the perceived probity of the process. In this regard, AGS advised ANAO that:

One advantage of engaging a probity adviser is that one person at least will be fully focussed on the probity of the process. Tender processes can be complex and those involved in their conduct can sometimes lose their objectivity as they focus on bid development through phases of a tender process and the potential outcomes for the Commonwealth. A probity adviser should maintain that objectivity and should be keeping a complete record of all the probity issues that arise over the life of the process. Not only does this allow the probity adviser to

<sup>194</sup> In this regard, in August 2002, the Legal Adviser referred ANAO to the following statement in their advice dated 2 August 1999 to OASITO regarding the late lodgement:

As we have indicated above, the Commonwealth has reserved great flexibility to itself in the RFT process. Nonetheless, we have also indicated that, if there had been some trend whereby IBM GSA had been given preferential treatment to the other Tenderers or it had missed a number of deadlines, that there could have been some concerns that OASITO was giving IBM GSA preferential treatment over the other Tenderers. However, we understand from you that that is not the case.

give a complete sign off at the end of the process but it allows the probity adviser to alert the project to issues that may potentially have a greater impact because of a cumulative effect with other issues that have previously arisen than if they were considered in isolation.

**4.81** There is no documented consideration by the Probity Auditor of the potential for a cumulative effect to have arisen from the disclosure event, the late lodgement and significant movements in tendered prices, or of advice to OASITO that it should consider such an effect. In July 2002, the Probity Auditor advised ANAO that:

We did give serious consideration to the issue of the cumulative effect. We also sought the views of the CEO and officers of OASITO as to this possibility. We concluded that this was unlikely.

We were never requested to provide written advice on this aspect. Had we been requested to do so we would have been reluctant. We (like you) would have had insufficient evidence to form an opinion. We therefore would have been incapable of supporting that opinion.

### *Disclosure and late lodgement*

**4.82** In the context of the disclosure event, the Probity Auditor made a number of references to maintaining the closing time for the 2 August lodgement, including in his written advice to OASITO of 29 July 1999<sup>195</sup> and the record of the 30 July meetings with the tenderer CEOs<sup>196</sup> (see paragraphs 4.35 and 4.51) In that context, AGS advised ANAO that:

...it may be arguable that the admission of the late tender when considered in isolation did not have a significant potential to impact upon the credibility of the evaluation outcome. However, that significance increases when the admission is considered in conjunction with representations made to tenderers about the closing time and date in the previous week in the context of the resolution of another probity issue.

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<sup>195</sup> The Probity Auditor's file note of a discussion with OASITO on 29 July 1999 regarding the disclosure event records that: 'We also agreed that the tender pricing close should not be extended as this could give the wrong impression to IBM GSA'. Similarly, the written advice from the Probity Auditor to OASITO of 29 July 1999 included a statement that: 'It is currently envisaged that the pricing re-bids are due at 9.00 am on 2 August 1999. I do not believe that it would be appropriate to extend this as the violation should not be seen to effect the process'.

<sup>196</sup> The file note of the discussions on 30 July 1999 between OASITO and the CEOs of the other two tenderers about the disclosure, prepared by OASITO and co-signed by the Probity Auditor, records a statement by the Probity Auditor that: '...it was appropriate that the 2<sup>nd</sup> of August be retained as the closing date for lodgement of any refinements to offers as this did not provide any additional time to formulate their new pricing had they seen anything of relevance not referred to in the Statutory Declaration'.

**4.83** However, the internal OASITO minute regarding the late lodgement made no reference at all to the earlier disclosure event involving the same tenderer<sup>197</sup> or to relevant comments about subsequent tender lodgement made by the Probity Auditor at the time of that event.<sup>198</sup> The minute argued that, because the other tenderers' information was unopened and remained under the control of the Probity Auditor, OASITO had been able to ensure that there was no leakage of the revised information to IBM GSA while it was preparing its documentation for lodgement. However, advantage in a late tender situation can also arise from having additional time to compile a submission or to incorporate newly acquired information should that have been the case. At the time of determining whether the late offer would be accepted into the evaluation, it is not apparent that OASITO would necessarily have been aware of the nature or extent of changes in the revised pricing submitted that day by the other two tenderers from that previously tendered by them. In that context, it would seem reasonable to have made reference in the documentation on the late lodgement to the fact that OASITO had, the previous week, provided IBM GSA with a disk containing the other tenderers' previously tendered pricing. Indeed, this would have been prudent given that OASITO had advised the Minister on 30 July 1999 that:

With revised pricing due from bidders by 9.00 am on Monday 2 August it is the probity auditor's view that we should maintain the timing to minimise any opportunity to gain any competitive advantage in the event that IBM has examined the confidential material...

**4.84** Although the Probity Auditor's advice to OASITO on the disclosure event included a reference to the 9.00 am closing time, this was in the context of the appropriateness of extending the due time for tenders. There is no evidence of a request for an extension to the lodgement time having been received from IBM GSA, or of OASITO formally advising it of any such extension. On that basis, it can be argued that there was no formal extension provided. Rather, IBM GSA was late in lodging its revised bid and acceptance of the bid was considered in that context.

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<sup>197</sup> In August 2002, the Legal Adviser advised ANAO that: 'We discussed the issue with OASITO on 2 August in the context of whether IBM GSA was getting preferential treatment (see also [relevant paragraph] our advice of 2 August 1999).' [see footnote 194 of this report for the relevant part of the advice referred to].

<sup>198</sup> Finance advised ANAO in May 2002 that: '...the letter to Chief Executives of the group agencies advising them of the disclosure event was signed the same day. The issues associated with these events (and their cumulative effect) were clearly in the minds of those involved at the time'.

**4.85** However, in the interests of transparency, ANAO considers that it would have been prudent for OASITO to have obtained documented confirmation from the Probity Auditor that this interpretation accorded with the Probity Auditor's previous advice, and that no additional probity concerns arose from the late lodgement by IBM GSA. This may have assisted in avoiding the debate that arose in the course of the Senate Committee's inquiry regarding this issue.<sup>199</sup>

**4.86** Finance advised ANAO in May 2002 that: '...the Commonwealth clearly understood that it had the ability to exercise its discretion to accept late tenders or re-priced offers'. In August 2002, the Legal Adviser confirmed to ANAO that:

There was no extension of the closing time. The issue was whether OASITO could and should exercise its discretion to accept information lodged between 3 and 5Ω hours late given the ambiguities in OASITO's instructions to tenderers re the time by which this information was required to be lodged.

### *Disclosure, late lodgement and price movements*

**4.87** OASITO acknowledged in its 30 July 1999 advice to the then Minister for Finance and Administration the potential for perceived cumulative effects to arise from the proximity of the disclosure event to subsequent price movements. OASITO advised that one key sensitivity emerging from the situation was the likelihood that IBM GSA would reduce its pricing substantially on 2 August 1999. OASITO recognised that, if this eventuated, there may be a temptation to draw conclusions that the price movement had been as a result of the error.

**4.88** OASITO advised the Minister that the prospect of a substantial price reduction had been highlighted by IBM GSA on several occasions prior to the disclosure event of 28 July 1999 (see paragraphs 3.105 to 3.106 and 4.20). OASITO noted that: 'We have a prior file note of a discussion with IBM on 20 July 1999 that confirms that their repricing intent preceded this incident'. The file note was of a meeting between the recently appointed Chief Executive of IBM Australia (one of the three joint venture owners of IBM GSA), and OASITO

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<sup>199</sup> See, for example, the discussion of this matter in the Senate Committee's second interim report on its inquiry, Senate Finance and Public Administration References Committee, Inquiry into the Government's Information Technology Outsourcing Initiative, op. cit., pp. 29–30.

senior executives.<sup>200</sup> A similar position was reflected in an OASITO note of a meeting with IBM GSA on 27 July 1999 which records that:

IBM GSA stressed that it was canvassing all options with the view to reducing its price on 2 August 1999. It expressed some confidence that it would be more competitive with pricing'.<sup>201</sup>

**4.89** These records provide some basis for concluding that the movement in IBM GSA's pricing on 2 August 1999 was not a direct result of the disclosure event. However, given the sequence of events, it would have been beneficial for OASITO to have sought to complement those initial indicators with additional inquiries and assessments to provide further support for its position.

**4.90** There is no documentation of the Minister having been provided with any subsequent advice regarding the nature of the actual price movements that arose from the 2 August round of bids, or of the late lodgement by IBM GSA. There is also no evidence of OASITO examining the pricing lodged in the final re-pricing exercise of 2 August 1999 in order to be satisfied that there was no apparent connection between the information disclosed and the price movements, nor of the Probity Auditor recommending such analysis be undertaken (see paragraphs 4.77 and 4.163).<sup>202</sup>

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<sup>200</sup> The file note records that the meeting had been sought by IBM Australia as an introductory meeting, and to seek feedback, in broad terms, on IBM's performance to date under the IT Initiative. It records that IBM Australia advised that it was working very hard to improve its response to the Health Group tender in the key areas of 'price, where he flagged the potential for IBM to offer material reductions; Industry Development, where IBM is working hard to improve its SME participation; and Services Agreement, where IBM would look to match the Commonwealth's position wherever possible'. IBM GSA subsequently made substantial improvements in each of those areas of its final revised offer, resulting in a significant improvement in its relative competitive position.

<sup>201</sup> Although the file note states that IBM GSA had requested the meeting to discuss its industry development offering, it also took the opportunity to explore other issues relating to its tender. One of those issues was the acceptability of a proposed equipment leasing arrangement. The offer lodged by IBM GSA on 2 August 1999 included a revised leasing structure which contributed significantly to the price reductions made.

<sup>202</sup> In discussions with ANAO, the Probity Auditor advised that OASITO had been given oral advice that analysis of the IBM GSA offer should be undertaken to ascertain whether there was any indication that the information on the disk had been used, and had received oral advice back from OASITO that there was no indication of that.

**4.91** In particular, it would have been prudent for further inquiries to have been undertaken of IBM GSA in regard to its internal pricing approval process. If it could be established that the pricing lodged on Monday 2 August 1999 had been substantively finalised prior to the disclosure event on the preceding Wednesday, 28 July 1999, much of the potential individual and cumulative implications of the disclosure and subsequent late lodgement could be appropriately put aside. As noted, the OASITO internal minute regarding the late lodgement by IBM GSA on 2 August did not refer to the disclosure event, but it did comment that:

One possible concern was that IBM GSA had had additional time to complete its adjustment process, but given the strong likelihood that the revised pricing information would have been signed off within IBM GSA most likely by late last week, there appears to have been no practical advantage for IBM GSA in this situation.

**4.92** OASITO informed the Senate Committee on 19 June 2001 that its assumptions about internal clearance processes for bidders were 'based on more than a decade of experience relating to the preparation of and internal approval procedures relating to large proposals from industry'.<sup>203</sup> In discussions with ANAO, officers of the former OASITO confirmed that no specific inquiries were undertaken of IBM GSA in this regard.

**4.93** IBM GSA advised ANAO in a letter of 8 March 2002 that:

...given the internal approval and planning cycle, it is our view and belief that IBM GSA would have practically been unable to adjust its pricing within a period of less than a week.

**4.94** IBM GSA further advised that its internal processes did not require the retention of pricing and other approvals for each tender response in the Health Group tender process; rather it only required evidence of relevant approvals for final contract signing (which occurred in late 1999). IBM GSA advised that, despite extensive enquiries and searches, it had been unable to find any specific contemporaneous document showing pricing approval for the 2 August 1999 bid response.<sup>204</sup> IBM GSA also confirmed to ANAO in that letter that the enquiries and searches did not reveal any e-mail or other document to indicate that any adjustment was made to the pricing of the 2 August 1999 bid response on or after the events of Wednesday, 28 July 1999. ANAO notes that the potential to obtain any relevant documentation from IBM GSA in this regard would have been significantly greater if inquiries of this nature had been undertaken by OASITO at the time of the events in question.

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<sup>203</sup> Senate Finance and Public Administration References Committee, Final Report on the Government's Information Technology Outsourcing Initiative, op. cit., p. 77.

<sup>204</sup> IBM GSA advised that it believed that this was due in most part to the fact that the then bid pricing manager and his then manager are no longer employed by IBM GSA and IBM GSA no longer has a record of their e-mail.



**4.95** The Senate Committee commented in its final report that it believed that: ‘...assumptions, even those based on years of experience are a poor substitute for thorough checking and well documented procedures...’<sup>205</sup> ANAO concurs with this view, and considers that where opinions or assertions are to be taken into account in determining the outcome of a matter relating to the probity of a tender process, the transparency and accountability of that process would be better served by the officers involved ensuring there is adequate and reliable evidence to support those opinions or assertions. Alternatively, the basis of the opinion or assertion, and the extent to which reliance can be placed upon it, should be clearly identified in the relevant documentation.

**4.96** ANAO considers that management of the probity aspects of the Health Group tender would have been improved by documented consideration of the broader cumulative effect of events over the course of the tender. This would have been of particular assistance in terms of enhancing the perception that due process was properly followed in relation to all parties.

## Informed decision-making

**4.97** As noted in Chapter 1, one of the key objectives of this performance audit was to examine the advice to the decision-maker leading to the selection of the preferred tenderer. As decision-makers, the relevant Ministers and the Boards of the HIC and MPL were reliant upon the advice provided to them through: the evaluation reports, sign-offs and resolutions provided by the members of the Evaluation, Steering and Options Committees; the sign-offs provided by expert advisers; and through OASITO in its overall coordinating role.<sup>206</sup> In this respect, ANAO noted aspects of the approach taken in the management of the probity aspects of the Health Group tender that appeared to limit the level of assurance potentially available from the advice and sign-offs provided.

## Expert sign-offs

**4.98** Agencies cannot substitute the sign-off of expert advisers for their own accountabilities and obligations in regard to the proper conduct of competitive tendering exercises. Both the Government and Parliament have observed at various times that agencies cannot ‘outsource accountability’. However, certain expert advisers engaged in large scale tender processes are frequently contracted to provide sign-offs to demonstrate their involvement in the process and to document conclusions reached from their participation.

<sup>205</sup> Senate Finance and Public Administration References Committee, Final Report on the Government’s Information Technology Outsourcing Initiative, op. cit., p. 77.

<sup>206</sup> In August 2002, the Legal Adviser advised ANAO that: ‘Officials from each Agency also briefed their agency and relevant Ministers. We understand that the Strategic Adviser also briefed agencies and Ministers.’

**4.99** Sign-offs were provided by the Legal Adviser, the Probity Auditor, and the Strategic Adviser at various stages of the Health Group tender, including at the completion of the evaluation process. However, there does not appear to have been a shared and consistent understanding across all relevant parties, including the relevant decision-makers and responsible Committees, as to the scope and nature of the sign-offs that were to be provided and, therefore, the level of assurance that could reasonably be derived from them. The report of the Finance internal audit review noted that the utilisation of a probity auditor and the acquisition of legal sign-offs are consistent with better practice, but that it had also noted:

... significant weaknesses in the appointment and use these auditors/advisers that potentially expose OASITO to criticism in connection with the probity structures around the Process. These largely relate to a lack of clarity regarding the basis upon which sign-offs were obtained, and the form in which sign-offs were received...

#### *Legal Adviser sign-off*

**4.100** Their Consultancy Agreement with OASITO required the Legal Adviser to provide OASITO with such legal advice as was required from time to time, including in relation to probity. The Agreement did not specify a general oversight role in respect of the conduct of individual tender processes.<sup>207</sup> Nor did it detail any specific requirement for the Legal Adviser to provide sign-offs, nor the form such sign-offs should take. The Legal Adviser was required to provide OASITO with written reports as requested from time to time.

**4.101** OASITO developed the form of suggested sign-offs to be provided by the Legal Adviser in the course of the first tenders that adviser was involved in, Group 5 and ATO (each completed in March 1999).<sup>208</sup> For the Health Group tender, the Legal Adviser provided sign-offs in respect of aspects of the RFT, tender evaluation process, re-assessment of savings by Finance, and completion of final contract negotiations. These sign-offs included an additional form of sign-off provided at the conclusion of the evaluation process not provided in earlier tenders. The sign-offs provided by the Legal Adviser were qualified by the extent of their involvement in the tender process and reliance upon advice and assertions from OASITO.

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<sup>207</sup> In August 2002, the Legal Adviser advised ANAO that: 'We did not have a general oversight role in respect of the conduct of individual tender processes. This task rested with OASITO and the Strategic Adviser.'

<sup>208</sup> In August 2002, the Legal Adviser advised ANAO that: 'OASITO provided us with the form of sign-off they required (during the ATO process). We understand this form was agreed in the Cluster 3 process, which predated our involvement in the ITO initiative.'

**4.102** On 30 August 1999, the Legal Adviser provided OASITO with a confirmation regarding matters such as the negotiation of legal and commercial issues and the draft Services Agreement with each tenderer. Records maintained by the Legal Adviser indicate that on 2 September 1999 OASITO asked for the legal sign-off to be expanded to include a confirmation that the tender process had been conducted in accordance with the RFT. The Legal Adviser recorded that their advice to OASITO was that they could not do that, as they did not have knowledge of how the whole process had been conducted, but could sign-off on the legal negotiations that they had conducted.<sup>209</sup> The Legal Adviser recorded that OASITO wanted a broader coverage than that, but that the Legal Adviser had indicated to OASITO their understanding that OASITO had a sign-off from its probity advisers. A further sign-off was issued by the Legal Adviser on 2 August 1999<sup>210</sup>, which included an additional confirmation that:

the legal negotiations that were attended by [us], OASITO and representatives of each Group Agency and their respective legal advisers were conducted in accordance with the rules of the RFT. We are not able to comment on the other negotiations with Tenderers as we have no knowledge about their conduct but we note that OASITO has obtained a sign off on RFT probity issues from its probity advisers.<sup>211</sup>

### *Probity Auditor sign-off*

**4.103** In Audit Report No.9 2000–01, ANAO found that the nature of the sign-off to be provided by the Probity Auditor was not stipulated and agreed prior to the commencement of the engagement and was not included in the contract for the engagement.<sup>212</sup> A May 1998 amendment to the schedule of services required of the Probity Auditor replaced a reporting deliverable with a series of four milestones at which a ‘sign-off’ was to be provided (see paragraphs 4.133 to 4.134). The Probity Auditor provided three of the four required milestone sign-offs, but did not provide the fourth (that the recommendation to the Minister accorded with the final report). Nor was the Probity Auditor’s sign-off on the ID evaluation methodology obtained (see paragraphs 3.90 to 3.97).

<sup>209</sup> In August 2002, the Legal Adviser advised ANAO that: ‘We were only involved on the negotiation of the terms and conditions of the Services Agreement. We provided ad hoc legal advice as requested. The Strategic Adviser ran the negotiations on [Statement of Work], Service Levels and Price Schedules. In the Health transaction they also negotiated the performance guarantee.’

<sup>210</sup> The 2 September 1999 sign-off made no reference to the sign-off provided on 30 August. Therefore, it is not clear whether it was intended to replace the earlier sign-off.

<sup>211</sup> A further sign-off was provided by the Legal Adviser on 6 December 1999 confirming that the Health Services Agreement had been finalised in accordance with Commonwealth instructions. The Legal Adviser also confirmed that the Services Agreements for HIC and MPL, for which they maintained document control, were not amended without instructions to do so. The Legal Adviser noted that they had not had carriage of technical or pricing issues.

<sup>212</sup> Audit Report No.9, op. cit., p. 90.

**4.104** The RFT milestone sign-off provided by the Probity Auditor was limited to two parts of the RFT—Tender Evaluation Criteria and Due Diligence Procedures for Prospective Tenderers.<sup>213</sup> The sign-off provided by the Probity Auditor on 24 November 1998 made no reference to other sign-offs. The sign-offs on the RFT by the Legal Adviser, Strategic Adviser and two of the three agencies were prepared after that date.

**4.105** The sign-off provided by the Probity Auditor at the completion of the Health Group evaluation was similar in form and content to those provided in respect of earlier tenders under the IT Initiative, including Cluster 3 which predated the change in the schedule of services. The sign-off was broad and general in its terms, stating that the Probity Auditor confirmed that:

(a) I am satisfied that the Reports of the Evaluation Teams (and supporting materials) present an assessment of the Health tenders that are consistent with the Evaluation Criteria specified in the Health Group Request for Tender and the evaluation methodology approved<sup>214</sup> for this project; and

(b) I am not aware at this time of any circumstances arising out of the evaluation and parallel negotiation phases of the Health competitive tender process which present unresolved probity issues or concerns.

### *No sign-off of complete tender process*

**4.106** None of the sign-offs provided by advisers to the Health Group tender represented a clean sign-off on the tender process as a whole.<sup>215</sup> ANAO's

<sup>213</sup> The revised schedule of services identified a required milestone sign-off of 'RFT', as well as a critical task to: 'Review RFT, especially in respect of Evaluation Criteria and Disclaimers'. On 4 November 1998, OASITO forwarded a draft sign-off in respect to the Health Group RFT to the Probity Auditor for signature. The draft sign-off sought confirmation by the Probity Auditor that he had assisted OASITO and the Group Agencies in the preparation of the RFT concerning Tender Evaluation Criteria and Due Diligence Procedures for Prospective Tenderers, and was satisfied that the relevant provisions adequately addressed probity management considerations. OASITO recorded a conversation with the Probity Auditor on 5 November 1998 to the effect that: '...he will not/cannot sign this as he had no role in preparing the RFT, nor had he read it. I noted the probity related issues of the RFT but he didn't think it was relevant'. On 13 November 1998, OASITO requested that the Probity Auditor review two sections of the RFT which dealt with matters of probity and evaluation and which were potentially sensitive. These were the two sections on which a probity sign-off had been earlier requested. OASITO advised the Probity Auditor that it had taken on board the Probity Auditor's earlier comments on a sign-off and provided a modified draft sign-off to better accommodate his involvement in the project. The second draft sign-off proposed by OASITO sought the Probity Auditor's confirmation that he was satisfied that the two sections of the RFT identified addressed probity management considerations, and that he had been consulted on probity issues throughout the preparation of the Health Group RFT and was comfortable that probity issues had been addressed appropriately in a timely manner. The sign-off ultimately provided by the Probity Auditor on 24 November 1998 simply stated that he had reviewed the two identified sections of the RFT and had not identified any probity issues in respect of those parts of the Health Group RFT.

<sup>214</sup> As discussed in Chapter 3, the ID evaluation methodology was not submitted to the Probity Auditor for sign-off that it was consistent with the RFT.

<sup>215</sup> Finance advised ANAO in May 2002 that: '...The Probity Auditor had a wide ranging role in IT Outsourcing transactions and was heavily involved in the disclosure event and these facts were reflected in the brief'. Finance further advised that the sign-offs are appropriately limited to the roles the advisers were contracted for and provide a reasonable level of assurance in relation to legal and probity matters.

examination of the tasks described in the consultancy agreements with the Legal Adviser and the Probity Auditor, and of the available evidence regarding the nature and extent of involvement or oversight by those advisers of the various aspects of the tender process, confirmed that neither appeared to have been in a position to provide a final sign-off on the complete process. However, it is apparent that not all relevant parties were adequately aware of this, nor of the qualifications that necessarily applied to the sign-offs provided as a result.

**4.107** In interviews with ANAO, a number of the members of the Evaluation, Steering and Options Committees indicated that it had been their understanding that the legal and probity sign-offs could be relied upon as a clean sign-off of the overall tender process. Members indicated that they had been given no advice or indication that the scope of the sign-offs was qualified or limited in any way. In August 2002, the Legal Adviser queried the advice given to ANAO:

...at least for the Evaluation and Steering Committees in relation to our role. Those Committees knew what we were/were not involved in. In addition, each agency had also engaged its own legal advisers. We did not have dealings with the Options Committee.

**4.108** ANAO understands from advice received that the Office of the then Minister for Finance and Administration was kept abreast of developments in the Health Group tender process, and in the IT Initiative more broadly. However, ANAO did not sight evidence of OASITO advising the then Minister of any limitation or qualification in the scope of the legal and probity sign-offs provided.<sup>216</sup> In referring the Options Committee's recommendation for the preferred tenderer to the Minister on 8 September 1999, OASITO advised that: 'Appropriate 'signoff' on the process and findings have been provided by the key parties involved in the evaluation and negotiation process'. Finance advised ANAO in May 2002 that:

Qualifications limiting sign-offs to the role performed by advisers is to be expected. The signoffs from the key advisers (Legal, Probity and Strategic) therefore appropriately covered the issues and processes in which they were involved.<sup>217</sup>

<sup>216</sup> The report of the Finance internal audit report found that: '...in light of our concerns with regard to the form, content and nature of the sign-offs provided by the probity auditor and the legal adviser ...we believe that the Minister could have been better informed of the nature of the sign-offs that he could rely on, and any potential issues with regard to that reliance.' In this regard, the report noted that: '...OASITO advised the Minister based on common practice in the Commonwealth at the time.'

<sup>217</sup> ANAO could not locate in the OASITO records made available for review the sign-off on the Health Group evaluation phase provided by the Strategic Adviser. ANAO notes that the final sign-offs provided by the Strategic Adviser in respect of other tenders under the IT Initiative were qualified to specifically exclude areas for which the Strategic Adviser did not take responsibility or provide advice.

**4.109** OASITO advised the Minister that sign-offs had been provided by a number of key parties including the Legal Adviser and the Probity Auditor, but copies of the sign-offs were not provided for the Minister's examination.<sup>218</sup> OASITO also advised the Minister that the process had been monitored throughout by the Probity Auditor and the Legal Adviser for probity and legal robustness in order to protect against any challenge of bias. In August 2002, the Legal Adviser advised ANAO that: 'We confirm that we provided ad hoc legal advice and were not responsible for 'monitoring' the RFT process.'

**4.110** In a February 2000 brief to the then Minister's office regarding the disclosure event, OASITO stated that:

...The signoff provided by the Probity Auditor for the project confirmed that no unresolved probity issues remained. This signoff covered the Health project in its entirety—including the events described in this brief and its attachments.

### *Clarity of scope of sign-offs*

**4.111** Questions about the nature of the legal and probity sign-offs provided for the Health Group tender arose in the context of the Senate inquiry into the IT Initiative. The Chairman of the Senate Committee wrote to the then Minister on 8 June 2001 asking that he re-consider an earlier decision to decline, on public interest grounds, to provide the Senate Committee with access to unexpurgated copies of the evaluation reports for the Health Group tender. The Chairman advised that the information contained in the requested documents appeared to be central to its investigation of serious questions that had been raised about the probity of that process. Finance and OASITO provided the then Minister with a joint briefing on the Senate Committee's request on 14 June 2001. The briefing stated, inter alia, that OASITO was not aware of any outstanding probity issues in relation to the Health Group project, and that: '...Full probity and legal sign-offs were obtained to the effect that there were no outstanding probity/legal issues at the end of the project...'.

**4.112** As noted at paragraph 4.39, OASITO had contacted the Legal Adviser in May 2001 seeking assistance in compiling documents requested by the Senate Committee. A draft letter provided to OASITO by the Legal Adviser on 4 June 2001 stated that:

In relation to broader 'sign offs' we expressed our 'concerns' about the conduct of the Health process on a number of occasions. We were instructed not to take the matter further. However, an outcome of this is that no clean process 'sign off' was given by [us] in respect of the Health Group RFT process.

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<sup>218</sup> This is in contrast to the approach adopted for the ATO tender, where the sign-offs provided by the Legal Adviser, Strategic Adviser and Probity Auditor were attached to the Brief provided to the Minister recommending the preferred tenderer.



**4.113** As was the case with the paragraph quoted earlier (see paragraphs 4.39 to 4.40) relating to the option of terminating the tender following the disclosure event, this paragraph was excluded from the final version of the Legal Adviser's letter. However, on 15 June 2001, the Legal Adviser orally confirmed to OASITO that an 'overall process sign-off' had not been provided.

**4.114** At the request of the then Minister's office, the then Secretary of Finance met with the Legal Adviser on 16 June 2001 to clarify the status of their 4 June 2001 letter. The Secretary advised the Minister's Office that the meeting had identified that:

- the draft cover letter and copies of documents on file were forwarded to OASITO in response to a request for a final legal sign-off on the Health Tender process. The Secretary noted that they were advised that the material was not forwarded in response to a simple request for copies of documents on file;
- there has been no final legal sign-off by the Legal Adviser on the Health Tender process; and
- the reason for submitting the draft was to remind OASITO that there had been no final sign-off by the Legal Adviser, so that OASITO did not inadvertently mislead the Senate or other parties.

**4.115** In August 2002, the Legal Adviser advised ANAO that:

We confirm the dot points except to note that our sign offs were finals in the areas that we were to sign off on. However, in the note in the draft, we were clarifying that we did not give an overall process sign off—as we were not involved in the overall process. We included the note in the draft letter provided to OASITO as there had been a turnover in OASITO personnel between the Health Group ITO process and June 2001—we were concerned to ensure there was no confusion about what our role was in the Health process. We were also concerned, as we had been asked for a new sign off over 2 years after the events in question...

**4.116** In May 2002, Finance advised ANAO that: 'The request made to the Legal Adviser by OASITO sought copies of the sign offs originally provided for the Health Group transaction. Other interpretations are not correct.'

**4.117** On 18 June 2001, the then Minister suggested that Finance request the Probit Auditor to provide a report on the issues discussed with the Legal Adviser. Finance's letter of the same day to the Probit Auditor noted that, in recent discussions, the Legal Adviser had advised Finance that because of the nature of their involvement in the Health Group process, a final legal sign-off to the process had not been provided by the Legal Adviser.<sup>219</sup> Finance requested the Probit Auditor's views on this matter, in particular advice on whether and,

<sup>219</sup> In August 2002, the Legal Adviser advised ANAO that: 'We provided a final legal sign off in respect of our limited role. We did not provide a legal sign off on the entire RFT process as we were not involved in the entire process. OASITO was aware of the scope of our sign off in 1999.'



if so, how the Probity Auditor took this situation into account in his probity review. On 27 June 2001, Finance provided the then Minister with the Probity Auditor's report in which the Probity Auditor advised that: 'Our contract with OASITO did not provide for an overall probity sign-off on the entire process for the Health Tender. We were contracted only to supply milestone sign-offs'.

**4.118** The Probity Auditor further advised that as his contract did not require a sign-off on the entire process, he did not require a whole of process sign-off from the Legal Adviser, and that he was not aware as to whether the Legal Adviser's contract with OASITO required one. The Probity Auditor's report noted that, in respect of the evaluation, the Legal Adviser did provide a sign-off report qualified to the extent of their participation. The Probity Auditor also stated that:

Our discussions and inquiries with [*the Legal Adviser*] throughout the process did not highlight any issues of probity which were unresolved arising out of the evaluation and parallel negotiation phase...

**4.119** In August 2002, the Legal Adviser advised ANAO that:

Other than Steering Committee Meetings we do not recall other meetings where the Legal Adviser and Probity Auditor were both present. It was not OASITO's practice for the advisers (except in respect of dealings with the Strategic Adviser) to deal with each other outside OASITO formally convened meetings.

**4.120** Finance advised the then Minister that it had signed the joint brief of 14 June 2001 on the basis of verbal advice from OASITO that a final legal and probity sign-off had been obtained by OASITO. Finance further advised that the Probity Auditor's report had provided new information to Finance that only milestone sign-offs were obtained from advisers, and that the legal and probity sign-offs were qualified by the extent of the involvement of those advisers in the process. Finance advised the then Minister:

It is not clear to us that any adviser provided a final sign-off on the complete process. Conceptually an adequate level of assurance could be provided if the advisers had been involved in the entirety of the process and had given a series of milestone sign-offs. However, it is clear (at least in the case of the probity and legal advisers) that they were not involved in all aspects of the process, and their sign-offs were, therefore, qualified.

**4.121** Finance further advised the then Minister that, on the basis of this new information, the department considered it appropriate to have an independent review undertaken of the Health Group tender process, and recommended that the Minister ask the Secretary of Finance to arrange for Finance's Internal Audit Unit to undertake a review of the Health Group tender process. The option of referring the matter to the Auditor-General was also canvassed. The Minister requested that an internal audit review occur. The review concluded in July 2002 (see Figure 1.2 for overall findings of the agreed-procedures review).

#### 4.122 Finance advised ANAO in May 2002 that:

...the Legal Adviser conducted or was involved in legal negotiations, and probity issues arising through the course of the process were referred to the Probity Auditor for action or advice. The signoffs obtained reflected these roles and were complete in that respect...discussions and inquiries with (the Legal Adviser) throughout the process did not highlight any issues of probity which were unresolved arising out of the negotiation and parallel negotiation phase.<sup>220</sup>

#### 4.123 In August 2002, the Legal Adviser advised ANAO that:

We were not aware at any time during the Health process that there was a lack of understanding by OASITO about the scope and nature of the sign offs to be provided by us.

#### 4.124 The Legal Adviser further advised ANAO that OASITO had provided the form of sign-off and all changes to that form were discussed with OASITO. However, the Legal Adviser also advised that:

At the outset, it can be noted that OASITO used a Strategic Adviser. To our knowledge, the Strategic Adviser was heavily involved in all decision making by OASITO. The other advisers were accordingly involved on a more ad hoc task specific basis. This approach was adopted by OASITO and the Strategic Adviser for the IT&T Outsourcing Initiative including the Health transaction. While this model may be utilised by clients it has the effect that the other advisers do not have full knowledge of the transaction. This in turn affects their ability to provide advice and signoffs in relation to the transaction. We raised the issue of lack of knowledge about what was happening in the Health transaction on a number of occasions with OASITO.<sup>221</sup>

#### 4.125 Decision-makers place considerable reliance on the sign-offs provided by expert advisers in forming conclusions about the tender outcome. It is important, therefore, that they are fully informed as to any qualifications or limitations that may attach to the scope of a sign-off. The experience of the Health Group tender highlights the need for agencies to ensure that there is a clear understanding, on the part of all parties at the commencement of a tender process, as to the level of assurance the Commonwealth will be seeking from an adviser. This is critical to ensuring that the roles and tasks to be played by the advisers are appropriately aligned with that expectation. An effective means of accomplishing this outcome is for the nature or form of the sign-offs to be agreed between the parties before the process commences and incorporated into the consultancy agreement.

<sup>220</sup> Finance further advised ANAO that: 'The level of assurance expected from the advisers concerned was clear to the contracting party as these advisers had provided signoffs for similar transactions during the two years prior to the Health Group completing its evaluation. Signoffs were broadly agreed between the parties based on the previous transactions. Roles and tasks were aligned to signoffs'.

<sup>221</sup> The Legal Adviser also noted that each of DHAC, the HIC and MPL had engaged their own legal advisers, and that the HIC also engaged technical advisers.

## Clarity of role—probity auditor or adviser

**4.126** The basis on which probity advice will be provided, and the means by which the appropriateness of the actions taken will be subsequently audited, is an area in which particular clarity is needed prior to commencing the tender process. It is essential that all parties have a clear understanding of the scope of the probity engagement, the deliverable(s) expected to be provided, and the nature of the inquiry, analysis or review tasks that will be undertaken in order to support any opinions or conclusions expressed.

**4.127** Probity auditors and/or probity advisers are sometimes used interchangeably, but there can be significant differences in the role they are intended to play. The essential characteristic that sets an ‘auditor’ apart from an ‘adviser’ is the extent to which they are self-directing. Once engaged, an auditor would be expected to independently establish a program of audit testing and observation based upon articulated criteria (or probity principles) having regard for the entity’s business risks. Through that process, the auditor seeks to establish sufficient relevant and reliable evidence to be able to express an objective opinion in a report, either at the end of the process or at relevant stages. An adviser would typically be expected to provide advice as requested, including on how specific issues that arise should be addressed.

**4.128** It is important, therefore, to have clarity as to which role a probity expert is being engaged to perform. A particular issue, highlighted by the use made of the Probity Auditor in the Health Group tender, is the care that needs to be taken in obtaining advice from a probity auditor on the resolution of probity issues that may arise in the course of the tender. This issue has implications for the level of independent assurance that can be derived from a sign-off subsequently provided by a probity auditor.

### *Role of a probity auditor*

**4.129** In this regard, ANAO notes that a range of views have been expressed regarding the extent to which a ‘probity auditor’ should become actively involved in advising those conducting a tender on how probity problems should be addressed. The Probity Policy issued by the Victorian Department of Treasury and Finance states that the probity auditor should play a pro-active role in advising the project team on how to solve any problems that may arise during the tendering process.<sup>222</sup>

**4.130** The South Australian Auditor-General, in a report on the electricity business disposal process, noted that, although a probity auditor may provide

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<sup>222</sup> The policy acknowledges, however, that in order to maintain independence and objectivity, the probity auditor cannot participate in the commercial decision-making process (ie the evaluation of bids, negotiation with bidders or the selection of preferred tenderers); Department of Treasury and Finance, Victoria, *Probity Policy*, 2001.

comment on how to manage the integrity of a sale or tender process as fairly and transparently as possible, the probity auditor is not the legal adviser or probity adviser, and therefore is not responsible for advising on how to conduct the process or how to deal with issues, including probity issues that arise during the process.<sup>223</sup> The report also noted that in discharging their responsibilities, the probity auditor may receive, investigate, monitor, and report on any allegations of probity breaches or concerns raised by bidders. The South Australian Auditor-General's view was that, notwithstanding that the probity auditor is not performing the probity adviser role:

...it is still intended that the probity auditor raise identified probity issues as soon as possible so as to minimise their adverse impact. It is not intended that the audit be conducted only after the entire process has been completed.<sup>224</sup>

**4.131** The *Probity Guidelines for Tendering and Contracting* issued by the Tasmanian Department of Treasury and Finance in May 1999 also acknowledge that there is a distinct difference between the two roles. However, they state that the probity auditor's role is more generally an *ex post* role that audits the process by way of observing and reviewing after the process is completed. In contrast, the guidelines show the probity adviser's role as more generally an *ex ante* role, that is pro-actively being involved prior to embarking on a tender; providing advice on probity issues which may arise; and providing advice on strategies to overcome potential problems.<sup>225</sup>

### *Role of a Probity auditor to IT Initiative*

**4.132** The Probity Auditor to the IT Initiative, engaged in October 1997, provided probity services in respect of the Health Group, which commenced in November 1998. In March 1998, OASITO had asked the then Minister for Finance and Administration to note that it was redefining the role of the Probity Auditor as it considered that a Probity Auditor intensively involved in auditing the probity and accountability processes was no longer required. OASITO advised the Minister that, as the procedures and principles which the Probity Auditor had set up for the initial Cluster 3 tender process were now largely entrenched in the culture and practices of OASITO, it would now be more appropriate to re-define the Probity Auditor role to that of an adviser on specific issues as they arose. The Minister responded that he supported an independent probity auditor but believed that the work could be restricted to a sign-off at key stages of each project.<sup>226</sup>

<sup>223</sup> South Australian Auditor-General, *Electricity Business Disposal Process in South Australia: Arrangements for the Probity Audit and Other Matters: Some Audit Observations*, 1999, Part 3, p. 13.

<sup>224</sup> *ibid.*

<sup>225</sup> Tasmanian Department of Treasury and Finance, *Probity Guidelines for Tendering and Contracting*, May 1999, p. 6.

<sup>226</sup> In August 2002, the Legal Adviser advised ANAO that: 'The interactions between OASITO and the Minister in relation to the role of the Probity Auditor...were not known to us. Similarly, we were not involved in the engagement of the Probity Auditor nor requested to advise on the role of the Probity Auditor.'

**4.133** Various aspects of the engagement of the Probity Auditor to the IT Initiative examined in Audit Report No.9 2000–01 were also relevant to the Health Group tender process, which was completed prior to the conduct of that audit. As noted in Audit Report No.9, a revised schedule of services agreed with the Probity Auditor by OASITO in May 1998 involved the removal of any specific reference to an ‘audit’ role.<sup>227</sup> The requirement to prepare a report at each specified phase of the process was replaced with a requirement for milestone sign-offs, which were poorly defined and identified only as: RFT; Evaluation criteria; Final report accords with RFT and evaluation criteria; and, Recommendation to Minister accords with final report. New requirements were also introduced to provide ad hoc advice on issues of probity and to prepare and update probity protocols. There was no evidence available to ANAO to indicate that the Minister was advised as to the nature of the amended schedule of services.

**4.134** Audit Report No.9 reported that there had been no articulation of the independent audit testing the Probity Auditor planned to undertake as the basis for providing the required milestone sign-offs, or of the probity principles that would be applied in forming those assessments.<sup>228</sup> The 2002 report of the Finance internal audit review similarly found that there was no guidance, documentation or formalisation of the ‘criteria’ for the revised, milestone probity sign-off provided by the Probity Auditor in the Health Group tender.

**4.135** Although continuing to be officially referred to as the ‘Probity Auditor’, including in advice to the Minister, the role envisaged under the revised schedule of services appears to have been more in the nature of an adviser. This issue was canvassed at some length by the Senate Committee in its inquiry into the IT Initiative. The Senate Committee found that the primary role performed by the Probity Auditor in the Health Group tender had been that of a probity ‘adviser’ providing, where necessary, pro-active advice to all players involved in the tendering process.<sup>229</sup>

**4.136** As noted, the Probity Auditor provided advice to OASITO in respect to the disclosure event, and attended the meetings with the CEOs of the other two tenderers. The Senate Committee found that, given the serious nature of the breach of confidentiality, the Probity Auditor, in his capacity as probity ‘adviser’, was not in a position to carry out an ‘audit’ of the Health tender process.<sup>230</sup> The Senate Committee referred to growing recognition by the Victorian, Tasmanian

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<sup>227</sup> Audit Report No.9, op. cit., p. 89, footnote 98.

<sup>228</sup> *ibid.*

<sup>229</sup> Senate Finance and Public Administration References Committee, Final Report on the Government’s Information Technology Outsourcing Initiative, op. cit., p. 91.

<sup>230</sup> The Senate Committee had pointed out to OASITO at the public hearing on 19 June 2001 that given the Probity Auditor’s proactive role following the unauthorised disclosure, it would have been difficult for him to have conducted an audit of his own advice when the process was completed, *ibid.*

and South Australian state governments of the important distinction between a probity auditor and adviser.<sup>231</sup> The Senate Committee found that the respective roles and functions should be carefully stipulated to ensure that the independence and objectivity of the probity auditor's position is maintained at all times.<sup>232</sup>

**4.137** The report of the Finance internal audit review identified that there had been a '...blurring of the role between probity auditor and probity adviser (to the extent that the probity auditor was responsible for the development of the probity protocols against which he was auditing).' It is not clear that the implications of this were adequately recognised by OASITO and advised to the Minister.

**4.138** Finance advised ANAO in May 2002 that:

The Probity Auditor had a free ranging role to audit or otherwise advise on probity issues relevant to the IT Outsourcing Initiative. The breadth of this role included the ability for agencies to consult directly with the Probity Auditor on issues they considered relevant and also for the Probity Auditor to have a direct line of communication with the Minister for Finance and Administration should [the Probity Auditor] consider that warranted. The scope of the contract was clear and understood by the parties.<sup>233</sup>

### *Form of probity report*

**4.139** The milestone sign-off on the evaluation phase of the Health Group tender provided by the Probity Auditor on 3 September 1999 essentially represented a statement of 'negative assurance'. That is, it stated that the Probity Auditor was '...not aware at this time of any circumstances arising out of the evaluation and parallel negotiation phases of the Health competitive tender process which present unresolved probity issues or concerns' (see paragraph 4.105). However, the sign-off provided no detail as to the scope of the engagement nor the tasks undertaken by the Probity Auditor in order to be aware of such issues or concerns.

<sup>231</sup> The Senate Committee referred to comments about the need to distinguish between these roles made in a number of publications, including the Department of Treasury and Finance Victoria, *Probity Guidelines for Government Tendering Projects in Victoria*, 2001; the Department of Treasury and Finance Tasmania, *Probity Guidelines for Tendering and Contracting*, May 1999; the Auditor-General's Department, South Australia, *Electricity Businesses Disposal Process in South Australia: Arrangements for the Probity Audit and Other Matters: Some Audit Observations*, 28 October 1999, Part3; and the Audit Review of Government Contracts, *Contracting, Privatisation, Probity & Disclosure in Victoria 1992-1999*, An independent report to Government, May 2000; *ibid.*, pp. 83–87.

<sup>232</sup> *ibid.*, p. 94.

<sup>233</sup> The Probity Auditor's schedule of services was further amended in December 2000 to include the following additional tasks: development of probity plans for IT Outsourcing projects (as had been recommended by ANAO in Audit Report No.9 *op. cit.*, p. 91); review of security arrangements for bids and procedures generally; attending lodgement of bids by tenderers; investigation of probity breaches (and suggested or alleged breaches); other probity related services as directed by OASITO or agreed from time to time; and the provision of an additional milestone sign-off at the execution of the final contract (as was also recommended in Audit Report No.9 *loc. cit.*).



Nor did it identify the probity issues that the Probity Auditor had been aware of, or the inquiries or deliberations undertaken to arrive at a conclusion that those issues were ‘resolved’.

**4.140** The Senate Committee found in its final report that a probity auditor should be responsible for producing a full report at the end of the tender process certifying that all procedures have been followed in accordance with probity principles covered in a probity plan established *before* the commencement of the tender process.<sup>234</sup>

**4.141** There are currently no guidelines or instructions as to the form of probity sign-off or report that should be obtained in respect of Commonwealth tendering processes. The probity guidelines for the Victorian Government provide that a probity auditor should, at the end of the process, prepare and submit a Tender Selection Probity Report which sets out his/her professional view of whether the process which has been followed was open and fair and met the required standards of probity.<sup>235</sup> The report template attached to the Victorian guidelines is considerably more substantive than that provided by the Probity Auditor to the Health Group tender (see Figure 4.1). It suggests that the report should present, *inter alia*, a brief description of the probity framework against which the review has been conducted; any qualifications or limitations on the probity auditor’s opinion on the process; and a positive statement of opinion about whether, in all material respects and based on the probity framework, the process has been undertaken in accordance with identified probity principles covered in the probity plan.

**Figure 4.1**

**Recommended coverage of probity auditor’s report**

1. Description of the scope of the audit.
2. Statement that the probity auditor has fulfilled his/her Project Brief in order to express an opinion on the tender process.
3. Purpose for which the probity auditor’s report has been prepared.
4. Brief description of the probity framework (eg plans, policies, guidelines etc) against which the review has been conducted.
5. Statement whether or not the audit has been conducted in accordance with this framework.
6. Any qualification or limitation on the probity auditor’s opinion on the process.
7. Findings in the form of an expression of opinion about whether, in all material respects and based on the probity framework, the process has been undertaken in accordance with identified probity principles covered in the probity plan.

Source: Probity Guidelines for Government Tendering Projects in Victoria, Department of Treasury and Finance, Victoria, 2001

<sup>234</sup> Senate Finance and Public Administration References Committee, Final Report on the Government’s Information Technology Outsourcing Initiative, *op. cit.*, p. 94.

<sup>235</sup> Department of Treasury and Finance Victoria, *op. cit.*



**4.142** In addition to the matters identified in the Victorian Government guidelines, ANAO considers that it would be good practice to require the probity auditor to include, either in the final probity audit report or in a separate report, a description of the probity matters that came to his/her attention in the course of the tender. This is consistent with the practices recommended in, for example, the Tasmanian Government probity guidelines. Those guidelines require that the final report should, in addition to presenting the purpose, scope and results of the probity audit and an expression of opinion on the process, also highlight significant findings and recommendations and inform management of any major deviations from the approved process and the reason for those deviations.<sup>236</sup>

**4.143** The provision of a more substantive probity report along the lines proposed in the Victorian and Tasmanian guidelines would have been of assistance in the Health Group tender in enhancing the transparency of the significant probity issues that arose and the manner in which they had been addressed, and ensuring that readers of the sign-off were properly informed as to the level of assurance they should derive from it. In this regard, the report of the Finance internal audit review of the Health Group tender process similarly noted that:

In connection with the probity sign-offs in general, we would note that our practice would be to provide more robust sign-offs that explain the basis for the sign-off (ie. the 'criteria for probity' as agreed with OASITO) and the key probity issues that were considered and addressed as part of the probity audit. We believe that this would have provided OASITO with a more robust sign-off and hence more positive assurance with regard to the probity of the process. This also provides other users of the sign-off with more information to allow them to rely on the sign-off more readily. However, we note that this is a matter of professional practice, which can differ between providers of probity services. We do not assert that this difference in the form of sign-offs indicates that the probity of the Process was compromised, or that the approach to probity sign-off by OASITO and [*the Probity Auditor*] was inappropriate.

**4.144** In engaging probity auditors in respect to the conduct of future tender processes, agencies should consider including a template of the audit report to be provided at the end of the process in the agreement with the probity auditor. Audit Report No.9 2000–01 issued subsequent to the Health Group tender recommended that the consultancy agreement with probity auditors stipulate the nature of any sign-offs and reports to be provided.<sup>237</sup> The whole-of-government response provided by Finance agreed with that recommendation.<sup>238</sup>

<sup>236</sup> Tasmanian Department of Treasury and Finance, op. cit., p. 14.

<sup>237</sup> Audit Report No.9, op. cit., pp. 90–91.

<sup>238</sup> The agreement carried the comment: '...providing it is acknowledged that the decision maker was advised of probity auditor sign offs at relevant project milestones and that the sign offs agreed with the probity auditor were in an acceptable form'.

## Role of committees in considering probity issues

**4.145** The purpose of obtaining tender evaluation reports signed off by responsible committees is to provide the decision-maker with an account of the evaluation process as a basis for determining the outcome of the tender. As part of that process, it is normal practice for those committees to be advised of probity issues that may arise. The question as to which parties should properly have been advised of such matters in tenders conducted under the IT Initiative was more complex than would normally be the case.

**4.146** As part of its responsibility for the overall management and implementation of the Initiative, OASITO had a responsibility to 'in consultation with agencies, manage the conduct of each tendering process to ensure that a fair, open and competitive process is followed within a consistent project framework and documentation'.<sup>239</sup> This included specific responsibility to, with the full participation and cooperation of agencies, manage the evaluation and negotiation process to ensure fairness and probity in all aspects of the process.<sup>240</sup>

**4.147** The Options Committee for the Health Group tender was responsible for formulating selection options for consideration by Ministers based on the ID Evaluation Report prepared by the IDET, and the IT&T Services Final Evaluation Report prepared by the Evaluation Committee and approved by the Steering Committee. Under its terms of reference, the Evaluation Committee<sup>241</sup> was responsible for the implementation and control of the tender on a day to day basis, including implementing and monitoring the probity and security procedures and rules as provided by OASITO. The Steering Committee was responsible for managing the tender of the agencies' IT infrastructure. The Health Group Evaluation Guide stated that all tactical decisions regarding the conduct of the evaluation would be referred to OASITO for resolution having regard to the need for probity, efficiency in the tendering process, fairness to tenderers, the needs of Group agencies and maximisation of competitive tension. The Guide stated that OASITO would make these tactical decisions in consultation with the Steering Committee.

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<sup>239</sup> Roles and Responsibilities for Agencies and OASITO in the IT Outsourcing Initiative, issued by the Minister for Finance and Administration, January 1999.

<sup>240</sup> Other key roles for OASITO were to approve all key project milestones such as tender release and closing dates, and make tactical decisions regarding interactions with industry; and manage the progress of key recommendations through relevant committees, including chairing the Options Committee that provided advice to Ministers on source selection. The roles and responsibilities of group agencies under the IT Initiative included: defining, with assistance and guidance from OASITO, their service requirements within and subject to the required scope; developing a cost model under OASITO supervision using a proforma cost model and methodology provided by OASITO; and playing a central role in the evaluation of tenderers' IT services offerings, including determining whether each tender met agency service requirements and preparing evaluation reports consistent with the tender evaluation methodology as required to enable key decision to be made., *ibid*.

<sup>241</sup> Initially the Group Management Team.

**4.148** These specified roles appear to indicate that it was envisaged that the Evaluation and Steering Committees would fully participate in the management of the tender process, including in regard to ensuring fairness and probity. Such an approach would accord with advice to ANAO by AGS that, having regard to the particular evaluation and decision-making structure used in the Health Group tender, accepted practice on identification of a probity issue would be that:

Usually one person is in charge of the day to day management of tender issues. Often this is the chair of the evaluation team, however, it can also be the person named as the contact officer in the RFT or another manager in the process. It appears from the way in which the Evaluation Guide is structured that the person in question in this case was the OASITO Project Coordinator. That person would be responsible for obtaining the relevant advice in relation to probity issues. In the first instance the issue and the advice would be reported to the evaluation committee. This report would occur after the issue had been resolved for minor matters, unlikely to affect the evaluation and would occur before a decision was taken as to how to resolve a more major issue that had significant implications for the evaluation.

The report to the evaluation committee would be reported in the minutes of the evaluation committee meeting. The evaluation committee, where it was considering the resolution of a major issue would consider whether it could decide the resolution of the issue or whether to refer the matter to the Steering Committee for resolution. If for example, it was considered that the issue could only be resolved by terminating the tender process it would be expected that the issue would be referred up the line perhaps even as high as the decision-maker.

Even if the issue was such that it could be resolved at a fairly low level, the issue would still be reported up the line through the committee structure. Thus one would expect to see in the evaluation report where a minor issue had been resolved, something to the effect that a probity issue had been identified and resolved with assistance from the probity adviser and in the Committee's opinion, had no impact on the evaluation outcome.

In many cases where a probity adviser is engaged the probity adviser provides an interim report at the time of submission of the evaluation report. The interim report would list all issues and their resolution to that point and express the level of assurance that the probity adviser was prepared to give as to the probity of the process to that point. This form of reporting allows the Options Committee at the end of the process to make its recommendation to the decision maker on the basis of a sign-off from the committees reporting to it and the probity adviser that there is a certain level of assurance concerning the process.

**4.149** The practice outlined by AGS provides for transparency in decision-making and ensures that the findings and recommendations of the responsible committees are appropriately informed. In the Health Group tender, the

Evaluation, Steering and Options Committees were not well served in being able to fulfil their proper roles as they were not informed at the time, as Committees, of the disclosure or late lodgement events involving IBM GSA. There is also no reference in the evaluation reports to any probity issues having arisen during the tender. As noted above, the Probity Auditor's sign-off did not include a list of the issues considered and their resolution. Finance advised ANAO in May 2002 that the operational management of tender (or re-priced offer) receipt and openings for tenders under the Whole-of-Government IT Outsourcing Initiative was managed by OASITO and/or the Probity Auditor, and that OASITO was acting in accord with its responsibilities for management of the tender processes at the time. In August 2002, the Legal Adviser advised ANAO that: '[We] did not know why the issues referred to were not discussed with/by the Committees.'

### *Reporting of disclosure event to Committees*

**4.150** In their advice of 30 July 1999, the Legal Adviser recommended that OASITO inform the Group Agencies of the disclosure event (see paragraph 4.37). In the normal course of arrangements, OASITO advised the Group Agencies of matters relating to the tender through the formal Committees established for the process, with the matter and position of each agency in respect to it, being recorded in Committee minutes. The Legal Adviser advised ANAO in August 2002 that OASITO also had many dealings with the agencies outside of the Committee process.

**4.151** In the case of the disclosure event, OASITO did not advise the Committees. Instead, it advised the heads of each agency directly. There is no documentation of the deliberations that led to OASITO electing to adopt that strategy, nor of the rationale underlying it<sup>242</sup>, other than comments in the letters from the then OASITO Chief Executive to the agency heads to the effect that:

I am concerned that if the media in particular becomes aware of the incident, then a campaign to discredit the current tender process may eventuate...I seek this confidentiality in order to protect progress with implementation of the Government's policy in respect of the IT infrastructure outsourcing.

**4.152** Letters dated 2 August 1999 were provided to the Secretary of DHAC and the Managing Directors of the HIC and MPL by OASITO in individual meetings over the period 4 to 5 August 1999. The letters asked that the existence of the incident be confined to the narrowest possible audience '...having regard to your own accountabilities'. ANAO understands that OASITO made no record

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<sup>242</sup> In August 2002, the Legal Adviser advised ANAO that: 'We were not involved in the development of the strategy.' The Legal Adviser also confirmed that there is nothing on their files that indicates that they had discussions with OASITO in relation to this strategy.

of its meetings with the agency heads. A file note made on 8 October 1999<sup>243</sup> by the then Secretary of DHAC recorded that the OASITO representatives made a 'strong request' that he not inform other DHAC officers of the event. Similar requests were made of the Managing Directors of the HIC and MPL.

**4.153** The Secretary's file note records that he agreed to OASITO's request, but insisted on the need to advise the Minister for Health and Aged Care and consult with the Managing Director of the HIC. The Secretary met with the Managing Director of the HIC on 6 August 1999 and subsequently spoke to the Minister. The Managing Director of the HIC made no record of his knowledge of the disclosure, of the conversation with OASITO, nor of the deliberations or actions undertaken by him. The HIC advised ANAO in May 2002 that:

The Managing Director held discussions with the Secretary of the Department and the head of the IT Outsourcing Sub-Committee of the HIC Board. In these discussions the Managing Director made it clear that the information should not be passed on to others as advised by OASITO in their letter to him. In view of the warnings contained in the OASITO letter, the Managing Director of HIC advised that he made no record of his knowledge of the disclosure.

**4.154** In discussions with ANAO, the HIC Managing Director advised that he first became aware of the disclosure when advised by OASITO and did not advise other HIC officers, apart from the Chairman of the HIC Board IT Outsourcing Sub-Committee who was also a member of the Steering Committee (see paragraphs 4.166 and 4.171). None of the agency heads provided a documented response to OASITO regarding the letter.

**4.155** There is no evidence of OASITO seeking advice from the Probity Auditor as to which participants in the tender evaluation process should have been advised of the disclosure in order that they could adequately discharge their responsibilities. Finance responded to ANAO in May 2002 that: '...advice to the Chief Executive of an organisation obviously constitutes advice to that organisation. The Chief Executives then dealt with that advice as they considered necessary, presumably within the bounds of their responsibilities under the FMA and CAC Acts'. The Probity Auditor was not present at the meetings at which the agency heads were advised of the disclosure. As noted at paragraph 4.54, the previous Minister for Finance and Administration advised ANAO in September 2002 that, upon being advised of the disclosure event, he had requested, inter alia, that '...all subsequent dealings on this issue be in the presence of the Probity Auditor.'

<sup>243</sup> The events recorded in the 8 October 1999 file note occurred between 5 and 6 August 1999. The preferred tenderer was endorsed on 23 September 1999. Two DHAC Steering and Evaluation Committee representatives became aware of the disclosure event at the debriefing of one of the unsuccessful tenderers on 5 October 1999. The second DHAC Steering Committee representative was advised of the disclosure later that day by one of his Steering Committee colleagues. See also paragraph 4.79.

**4.156** The file note prepared by the then DHAC Secretary recorded that, given OASITO's advice that both other tenderers and the Probity Auditor had agreed that the process should continue, he had agreed there appeared to be no other option but had expressed extreme concern about the matter. It further recorded that, at the meeting on 6 August 1999, the Managing Director of the HIC had confirmed that he very much shared the Secretary's concerns, but that there was little option but to proceed given OASITO's assurances and the agreement of CSC and EDS. The file note stated: 'Nonetheless, we both felt extremely uncomfortable about the propriety of the process'.

**4.157** The Secretary's file note recorded that copies of the advices from the Legal Adviser and the Probity Auditor were not attached to the letter provided to him by OASITO as had been stated in the letter. Those advices were provided to DHAC by OASITO in March 2000, some six months after the conclusion of the tender process. As a result, the Secretary was reliant upon the oral assurances of OASITO as to the nature of any advice or conclusions reached by those advisers.<sup>244</sup> The Managing Director of the HIC advised ANAO that he believes that the legal and probity advices were attached to the letter provided to him, but this could not be confirmed by ANAO as the HIC advised that the original attachments to the letter had been misplaced.

**4.158** ANAO raised with the then Secretary of DHAC and the HIC Managing Director whether they obtained independent legal advice on the matters they should consider in agreeing to OASITO's request to keep the information restricted and continue with the tender. For example, such advice may have alerted them to the fact that neither the Probity Auditor nor the Legal Adviser had provided a documented sign-off to the event. Both the Secretary and the Managing Director advised ANAO that a factor in their decision to agree to the confidentiality request was a concern that, despite the agreement of the other tenderers to the tender continuing, it could be disrupted if the matter became public. Each indicated that, on balance, they considered that the risk of that occurring through making the information more widely known was not acceptable when they had been assured the event had been properly dealt with. The Managing Director of the HIC advised ANAO that terminating and re-starting the tender would have been disastrous for the HIC, given the loss of staff and delays in IT investment it had already experienced.

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<sup>244</sup> The Secretary also recorded that the OASITO representatives gave him assurances about his concerns about the process (see paragraph 4.79), including an assurance that CSC and EDS had agreed to accept the delay in IBM's tender. ANAO notes that a letter of 4 August 1999 informed each tenderer that a bidder had been late in lodging its revised offer on 2 August 1999 and that, in accordance with the RFT provisions, the Chief Executive of OASITO, following receipt of legal and probity advice, had allowed the information to be accepted and evaluated. The letter stated that in the interests of transparency, OASITO thought that it should bring this matter to the tenderers' attention as soon as possible. The tenderer that had been late was not identified, and neither of the other tenderers was asked whether they agreed or otherwise with the acceptance of the late tender.



**4.159** ANAO notes that Committee members had signed acknowledgments of obligations in regard to confidentiality. Those obligations were in addition to the normal confidentiality requirements that apply to members of the APS. The letters to the agency heads stated that OASITO staff and advisers aware of the event had been advised that legislative and confidentiality obligations, including those under the Crimes Act, applied to the incident and requested the agency heads to do the same where it was considered necessary to inform others of the event.<sup>245</sup> There is no record of OASITO obtaining legal advice regarding the applicability of the Crimes Act to this incident or the entities involved, which included the HIC and MPL.<sup>246</sup>

**4.160** AGS advised ANAO that reporting to the Evaluation Committee of a major probity issue which had significant implications for the evaluation, and of the advice obtained regarding it, should occur before a decision is taken as to how to resolve the issue (see paragraph 4.148). The agency heads were not informed of the disclosure event until some days after it had occurred, by which time the decision on how to resolve it had been taken by OASITO. Even if it were considered that it was appropriate to inform the agency heads of the issue rather than the Committees, this approach does not accord with the good practice identified by AGS.<sup>247</sup> In August 2002, the Legal Adviser advised ANAO that they agreed with these comments.

### *Reporting of late tender to Committees*

**4.161** The Evaluation Guide for the Health Group tender stated that, if a tender were received after the deadline declared in the RFT, the issue would be referred to OASITO's Project Coordinator. The Guide did not identify the responsibilities of the Project Coordinator in regard to informing the relevant Committees of the receipt of late tenders, either before or after the decision to accept or reject them had been made. AGS advised ANAO that usual practice in this area is that:

...regardless of who in the evaluation and decision making structure makes the decision to admit the late tender to evaluation, the circumstances leading up to and the reasons for exercising the discretion to admit should be fully documented, reported to the committees and included in the evaluation report. It would also be referred to in any report accompanying the probity adviser's sign off in relation to the probity of the conduct of the tender process.

<sup>245</sup> An e-mail message was sent to all IT Outsourcing staff within OASITO on 28 July 1999 advising those staff who were aware of the disclosure event that disclosure of information regarding this event was covered by the provisions of the Commonwealth Crimes Act and their strict confidentiality on this matter was required.

<sup>246</sup> In August 2002, the Legal Adviser advised ANAO that: 'We confirm that there is nothing on our files or in our recollection that indicates that [we] were asked to advise on the applicability of the Crimes Act to the incident or the entities involved.'

<sup>247</sup> Finance advised ANAO in May 2002 that: '...the framework for, and practice of, management of the ITO transactions involved a large number of process issues being dealt with as responsibilities of OASITO and relevant advisers'.



**4.162** The file note prepared by the Probity Auditor's representative present on the day of the late lodgement<sup>248</sup> recorded that she asked the OASITO Executive Coordinator to prepare a file note stating that the Executive Coordinator had considered the late offer by IBM GSA and was prepared to accept it. The Probity Auditor's representative's file note records that the OASITO officer advised that he would state that he was prepared to consider the late bid and that '...the Committee could decide if it was to be accepted or not'. An internal OASITO minute regarding acceptance of the late offer was prepared (see paragraphs 4.63 to 4.65). However, there is no evidence of any of the Committees being formally advised of the issue or being asked to consider whether it should be accepted. Nor is there any reference to the late lodgement in the Evaluation Reports or the Probity Auditor's sign-off.

### *Reporting of changes in tenders*

**4.163** The IT&T Services and ID Evaluation Reports both record that the tenderers were provided with multiple opportunities to revise their offers. However, as it is the final offers received that are relevant in terms of the selection of the preferred tenderer, the assessments contained in the reports are based on those offers. It is not possible to obtain from the Evaluation Reports an understanding of the extent to which individual tenderers revised their offer, or the movements that occurred in their relative competitive position as a result. The Evaluation Committee and Steering Committee were both aware of the price movements that occurred in the final round. However, as noted, as neither Committee was aware of the disclosure event, they did not examine the movements in that context (see paragraphs 4.77 and 4.90). There is no record of the Options Committee being advised of the reasons for, or nature of, changes to tenderers' offers that occurred over the course of the tender.

### *Committee sign-offs and resolutions*

**4.164** The IT&T Services Final Evaluation Report was endorsed by members of the Evaluation Committee on 2 September 1999. The Evaluation Committee stated that it was satisfied that throughout the course of the evaluation and negotiation process, each tenderer had been given a fair and reasonable opportunity to present its best offer. On 3 September 1999, the Steering Committee members signed off on a recommendation to the Options Committee that IBM GSA be selected as the preferred tenderer. This was based on its consideration of the findings of the Evaluation Committee as documented in the IT&T Services Final Evaluation Report. The IDET members signed off on the ID Evaluation Report on 1 September 1999, confirming that the evaluation conducted was consistent with the ID framework outlined in the RFT.

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<sup>248</sup> See paragraphs 4.60 and 4.68.

**4.165** The Options Committee met on 8 September 1999 to consider the IT&T Services and ID Evaluation Reports. Draft minutes of that meeting distributed by OASITO on 23 September 1999<sup>249</sup> recorded that the Options Committee had noted that the Evaluation Reports were ‘...well prepared documents indicating that the evaluation was conducted fairly and rigorously’. The draft minutes also included a comment by one industry representative on the Options Committee that he ‘...had no difficulties with the probity and rigour of the process’. The Probity Auditor was present at the 8 September meeting, but the draft minutes record no comments having been made by him or any discussion regarding probity issues that arose during the tender, how they were handled, nor the Probity Auditor’s views on the probity of the process.

**4.166** In providing these sign-offs and comments, there was an information asymmetry among members of the Evaluation, Steering and Options Committees<sup>250</sup> in respect to the probity aspects of the Health Group tender. The OASITO chairs of those Committees were aware of all relevant information. As noted, one of the HIC Steering Committee representatives (who was also the Chair of the IT Outsourcing Sub-Committee of the HIC Board) had also been advised by the Managing Director of the HIC, as the Chair of the IT Outsourcing Sub-Committee of the Board, of the disclosure event (see paragraphs 4.153 to 4.154 and 4.171). However, as also noted, there is no record of the Committees as a whole being advised of the significant probity issues that arose.

**4.167** ANAO received advice from some other members of the various Committees that they recalled becoming aware during the tender process of the disclosure and/or late lodgement issues. But recollections in this regard varied substantially. No documentation was available to assist the ANAO in clarifying which of the other members became aware of those events, nor in what circumstances, and who else may have been briefed on the various probity issues. It is clear, however, that at least some members were not aware of one or more of the probity issues that arose. A consequence of the approach adopted was that those latter members were not in a position to consider the potential cumulative effect on perceptions about the probity of the tender process before agreeing to sign-off on it.

<sup>249</sup> OASITO was unable to provide ANAO with a final version of the minutes endorsed by Committee members.

<sup>250</sup> The then Secretary of DHAC was aware of the probity issues. On 31 August 1999, the then Minister for Finance and Administration agreed to a request from the then DHAC Secretary to formally participate on the Options Committee, but the Secretary was not present at the 8 September 1999 meeting of the Committee and did not sign the Options Committee preferred tenderer recommendation (see footnote 61). The Secretary had been formally approved by the Minister as part of the Committee; had been briefed by OASITO on the papers to be presented to the Committee; and had reserved the right for the Committee to be re-convened if other members had a different view to his. In those circumstances, ANAO considers that the Options Committee resolution should have been forwarded to the Secretary for his separate signature (as had been done by OASITO on a number of other occasions when one or more members of a Committee were not present for the signing) or, otherwise, he should have been formally withdrawn from the Committee, with that action being recorded in the Committee minutes.

**4.168** It may have been that, once fully informed about all events with probity implications and the actions taken to address them, the Committees would have accepted the view that the issues had been adequately resolved. The agency heads had reached that view, and exercised a judgement that, in the circumstances, it was appropriate to accede to OASITO's request that the disclosure event be kept confidential. However, given the concerns expressed by the DHAC Secretary and the HIC Managing Director<sup>251</sup>, despite the assurances provided to them, there is a strong argument that the Committee members should have been provided with the opportunity to make an independent judgement on these significant issues. That they were not, diminished the transparency with which the tender process was managed. This appears to have contributed to the environment in which perceptions and concerns about the lack of sufficient probity in the tender process were perpetuated.

**4.169** As was noted by the Senate Committee in its second interim report of June 2001<sup>252</sup>, the letter from OASITO to the heads of the Health Group agencies had also given an undertaking that transparency would be provided by including reference to the disclosure event in the OASITO 1999-2000 Annual Report, but this did not occur.<sup>253</sup> Even if it had occurred, this would have post-dated the tender process and would not address the issue of transparent consideration by the authorised Committees of relevant events in the context of determining the tender outcome.

## **Assurances of probity and process**

**4.170** The Boards of both the HIC and MPL sought assurances from OASITO about the conduct of the Health Group tender process prior to authorising acceptance of a preferred tenderer recommendation. According to the minutes of the 27 August 1999 meeting of the HIC Board<sup>254</sup>, OASITO provided oral assurances to the Board that the evaluation process was complete<sup>255</sup>; it was confident the process was sound; that all bidders were given the same opportunity; and that the probity advisors would confirm that confidence and sign-off on the process. This may have conveyed an impression to the Board members that the sign-off to be provided by the Probity Auditor would represent

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<sup>251</sup> As recorded by the Secretary in his file note of 8 October 1999—see paragraphs 4.152 to 4.158. See also paragraph 4.79

<sup>252</sup> Senate Finance and Public Administration References Committee, *Inquiry into the Government's Information Technology Outsourcing Initiative*, op. cit., p. 25–26.

<sup>253</sup> Finance advised ANAO in May 2002 that: 'OASITO did not refer to the disclosure event in its Annual Report as the event had previously been put on the public record via evidence given to Senate Committees'.

<sup>254</sup> See footnote 84.

<sup>255</sup> ANAO notes that the financial evaluation process was not completed until 2 September 1999, with a number of adjustments to tenderers' bids not being entered into the savings model until very late in that process.

a sign-off on the complete process. As noted, this was not the case. Finance advised ANAO in May 2002 that:

... the signoff of the Probity Auditor stated that he was not aware of any unresolved probity issues or concerns. This is an expansive signoff in our view which could only be practically widened if a process adviser worked inseparably with others to manage and oversee the process.

**4.171** The minutes of the HIC Board meeting of 27 August 1999 record that a Board member<sup>256</sup> commented that: ‘...there may be questions regarding probity issues after the contract was finalised’. In this context, OASITO said that it was prepared to sign a Deed of Access with the HIC for documents relating to the process.<sup>257</sup> The Board also resolved that, prior to any final decision being taken, OASITO should provide assurance that, inter alia:

- the process undertaken for the HIC had complied with the purchasing policies and rules of the Commonwealth; and
- all reasonable steps had been taken to ensure that probity matters had been properly handled (see paragraph 2.88).

**4.172** On 1 September 1999, two days prior to the completion of the evaluation, the HIC formally requested these assurances from OASITO, noting that the process had been under the control of OASITO, with OASITO contacting vendors and participating in evaluation and preparation of reports. ANAO found no record of a written confirmation or assurance being provided from OASITO to the HIC.

**4.173** As noted earlier (see paragraph 2.89), on 8 September 1999 the MPL Board also sought assurances from OASITO as to the probity and rigour of the evaluation and selection process. The letter of assurance was not formally provided to MPL by OASITO until 11 November 1999. It was in the form of OASITO accepting in writing a series of confirmations and statements set out in a letter from MPL to OASITO. The letter set out MPL’s understanding of the key processes put in place by OASITO to manage the project and sought confirmation that OASITO was satisfied with the evaluation and selection process. Following a period of discussion, the final version of the letter was provided to OASITO by MPL on 10 November 1999. Among the statements confirmed by OASITO were that:

- tenders were secured by OASITO prior to opening and were opened in accordance with Commonwealth Government accepted tender opening procedures. All tenders were received prior to the submission deadline and no aspect of the evaluation process was commenced prior to the formal registration of the tenders;

<sup>256</sup> Upon being advised of the disclosure event by OASITO, the Managing Director of the HIC had advised that Board member (who was Chairman of the HIC Board IT Outsourcing Sub-Committee and also a member of the Steering Committee) of the event (see paragraphs 4.153 to 4.154 and 4.166).

<sup>257</sup> A Deed of Access was executed on 19 November 1999.

- all issues judged by OASITO to be material relating to probity matters were referred to the Probity Auditor for advice and appropriate steps were taken in each instance to address these issues; and
- to OASITO's knowledge, there have been no significant issues which have arisen which would affect the success and probity of the evaluation and selection process which have not been made known to Medibank Private during the project.

**4.174** As noted earlier, the IBM GSA revised offer of 2 August 1999 was not received prior to the submission deadline, and the matter was not formally referred to the Probity Auditor. While a representative of the Probity Auditor managed the retention and subsequent opening of offers, no written advice was provided by the Probity Auditor on the probity implications of accepting the late offer (see paragraphs 4.60 to 4.68 and 4.162). The Managing Director of MPL was advised of the disclosure event by OASITO, but there is no record of the late lodgement being reported to any Committees on which MPL was a participating observer.

**4.175** On that basis, it is not clear that the assurances provided to the HIC and MPL Boards adequately informed the Boards about all relevant information, including the scope of sign-off that could be expected from the Probity Auditor. The HIC advised ANAO in May 2002 that: '...it was reasonable for HIC and MPL to assume that relevant information had been received'. Nevertheless positive, and early, assurance would have been preferable in the circumstances.

**4.176 Finding:** A number of issues arose in the course of the Health Group tender that had the potential to compromise the probity of that process, or to at least give rise to a perception that it may have been or had been compromised. These included OASITO inadvertently sending a tenderer, IBM GSA, confidential pricing information relating to other tenderers on 28 July 1999 (disclosure event), and the subsequent late lodgement of a revised pricing offer by the same tenderer on 2 August 1999. The tender process also saw substantial change in financial rankings following the fourth and final pricing round and revision to savings identified by the evaluation following a review by Finance.

**4.177** ANAO identified shortfalls in good practice in a number of areas of the probity management process for this significant government contract. Some aspects of the shortfalls related to the unique tender management structure that existed under the IT Initiative until the Government's endorsement of the recommendations of the Humphry Review of December 2000. The problems identified primarily relate to:

- inadequate documentation of the tender process, including communications with tenderers;

- lack of transparency of the consideration of all relevant options, risks and information in the management of probity issues; and
- the adequacy of the information available to the decision-maker on probity issues, of the role of the probity expert engaged for the tender process, and of the scope and nature of sign-offs provided by external advisers.

**4.178** ANAO's capacity to examine the management of the probity aspects of the Health Group tender was limited by deficiencies in the contemporaneous records made. In a number of areas, the recollections of individuals were the only means of establishing important elements of the sequence of events.

**4.179** The documentation maintained by OASITO in respect to its management of both the disclosure event of 28 July 1999 and the late lodgement on 2 August 1999 does not provide a sufficiently comprehensive account of all relevant actions relating to these significant probity issues. Adequate records were not consistently maintained of significant discussions that occurred, nor of some of the key decisions taken and their underlying rationale. Within the material made available for review, ANAO was unable to locate records retained by OASITO of the time, participants and content of any of its meetings or discussions about the disclosure with the Probity Auditor, the Legal Adviser, the Secretary of DHAC, the Managing Directors of the HIC and MPL, or with the Minister's Office. ANAO was also informed that OASITO did not maintain records of any conversations with IBM GSA on 2 August 1999 regarding the late lodgement of its revised offer on that day.

**4.180** The issue of communication with tenderers was an area of some ongoing focus in the conduct of the Health Group tender process. It is apparent from contemporaneous documentation and subsequent discussions with ANAO that not all parties were confident that they were aware of all communication that occurred between tenderers, OASITO, its advisers and/or Group Agency representatives, or that the content of that communication had been properly recorded. The likelihood of such perceptions arising was increased by environmental factors, including perceived preferences for particular tenderers and the dual role played by OASITO in managing both the whole of Government IT Outsourcing Initiative and each tender process. The approach taken to documenting contact with tenderers did not assist in removing such perceptions. A coherent record of all meetings and conversations with each tenderer involving tender evaluation teams, OASITO or its advisers, and/or Group Agency representatives was not kept during the tender evaluation phase. A Contact Register was not maintained. The individual tenderer files did not contain all correspondence and contact with that tenderer. Negotiation and clarification meetings with tenderers were not



generally minuted, although the Legal Adviser advised ANAO in August 2002 that negotiations with tenderers in relation to the terms and conditions of the Services Agreement were documented and provided to all Group Agencies. Due to the ad-hoc structure of the available records, it was not possible to conclude whether all contact with tenderers had been properly recorded for accountability purposes.

**4.181** Transparency and confidence in the tender process would also have been enhanced through independent scrutiny of the procedures used in managing and recording contact with tenderers. The schedule of services for the Probity Auditor did not require assessment or certification of procedures adopted for the general management of the tender process, including communication with tenderers.

**4.182** The need for sound procedures in regard to managing and recording the dissemination of information to tenderers was highlighted by the disclosure event. OASITO was responsible for managing all communication to, and from, tenderers. In regard to the disclosure event, OASITO made no contemporaneous record, prior to providing IBM GSA with the disk, of:

- receiving a request from IBM GSA for an electronic version of the document previously faxed to it;
- the request by an OASITO officer of a member of the evaluation team for an electronic copy of the document, including the nature of that request;
- a disk containing confidential tenderer information being removed from the secure Evaluation Centre;
- the identity and contents of the document contained on the disk; or
- a disk containing pricing information being provided to a tenderer.

**4.183** No correspondence was prepared to accompany the disk. There was no examination made of the disk's contents prior to it being handed over to the tenderer. Nor was a hardcopy of the electronic document contained on the disk produced or retained at that time as a record of the information provided.

**4.184** Following the disclosure event, OASITO recognised the need to improve its information management processes and, on 2 August 1999, introduced revised interim procedures for the dissemination of hardcopy and electronic information to tenderers or agencies. OASITO engaged the Probity Auditor to review its operating procedures for the handling and security of tenderer information and communications with tenderers. The Probity Auditor strongly recommended that the procedures necessary for maintaining security of information within OASITO, both hard copy and electronically based, be



more comprehensively documented and promulgated as standard operating procedures (SOPs). The Probity Auditor agreed to formulate a set of SOPs for OASITO, providing recommendations in February 2000.

**4.185** Based upon the available documentation, all requests by OASITO for advice from both the Legal Adviser and the Probity Auditor regarding the disclosure event were oral. Oral requests to advisers for advice are not uncommon, but it is sound practice to document those requests and, particularly for significant issues, follow them up with written instructions. There was no record retained by OASITO of its conversations with either the Legal Adviser or the Probity Auditor in relation to the disclosure event, the instructions provided about the event and the nature of the advice sought by OASITO, nor of the options discussed with either party. The question as to whether the tender was compromised by the disclosure event to the extent that it should be terminated was clearly of particular significance to the appropriate consideration and resolution of this major probity issue. Yet, uncertainty and differing views remain about the extent to which the Legal Adviser was empowered to consider that question in framing their legal advice on the issue.

**4.186** Assurances that the disclosed pricing information had not been examined, or retained, were provided by relevant IBM GSA personnel through contemporaneous Statutory Declarations made following the disclosure event on 28 July 1999. Those assurances were confirmed in subsequent interviews with ANAO during the latter half of 2001. In advising the other two tenderers of the disclosure event, OASITO provided the Statutory Declaration received to that time to the bidders for their review. OASITO advised each tenderer that it was OASITO's intention to proceed with the tender process.

**4.187** Based upon available documentation and oral advice provided in discussions with ANAO, OASITO and the Probity Auditor relied extensively upon the assurances contained in the Statutory Declarations to conclude that the tender process could continue. AGS advised ANAO that, in these circumstances, Statutory Declarations provide a reliable record of a contemporaneous note by the witness as to what happened. ANAO considers that there were other inquiries that could reasonably have been undertaken in order to improve the capacity to demonstrate that all relevant information had been considered in forming conclusions about the disclosure event. The Statutory Declarations did not provide a complete and reconcilable picture of the timing and sequencing of events. During the latter half of 2001, ANAO held discussions with the IBM GSA declarants in an attempt to clarify events, but minor gaps, discrepancies and anomalies remained. This was due in part to the considerable time that had elapsed since the events in question and inconsistencies in individuals' recollections of events that occurred in mid-1999.

**4.188** Neither the Probity Auditor nor the Legal Adviser provided any further written advice or comments specifically relating to the resolution of the disclosure event, having regard to the actions taken following their initial advice (provided on 29 July 1999 and 30 July 1999 respectively). Also, neither provided a specific sign-off on the management of the disclosure event. In July 2002, the Probity Auditor advised ANAO that a request to provide any additional sign-offs or further written advice in respect of the disclosure event was never made by OASITO. The Legal Adviser similarly advised ANAO that no request was made by OASITO for the Legal Adviser to provide further advice or a specific sign-off on the disclosure event or to be involved in the briefing of tenderers or the Agencies. Better practice was subsequently followed by OASITO in respect to a probity issue that arose in the Group 1 tender process in May 2000. In that case, following a request from OASITO for a probity audit of the issue, the Probity Auditor prepared a full report setting out the scope of inquiries undertaken and the conclusions reached. The report was subsequently provided to the then Minister for Finance and Administration.

**4.189** The sign-off on the evaluation phase of the Health Group tender process provided by the Probity Auditor on 3 September 1999 indicated no awareness of unresolved probity issues or concerns, and made no reference to specific probity issues considered or inquiries undertaken. ANAO considers that a probity report of the type prepared in relation to the Group 1 tender, available at the time of a probity event, provides transparency and timely closure on the issue. In the absence of such a report, a clear accountability trail was not maintained of a decision being formally taken by an appropriately authorised entity that the tender should continue after the disclosure event, and the basis for that conclusion. In July 2002, the Probity Auditor advised ANAO that:

As there were no unresolved probity issues or concerns, we formed the view that to provide additional detail may have unnecessarily caused incorrect concerns regarding the probity of the process. We believe that there was no lack of transparency.

**4.190** In September 2002, the previous Minister for Finance and Administration advised ANAO that:

When the disc containing all three bids was delivered to IBM GSA in error my reaction on being informed directly by OASITO was to cancel the tender. I could not see that a tender process with integrity could continue. I conveyed this view to OASITO and I requested two things. Firstly, that all parties associated with the tender be informed of the potential breach of confidentiality and their views obtained. Secondly, that the Probity Auditor be immediately informed and that

all subsequent dealings on this issue be in the presence of the Probity Auditor so that a separate audit report could be prepared on this issue to underpin either cancelling the Health tender or proceeding with the concurrence of all parties.

At the conclusion of the tender I was both disappointed and annoyed at the limited role of the Probity Auditor and the absence of a separate report on this issue.

**4.191** There is no written advice from the Probity Auditor (who was overseas at the time), nor from his representatives, regarding the probity aspects of accepting the late offer from IBM GSA following the disclosure event, either before or after the decision to accept it had been made. OASITO made no record of having received such advice orally. There was also no record of the Legal Adviser's advice on the issue having been provided to the Probity Auditor. As with the disclosure, there is no specific reference to the late lodgement in the sign-off provided by the Probity Auditor at the conclusion of the evaluation process, some five weeks after the decision to accept the late offer had been made.

**4.192** The actions taken in respect to the late lodgement by IBM GSA leave open to interpretation important aspects of the management of that event by OASITO. In the circumstances, it would have been prudent for the documentation of OASITO's deliberations on the late lodgement by IBM GSA to have more fully reflected the timing of the actual decision to accept the late offer into the evaluation, and the nature and form of information available at that time to support that decision.

**4.193** There is no documented consideration by the Probity Auditor of the potential for a cumulative effect to have arisen from the disclosure event, the late lodgement and significant movements in tendered prices, or of advice to OASITO that it should consider such an effect. The internal OASITO minute regarding the late lodgement made no reference at all to the earlier disclosure event involving the same tenderer or to relevant comments about subsequent tender lodgement made by the Probity Auditor at the time of that event. OASITO records provide some basis for concluding that the movement in IBM GSA's pricing on 2 August 1999 was not a direct result of the disclosure event. However, given the sequence of events, it would have been beneficial for OASITO to have sought to complement those initial indicators with additional inquiries and assessments to provide further support for its position. There is no evidence of OASITO examining the pricing lodged in the final re-pricing exercise of 2 August 1999 in order to be satisfied that there was no apparent connection between the information disclosed and the price movements, nor of the Probity Auditor recommending such analysis be undertaken.

**4.194** ANAO considers that management of the probity aspects of the Health Group tender would have been improved by documented consideration of the broader cumulative effect of events over the course of the tender. This would have been of particular assistance in terms of enhancing the perception that due process was properly followed in relation to all parties.

**4.195** In particular, it would have been prudent for further inquiries to have been undertaken of IBM GSA in regard to its internal pricing approval process. If it could be established that the pricing lodged on Monday 2 August 1999 had been substantively finalised prior to the disclosure event on the preceding Wednesday, 28 July 1999, much of the potential individual and cumulative implications of the disclosure and subsequent late lodgement could be appropriately put aside. In discussions with ANAO, officers of the former OASITO confirmed that no specific inquiries were undertaken of IBM GSA in this regard. IBM GSA advised ANAO in a letter of 8 March 2002 that, despite extensive enquiries and searches, it had been unable to find any specific contemporaneous document showing pricing approval for the 2 August 1999 bid response. IBM GSA also confirmed to ANAO in that letter that the enquiries and searches did not reveal any e-mail or other document to indicate that any adjustment was made to the pricing of the 2 August 1999 bid response on or after the events of Wednesday, 28 July 1999. ANAO notes that the potential to obtain any relevant documentation from IBM GSA in this regard would have been significantly greater if inquiries of this nature had been undertaken by OASITO at the time of the events in question.

**4.196** As decision-makers, the relevant Ministers and the Boards of the HIC and MPL were reliant upon the advice provided to them through: the evaluation reports, sign-offs and resolutions provided by the members of the Evaluation, Steering and Options Committees; the sign-offs provided by expert advisers; and through OASITO in its overall coordinating role. In this respect, ANAO noted aspects of the approach taken in the management of the probity aspects of the Health Group tender that appeared to limit the level of assurance potentially available from the advice and sign-offs provided.

**4.197** The Evaluation, Steering and Options Committees were not well served in being able to fulfil their proper roles as they were not informed at the time, as Committees, of the disclosure or late lodgement events involving IBM GSA. There is also no reference in the Evaluation Reports to any probity issues having arisen during the tender. In their advice of 30 July 1999, the Legal Adviser recommended that OASITO inform the Group Agencies of the disclosure event. In the normal course of arrangements, OASITO advised the Group Agencies of matters relating to the tender through the formal Committees established for the process. In the case of the disclosure event,

however, OASITO did not advise the Committees, and instead advised the heads of each agency directly. There is no documentation of the deliberations that led to OASITO electing to adopt that strategy, nor of the rationale underlying it. There is no evidence of OASITO seeking advice from the Probit Auditor as to which participants in the tender evaluation process should have been advised of the disclosure in order that they could adequately discharge their responsibilities.

**4.198** ANAO raised with the then Secretary of the DHAC and the HIC Managing Director whether they obtained independent legal advice on the matters they should consider in agreeing to OASITO's request to keep the information restricted and continue with the tender. Both the Secretary and the Managing Director advised ANAO that a factor in their decision to agree to the confidentiality request was a concern that, despite the agreement of the other tenderers to the tender continuing, it could be disrupted if the matter became public. Each indicated that, on balance, they considered that the risk of that occurring through making the information more widely known was not acceptable when they had been assured the event had been properly dealt with. The Managing Director of the HIC advised ANAO that terminating and re-starting the tender would have been disastrous for the HIC, given the loss of staff and delays in IT investment it had already experienced.

**4.199** AGS advised ANAO that reporting to the Evaluation Committee of a major probity issue which had significant implications for the evaluation, and of the advice obtained regarding it, should occur before a decision is taken as to how to resolve the issue. The agency heads were not informed of the disclosure event until some days after it had occurred, by which time the decision on how to resolve it had been taken by OASITO. Even if it were considered that it was appropriate to inform the agency heads of the issue rather than the Committees, this approach does not accord with the good practice identified by AGS.

**4.200** As neither the Evaluation Committee nor the Steering Committee were aware, as a Committee, of the disclosure event, they did not examine the movements in price in the final re-pricing round in that context. There is also no record of the Options Committee being advised of the reasons for, or nature of, changes to tenderers' offers that occurred over the course of the tender.

**4.201** There was an information asymmetry among members of the Evaluation, Steering and Options Committees in respect to the probity aspects of the Health Group tender. The OASITO chairs of those Committees were aware of all relevant information. ANAO received advice from some other members of the various Committees that they recalled becoming aware during the tender process of the disclosure and/or late lodgement issues. But

recollections in this regard varied substantially. No documentation was available to assist the ANAO in clarifying which of the other members became aware of the disclosure and/or late lodgement events, nor in what circumstances, and who else may have been briefed on the various probity issues. It is clear, however, that at least some members were not aware of one or more of the probity issues that arose. A consequence of the approach adopted was that those latter members were not in a position to consider the potential cumulative effect on perceptions about the probity of the tender process before agreeing to sign-off on it. There is a strong argument that the Committees should have been provided with the opportunity to make an independent judgement on these significant issues. That they were not, diminished the transparency with which the tender process was managed. This appears to have contributed to the environment in which perceptions and concerns about the lack of sufficient probity in the tender process were perpetuated.

**4.202** Sign-offs were provided by the Legal Adviser and the Probity Auditor at various stages of the Health Group tender, including at the completion of the evaluation process. The Consultancy Agreement for the Legal Adviser did not specify a general oversight role in respect of the conduct of individual tender processes. Nor did it detail any specific requirement for the Legal Adviser to provide sign-offs, nor the form such sign-offs should take. The Legal Adviser was required to provide OASITO with written reports as requested from time to time. The sign-offs provided by the Legal Adviser were qualified by the extent of their involvement in the tender process and reliance upon advice and assertions from OASITO.

**4.203** The Probity Auditor provided three of the four milestone sign-offs required under the schedule of services in his Consultancy Agreement with OASITO, but did not provide the fourth (that the recommendation to the Minister accorded with the final report). Nor was the Probity Auditor's sign-off on the ID evaluation methodology obtained. The milestone sign-off on the evaluation phase of the Health Group tender provided by the Probity Auditor on 3 September 1999 essentially represented a statement of 'negative assurance'. That is, it stated that the Probity Auditor was '...not aware at this time of any circumstances arising out of the evaluation and parallel negotiation phases of the Health competitive tender process which represent unresolved probity issues or concerns'. However, the sign-off provided no detail as to the scope of the engagement nor the tasks undertaken by the Probity Auditor in order to be aware of such issues or concerns. Nor did it identify the probity issues that the Probity Auditor had been aware of, or the inquiries or deliberations undertaken to arrive at a conclusion that those issues were 'resolved'.



**4.204** None of the sign-offs provided by advisers to the Health Group tender represented a clean sign-off on the tender process as a whole. ANAO's examination of the tasks described in the consultancy agreements with the Legal Adviser and the Probity Auditor, and of the available evidence regarding the nature and extent of involvement or oversight by those advisers of the various aspects of the tender process, confirmed that neither appeared to have been in a position to provide a final sign-off on the complete process. However, there does not appear to have been a shared and consistent understanding across all relevant parties, including the relevant decision-makers and responsible Committees, as to the scope and nature of the sign-offs that were to be provided and, therefore, the level of assurance that could reasonably be derived from them.

**4.205** In interviews with ANAO, a number of the members of the Evaluation, Steering and Options Committees indicated that it had been their understanding that the legal and probity sign-offs could be relied upon as a clean sign-off of the overall tender process. Members indicated that they had been given no advice or indication that the scope of the sign-offs was qualified or limited in any way. ANAO understands from advice received that the Office of the then Minister for Finance and Administration was kept abreast of developments in the Health Group tender process, and in the IT Initiative more broadly. However, ANAO did not sight evidence of OASITO advising the then Minister of any such limitation or qualification.

**4.206** In a February 2000 brief to the Minister's office regarding the disclosure event, OASITO stated that: '...The signoff provided by the Probity Auditor for the project confirmed that no unresolved probity issues remained. This signoff covered the Health project in its entirety—including the events described in this brief and its attachments'. On 14 June 2001, Finance and OASITO provided the then Minister with a joint briefing on a request from the Senate Committee for the Minister to reconsider providing it with unexpurgated copies of the evaluation reports of the Health tender. The briefing stated, inter alia, that OASITO was not aware of any outstanding probity issues in relation to the Health Group project, and that: '...Full probity and legal sign-offs were obtained to the effect that there were no outstanding probity/legal issues at the end of the project...'.

**4.207** At the suggestion of the Minister, Finance sought a report from the Probity Auditor of his views on the nature of the Legal Adviser's sign-off. On 27 June 2001, Finance advised the Minister that the Probity Auditor's report had provided new information to Finance that only milestone sign-offs were obtained from advisers, and that the legal and probity sign-offs were qualified by the extent of the involvement of those advisers in the process. Finance



advised the Minister that it had signed the joint brief of 14 June 2001 on the basis of verbal advice from OASITO that a final legal and probity sign-off had been obtained by OASITO. The Minister subsequently requested that the Finance Internal Audit Unit undertake a review of the Health Group tender process. Finance advised ANAO in May 2002 that: 'The signoffs provided were largely consistent with those provided to the Commonwealth by the same advisers for outsourcing processes audited by ANAO. The fact that some of these signoffs are limited to the issues or processes in which those advisers were involved is to be expected and is not out of the ordinary'.

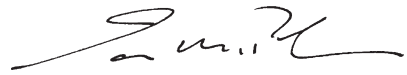
**4.208** Decision-makers place considerable reliance on the sign-offs provided by expert advisers in forming conclusions about the tender outcome. It is important, therefore, that they are fully informed as to any qualifications or limitations that may attach to the scope of a sign-off. The experience of the Health Group tender highlights the need for agencies to ensure that there is a clear understanding, on the part of all parties at the commencement of a tender process, as to the level of assurance the Commonwealth will be seeking from an adviser. This is critical to ensuring that the roles and tasks to be played by the advisers are appropriately aligned with that expectation.

**4.209** The basis on which probity advice will be provided, and the means by which the appropriateness of the actions taken will be subsequently audited, is an area in which particular clarity is needed prior to commencing the tender process. It is essential that all parties have a clear understanding of the scope of the probity engagement, the deliverable(s) expected to be provided, and the nature of the inquiry, analysis or review tasks that will be undertaken in order to support any opinions or conclusions expressed. An effective means of accomplishing this outcome is for the nature or form of the sign-offs to be agreed between the parties before the process commences and incorporated into the consultancy agreement. This was recommended in regard to probity auditing services in Audit Report No.9 2000–01. The whole-of-government response provided by Finance agreed with that recommendation.

**4.210** The Boards of both the HIC and MPL sought assurances from OASITO about the conduct of the Health Group tender process prior to authorising acceptance of a preferred tenderer recommendation. It is not clear that the assurances provided informed the Boards about all relevant information, including the scope of sign-off that could be expected from the Probity Auditor. The HIC advised ANAO in May 2002 that: '...it was reasonable for HIC and MPL to assume that relevant information had been received'. Nevertheless positive, and early, assurance would have been preferable in the circumstances.

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Canberra ACT  
29 October 2002

A handwritten signature in black ink, appearing to read 'Ian McPhee', with a long horizontal stroke extending to the left.

Ian McPhee  
Acting Auditor-General



# **Appendices**



# Appendix

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## Disclosure of pricing information

1. On 28 July 1999, one of the three tenderers for the Health Group, IBM GSA, was provided with a document that contained pricing information relating to the other two tenderers (the disclosure event). The sequence of events surrounding the disclosure event is as follows. Tenderers were advised of a third re-pricing opportunity, with revised offers due by 9.00 am on Monday 2 August 1999. As part of that re-pricing process, tenderers were to be provided with OASITO's interpretation of their previous pricing, including proposed adjustments.<sup>258</sup> OASITO faxed an Excel spreadsheet containing that information to each tenderer on Tuesday 27 July 1999. The documents were to be discussed at meetings with each tenderer scheduled in Canberra the following day, with IBM GSA's meeting scheduled for 3.00 pm.
2. The following morning, Wednesday 28 July 1999, IBM GSA contacted OASITO by telephone<sup>259</sup> advising that the fax it had received was illegible in part and requesting that it be provided with an electronic version of the document.<sup>260</sup> An IBM GSA representative collected a computer disk from the OASITO offices at about 10.45 am that same morning.<sup>261</sup> No check was made of the contents of the disk prior to it being handed to IBM GSA. Further, no documentation was created at that time to record that a request for an electronic version had been made or who within OASITO had approved the request.

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<sup>258</sup> Under the financial evaluation methodology, adjustments were applied to both tenderers' pricing and the agency cost baselines to ensure they were being compared on the basis of equivalent services and service levels.

<sup>259</sup> A contemporaneous record of the telephone call was not made by the OASITO officer who received the request.

<sup>260</sup> Based upon a record of events prepared by OASITO and advice provided by IBM GSA personnel in interviews with ANAO in the latter part of 2001, an electronic copy was requested to enable the document to be sent via e-mail to a member of the IBM GSA tender team in Sydney.

<sup>261</sup> An OASITO officer, who was not present at the time, prepared the only documentation of the process undertaken to create the disk. The file record states that another OASITO officer sought a copy of the IBM GSA pricing material from the Financial Evaluation Team and that a nominated Team member downloaded an Excel spreadsheet onto a computer floppy disk. There is no record of the Team member being advised of the purpose of the disk at the time of the request. In an interview with ANAO conducted in the latter part of 2001, the nominated Team member advised that it was not unusual for OASITO officers to enter the evaluation centre and request information, but that he has no recollection of a specific request of this nature being made or of being advised of the purpose of the request. The Team member was not provided with an opportunity to comment on or verify the accuracy of the statements and actions recorded in the OASITO file note.

3. Upon returning to the nearby IBM GSA Canberra office, the officer who collected the disk distributed the document contained on it via e-mail to relevant members of the IBM GSA Health Group bid team in both Canberra and Sydney. An IBM GSA officer in Sydney launched the document from the e-mail message and identified that it contained financial information that appeared to relate to other companies. That officer contacted the IBM GSA officer in Canberra and instructed that the e-mail be deleted from the personal computers of the other recipients. A teleconference was convened involving senior management within IBM GSA to determine the appropriate action.

4. Later that day, the IBM GSA Vice President Operations contacted OASITO by telephone to advise that the document provided by OASITO appeared to contain information relating to other companies.<sup>262</sup> He advised that the document had been immediately closed, had not been examined in detail, and that the disk had been stored in a secure place. It was agreed that IBM GSA would provide Statutory Declarations to support its assurances that the pricing information had not been examined or retained.<sup>263</sup> OASITO retrieved the disk from the IBM GSA office sometime later that same day, however, OASITO was unable to advise ANAO at what time that occurred.<sup>264</sup>

5. An OASITO note for file on this event records that a check of the contents of the disk upon its retrieval established that it contained pricing details of the bids for the other two tenderers. However, no record was made describing the specific nature of the document on the disk or of any other checks or analysis performed on the properties of the disk or the document. The disk was sealed in an envelope and held on file by OASITO.

6. In discussions with ANAO, former OASITO officers advised that the Probity Auditor, the Legal Adviser and the Office of the then Minister for Finance and Administration were contacted on the day of the disclosure to advise of the event. Records of those discussions were not maintained by OASITO. OASITO representatives met with the Probity Auditor in his Melbourne office at 8.30 am the next day, 29 July 1999. The Probity Auditor provided OASITO with written advice on 29 July 1999, which stated that, in his view, OASITO had little option, but to inform both of the other tenderers of the process violation and await their

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<sup>262</sup> That telephone call appears to have been received by the then Executive Coordinator of OASITO. However, a contemporaneous record of the time and content of the conversation was not prepared by that officer. ANAO was unable to establish what time IBM GSA first advised OASITO about its concerns regarding the contents of the disk.

<sup>263</sup> OASITO records indicate that it was IBM GSA that initially offered to provide the Statutory Declarations (see paragraph 7 of this Appendix), but ANAO received conflicting advice on this issue from participants in the Health Group tender process.

<sup>264</sup> The two offices were located within walking distance in the suburb of Barton in Canberra.



response.<sup>265</sup> The Probity Auditor also stated that it would be appropriate for OASITO to present the other tenderers with a copy of the Statutory Declaration from IBM GSA. The Probity Auditor's advice noted that it was currently envisaged that the pricing re-bids were due at 9.00 am on 2 August 1999 and stated that: 'I do not believe that it would be appropriate to extend this as this violation should not be seen to affect the process'.

7. Also on 29 July 1999, OASITO wrote to IBM GSA stating that IBM GSA's offer to provide Statutory Declarations was appreciated and asking that such Declarations be provided by close of business that day. The letter stipulated the nature of the information and assurances regarding access to, or retention of, the confidential material that such Declarations should contain.<sup>266</sup> The letter also reminded IBM GSA that its participation in the tender process was covered by the terms of confidentiality agreements, and asked that all steps be taken to ensure that the details of this event were contained within the tightest possible group of people within IBM GSA.

8. On 29 July 1999, OASITO received a Statutory Declaration by the IBM GSA officer who had first identified that the document contained information relating to other tenderers. The Declaration set out a sequence of events including the actions taken to delete the e-mail from his personal computer and those of the other recipients. The Declaration stated that the officer believed he was the only person who had opened the file, and that he did not examine the information, copy it or otherwise retain it in any form.

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<sup>265</sup> In his advice of 29 July, the Probity Auditor stated that he was in receipt of the letter to OASITO from the Legal Adviser dated 29 July 1999 and that he concurred with that advice. The Legal Adviser had provided draft advice to OASITO on 29 July 1999. Following a number of amendments, most notably the inclusion of a recommendation that OASITO inform the Group Agencies of the disclosure, final signed advice was provided by the Legal Adviser on 30 July 1999.

<sup>266</sup> OASITO requested that the Declarations detail the sequence of events from when IBM GSA received the material until the diskette was recovered by OASITO. As part of the Declarations, OASITO asked that IBM GSA provide assurance that the information (in whole or in part) had not been examined in any detail, copied or otherwise retained in any form by IBM GSA or any of its officers, employees or advisers, and that the document was closed as soon as the IBM GSA staff member identified that the document contained material sent to IBM GSA in error. OASITO further instructed that the Declarations confirm that IBM GSA and IBM Australia had not gained any information which could be construed as providing IBM GSA with any competitive advantage in the current tender process and which could either compromise the Commonwealth's commercial interests or disadvantage other bidders. OASITO obtained advice from the Legal Adviser in drafting this letter.

**9.** OASITO received signed written advice from the Legal Adviser on 30 July 1999. The Legal Adviser recommended that: IBM GSA be asked to provide Statutory Declarations, noting their understanding that letters had been forwarded to IBM GSA requesting that information; that the two other tenderers be briefed on the event and the action taken by OASITO; and that OASITO inform the Group Agencies, noting that two are separate legal entities to the Commonwealth. The Legal Adviser advised that, depending on the responses of those entities, OASITO would need to consider further action in this process, including whether to proceed with the process or not.

**10.** On 30 July 1999, OASITO and the Probity Auditor met with the Chief Executive Officers (CEOs) of the other two tenderers to advise them of the disclosure event. The CEOs were shown the Statutory Declaration provided by the IBM GSA officer. Both tenderers were concerned about the disclosure but, having regard for the Statutory Declaration, accepted that the tender would continue, albeit with varying degrees of comfort with the situation. The tenderers were advised that it was OASITO's intention to proceed with the process given the very late stage of the tender process and the close proximity of the Health Group to a decision point. In discussions with ANAO, both tenderers indicated that in the circumstances they had not considered it worthwhile to attempt to escalate the issue.

**11.** A significant factor in the decision to proceed was the substantial costs already invested in the tender process. For one tenderer, another factor was that the disclosed pricing material, relating to the previous pricing round, would be changing substantially when the new pricing was submitted on Monday 2 August 1999. OASITO reported that the other tenderer indicated that the process should proceed unchanged and that 'we will just have to wait and see what happens after [2 August 1999]'. Agreement to continue with the tender process was not received in writing from the tenderers, nor did the tenderers endorse the record of discussions maintained by OASITO. Following those meetings, OASITO provided written advice to the then Minister for Finance and Administration regarding the disclosure event on 30 July 1999.

**12.** A further four individuals from IBM GSA provided Statutory Declarations in similar terms over the next few days, with the last being executed on 4 August 1999. The IBM GSA Vice President Operations also executed a Statutory Declaration in which he stated that, to the best of his knowledge and belief, the information (in whole or in part) had not been examined in any detail, copied or otherwise retained in any form by the Company or any of its officers, employees or advisers; and that in light of the steps taken by the employees, he believed that the Company had not received any information about the competitors (apart from the identity of the competitors).

13. Letters from the OASITO Chief Executive were prepared on 2 August 1999 advising the Secretary of DHAC, the Managing Director of the HIC and the Managing Director of MPL of the disclosure event and the actions taken by OASITO. The letters were hand delivered by OASITO at meetings with those officers over the 4<sup>th</sup> and 5<sup>th</sup> of August. The letters stated that the CEOs of the other two tenderers had been advised of the incident and had indicated that they intended to proceed in the bidding process. The agency heads were provided with copies of the Statutory Declarations received to that time. The letters also stated that the advices received from the Legal Adviser and the Probity Auditor were attached, but a file note prepared by the then Secretary of DHAC dated 8 October 1999 recorded that copies of the advices were not attached to the letter provided to him. Those advices were provided to DHAC by OASITO in March 2000, some six months after the conclusion of the tender process. The Managing Director of the HIC advised ANAO that he believes that the legal and probity advices were attached to the letter provided to him, but this could not be confirmed by ANAO as the HIC advised that the original attachments to the letter had been misplaced.

14. The OASITO Chief Executive advised the agency heads that, in this situation, he was satisfied that the particular incident was a result of an isolated administrative error on the part of officers under high pressure. The letter stated that, given the considerable resources already committed by bidders and all agencies, it was important that the process be allowed to reach its conclusion as soon as possible. The OASITO Chief Executive asked that the existence of the incident be confined to the narrowest possible audience ‘...having regard to your own accountabilities. I am concerned that if the media in particular becomes aware of the incident, then a campaign to discredit the current tender process may eventuate’. There is no record of any of the Committees involved in the tender evaluation being formally advised of the disclosure event.

### **Late lodgement by IBM GSA**

15. The fourth, and ultimately final, round of submissions were due to be lodged with OASITO by 9.00 am on Monday, 2 August 1999. A submission lodged by one of the tenderers, IBM GSA, after the nominated closing time was accepted for evaluation. The sequence of events surrounding that event is as follows.

**16.** Tenderers were formally advised in a letter dated 14 July 1999 of the Health Group's decision to proceed through the final stages of parallel negotiation with all three tenderers. The letter advised tenderers that they would be provided with an opportunity to optimise their offering across the whole Group, with discussions to occur over the subsequent two weeks. The letter stated that any refinements or adjustments to their offer resulting from those discussions would need to be provided to OASITO by 2 August 1999. No closing time for lodgement on that date was identified.

**17.** On 28 July 1999, tenderers were provided with a further letter confirming the information that had been provided for their use in making refinements or adjustments to their pricing. That letter stipulated that those refinements, or adjustments, were due in at 9.00 am on Monday, 2 August 1999. The letter was faxed to each tenderer on 28 July 1999.

**18.** Revised offers were received from two tenderers by 9.00 am on 2 August 1999. However, IBM GSA had not lodged a revised offer by that time. ANAO was informed that an OASITO officer contacted IBM GSA by telephone when it was realised that IBM GSA had not met the lodgement time. However, OASITO made no record of that discussion nor of any instructions or directions that may have been given to IBM GSA regarding the subsequent lodgement of its offer. IBM GSA lodged its revised bid in two parts over the course of 2 August, with the second and final part being received at 2.35 pm.

**19.** At the request of the Probity Auditor's representative, who was present for the receipt of bids, the two submissions received by 9.00 am, and the first part of the IBM GSA submission received at 12.02 pm, were held unopened in a locked room with an OASITO officer having charge of the key. Following receipt of the final part of IBM GSA's revised offer at 2.35 pm, all three bids were opened at 2.55 pm on 2 August 1999.

**20.** The only written explanation provided by IBM GSA for being late in submitting its bid on 2 August 1999 was in the covering letter accompanying the first part of the material which stated that: 'IBM GSA were working to provide all the information requested by the deadline of the close of business today. In the rush late last week we missed the change in deadline to 9AM this morning'. The cover letter provided with that final part of the offer submitted on 2 August stated that the amended offer was being submitted in response to OASITO's letters of 14, 16 and 28 July 1999.

**21.** It is apparent from records held by the Legal Adviser and examined by ANAO that OASITO discussed IBM GSA's late submission with the Legal Adviser on that day and asked for advice as to whether the Commonwealth was able to consider the late re-pricing offer. No record of the time or content of those discussions was maintained by OASITO. Written legal advice on the matter, dated 2 August 1999, was faxed to OASITO on 3 August 1999. The Legal Adviser advised OASITO that, given the discretions reserved by the Commonwealth under the RFT, OASITO and the Group Agencies may consider the revised, but late, IBM GSA material.

**22.** A file note prepared by the representative of the Probity Auditor present for the receipt and opening of the revised tenders on 2 August 1999 indicated that she had asked the OASITO Executive Coordinator to prepare a file note stating that the Executive Coordinator had considered the late bid by IBM GSA and was prepared to accept it. The file note records that the Executive Coordinator advised that he would state that he was prepared to accept the late bid and that '...the Committee could decide if it was to be accepted or not'. There is no record of the matter being referred to the Steering or Evaluation Committee for consideration. There is no documented advice from the Probity Auditor to OASITO regarding the probity implications of accepting the late submission.

**23.** A 2 August 1999 minute, from the Executive Coordinator to the OASITO Chief Executive, recommended that the Chief Executive note that: '...subject to any views you might have, we intend to allow the information to be accepted within the tender rules which underpin this current tender process'. The Chief Executive noted the minute, and inserted a handwritten note to the effect that: 'This confirms my verbal agreement given prior to action being taken'.

**24.** The OASITO Project Coordinator advised all three tenderers, including IBM GSA, of the receipt and acceptance of a late bid in a letter dated 4 August 1999. The letter did not advise which tenderer had been late in lodging its bid, and did not seek any response, agreement or other comment from the tenderers. The letter stated:

Due to an innocent misunderstanding, one bidder in the Health tender process did not submit its amended bid information by the nominated time of 9.00 am on 2 August 1999. Two bids which were lodged on time were held securely and unopened until the third bidder lodged its additional information at approximately 2.30 pm on that day.

In accordance with the RFT provisions, the Chief Executive of OASITO, following receipt of legal and probity advice, has allowed the information to be accepted and evaluated. In the interests of transparency, I thought that I should bring this matter to your attention as soon as possible.

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