The Parliament of the Commonwealth of Australia

Report 393

- **Corporate Governance in the Australian Broadcasting Corporation**
- **Research Project Management CSIRO**
- **Preventing Unlawful Entry into Australian Territory**
- **DASFLEET Sale and Tied Contract**

Review of Auditor-General's Reports
2001–2002
Fourth Quarter

Joint Committee of Public Accounts and Audit

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Contents

APPENDICES

Foreword

Report 393 is the outcome of the review by the Joint Committee of Public Accounts and Audit (JCPAA) of the Auditor-General's audit reports tabled in the fourth quarter of 2001–2002. Of the 29 audit reports reviewed, the Committee selected four for further examination.

Audit Report No. 40, *Corporate Governance in the Australian Broadcasting Corporation*; Audit Report No. 51, *Research Project Management* ; Audit Report No. 57, *Management Framework for Preventing Unlawful Entry into Australian Territory*, various agencies; and Audit Report No. 63, *DASFLEET Tied Contract* were examined at public hearings in Canberra on 23 August 2002 and 20 September 2002.

Audit Report No. 40 examined ways in which the ABC aligns its strategic directions with its Charter requirements for programs broadcast on radio, television and on-line and assures itself, and Parliament, about the achievement of its Charter obligations.

The ABC admits to deficiencies in its data collection. The Committee considers that there is a particular lack of meaningful data in relation to young people, in particular those young people in Regional and Rural Australia.

The Committee considers that enhancement of data collection and analysis would assist the ABC in targeting the youth audience more effectively, particularly youth in regional and rural Australia and that more focussed data collection in rural and regional Australia would assist the ABC in planning to meet its Charter obligations in this area.

The Committee noted that the Dix report recommended the ABC adopt output budgeting in 1981. Despite this recommendation and subsequent recommendations by the ANAO output budgeting is not expected to be implemented until 2003.

The Committee concluded that the performance reporting of the ABC needs to be improved in order to enhance the ABC's accountability to Parliament and ensure fulfilment of its Charter obligations.

The performance reporting and external accountability of the ABC has been subject to scrutiny for some time. That it has taken 22 years to implement the recommendations of the Dix report, for example, indicates that there may be underlying cultural resistance to accountability which must be addressed. It is encouraging to see the ABC making positive progress in that regard. However, the Committee concluded that the ABC must devote considerable effort in improving its reporting across the board, including aligning financial and output budgeting information.

Audit Report No 51 *Research Project Management CSIRO* focused on research activities that were either formally designated as projects, or managed as projects and on relevant supporting administrative and information systems.

The Committee was concerned about the apparent lack of project management expertise throughout CSIRO. CSIRO spends more than $700 million dollars in research and development each year and so project management is an important function for the cost effective expenditure of Commonwealth resources.

The Committee notes that many of the differences in management practices between projects are cultural differences within the various divisions of the CSIRO. A key challenge for the CSIRO is to ensure that Project Management across the organisation improves in a systematic and structured way.

The Committee considers that CSIRO needs to pay attention to establishing and implementing consistent practices across the organisation, in order to facilitate consistent and coherent project management.

The Committee was concerned by the variability in project management standards between projects. For example, the ANAO found that externally funded projects were more likely to have effective project management than internally funded projects. The Committee considers that the disparities demonstrate a lack of depth in project management skills across the CSIRO.

The Committee therefore urged CSIRO to develop clear policy guidelines for the retention of IP which are more consistent across various types of projects.

Audit Report No. 57 focused on DIMIA's management of offshore measures to prevent and detect unlawful entry into Australia and the identification of opportunities for improvement. The audit found that DIMIA's management framework would be enhanced by a more systematic and documented governance structure.

DIMIA has relied heavily on individuals in its agency and their intuitive risk management, but is developing a risk management strategy due for completion in mid 2003.

To achieve organisational objectives and better outcomes, the Committee considers that DIMIA needs to pay greater attention to framework issues, and not focus only on implementation of policy and its response to business pressures.

At the same time, the Committee is aware that DIMIA was subjected to a great deal of pressure by the recent increases in the level of unauthorised arrivals and acknowledges its effective response.

Audit Report No. 63, *DASFLEET Tied Contract*, looked at the effectiveness of Finance's management of the Commonwealth's exposure under the DASFLEET Tied Contract and reviewed the action taken by the Department of Finance and Administration (DoFA) in response to the recommendation of Audit Report No. 25 1998-99, *DASFLEET Sale*, to assess the Commonwealth's exposure under the Tied Contract.

Amongst other things, the audit found that the Commonwealth bore all the risk for the vehicles leased under the Tied Contract, and that DoFA was not in a position to effectively monitor Macquarie Fleet's performance or the Commonwealth's exposure under the Contract due to the serious issues relating to the Contract which arose almost immediately after its commencement.

The audit noted that as a result of arbitration and the whole of dispute settlement completed by DoFA for the disputes with Macquarie Fleet / Macquarie Bank, the total potential exposure of the Commonwealth to possible payments to Macquarie Fleet was reduced from around $100 million originally claimed by Macquarie Fleet to around $50 million.

The Committee considers that the government's objective was to sell the DASFLEET business as well as the risk of that business. However, the Commonwealth bore the full risk for the vehicles leased under the Tied Contract. The Commonwealth's perception early in the sale was that the majority of the risk was being borne by Macquarie Fleet. Evidence uncovered during the audit makes it clear that Macquarie Bank viewed the arrangement from the beginning as a risk free investment. In short, Macquarie Bank had a very good understanding of the contract and Office of Asset Sales and Information Technology Outsourcing did not.

The Committee considers that the evaluation of the competing bids was flawed, and that advice from the business adviser was not reviewed. The Commonwealth ended up with a poorly constructed and complex contract and a total misunderstanding of the nature of the arrangement it was entering into. This resulted in substantial costs to the Commonwealth in connection with the DASFLEET transaction which were not envisaged at the start of the sale process.

The Committee acknowledges that DoFA's efforts in the settlement process reduced the Commonwealth's potential exposure by a very significant amount. However, the Committee has recommended that DoFA improve its record management practices and that in future, its requests for legal opinions are in writing.

Bob Charles
Chairman

Membership of the Committee

40th Parliament

Chairman	Mr Bob Charles MP	
Deputy Chair	Ms Tanya Plibersek MP	
Members	Senator Richard Colbeck	Mr Steven Ciobo MP
	Senator John Hogg	Mr John Cobb MP
	Senator Kate Lundy (from 19/11/02)	Mr Petro Georgiou MP
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	Senator Andrew Murray	Mr Alan Griffin MP
	Senator Nigel Scullion	Ms Catherine King MP
	Senator John Watson	Mr Peter King MP
		The Hon Alex Somlyay MP

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40th Parliament

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Senator John Hogg
Senator Kate Lundy (from 19/11/02)
Senator Claire Moore (until 19/11/02)
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Mr Steven Ciobo MP
Mr John Cobb MP
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List of abbreviations

ABC	Australian Broadcasting Corporation
ACS	Australian Customs Service
AFP	Australian Federal Police
ALO	Airline Liaison Officer
ANAO	Australian National Audit Office
Barings	Baring Brothers Burrows & Co., Limited
CSIRO	Commonwealth Scientific and Industrial Research Organisation
CEO	Chief Executive Officer
CPA	Commonwealth Public Account
DAS	Department of Administrative Services
DIMIA	Department of Immigration and Multicultural and Indigenous Affairs
DoFA	Department of Finance and Administration
IOM	International Organisation for Migration
IT	information technology
JCPAA	Joint Committee of Public Accounts and Audit

MOU	Memorandum of Understanding
NCA	National Crime Authority
NPV	Net Present Value
OAS	Office of Asset Sales
OASACS	Office of Asset Sales and Commercial Support
OASITO	Office of Asset Sales and IT Outsourcing
PNO(C)	Principal Migration Officers (Compliance)
PST	People Smuggling Strike Team
RBA	Reserve Bank of Australia
RWOG	Relative Whole of Government
UNHCR	United Nations High Commission for Refugees

List of recommendations

Recommendation 1

2.17 The Committee recommends that the Australian Broadcasting Corporation develop and implement a process for measuring performance data in urban, regional and rural Australia which provides timely and effective information in relation to its fulfilment of Charter obligations.

Recommendation 2

2.18 The Committee recommends that the Australian Broadcasting Corporation, as a matter of priority, develop and implement a process for using performance data to inform Corporate planning.

Recommendation 3

2.31 The Committee recommends that the Australian Broadcasting Corporation specifically report on its performance against Charter obligations in its annual report to Parliament.

Recommendation 4

3.25 The Committee recommends that the Commonwealth Scientific and Industrial Research Organisation develop and implement a consistent and coherent model of project management across the organisation.

Recommendation 5

3.34 The Committee recommends that the Commonwealth Scientific and Industrial Research Organisation develop and implement clear and consistent policy guidelines for the retention of intellectual property.

Recommendation 6

4.55 The Committee recommends that the Department of Immigration and Multicultural and Indigenous Affairs make better use of its information sources, evaluate the effectiveness of its current operations, and coordinate the sharing of information with other agencies.

Recommendation 7

5.117 The Committee recommends that the Department of Finance and Administration improve its record management practices with regard to dispute resolution activities.

Recommendation 8

5.119 The Committee recommends that in future the Department of Finance and Administration's requests for legal opinions are written requests.

1

Introduction

1.1 One of the statutory duties of the Joint Committee on Public Accounts and Audit (JCPAA) is to examine all reports of the Auditor-General. In doing this, the JCPAA considers the significance of the program or issues raised in the audit reports; the significance of the findings; the arguments advanced by the audited agencies; and the public interest of the report. The Committee then reports the results of its deliberations to both Houses of Parliament.

1.2 Upon consideration of the twenty-nine audit reports presented to the Parliament by the Auditor-General during the fourth quarter of 2001–2002, the JCPAA selected four reports for further scrutiny at public hearings. The public hearings were conducted in Canberra on Friday, 23 August 2002 and 20 September 2002 in the case of Audit Report No. 63.

1.3 The reports selected were:

- Audit Report No. 40, *Corporate Governance in the Australian Broadcasting Corporation,* Australian Broadcasting Corporation; **(Chapter 2)**
- Audit Report No. 51, *Research Project Managemen*t CSIRO; **(Chapter 3)**
- Audit Report No. 57, *Management Framework for Preventing Unlawful Entry into Australian Territory* Department of Immigration and Multicultural and Indigenous Affairs; **(Chapter 4)**
- Audit Report No. 63, *Management of the DASFLEET Tied Contract* Department of Finance and Administration; (**Chapter 5)**

The Report

1.4 This report of the JCPAA's examination draws attention to the main issues raised at the public hearings. Where appropriate, the Committee has commented on unresolved or contentious issues and made recommendations.

1.5 A copy of this report is available on the JCPAA website at *http://www.aph.gov.au/house/committee/ jpaa/reports.htm*

2

Audit Report No. 40, 2001–2002

Corporate Governance in the Australian Broadcasting Corporation.

Australian Broadcasting Corporation

Introduction

Background

2.1 The Australian Broadcasting Corporation (ABC) was originally established in 1932 as a statutory authority, then known as the Australian Broadcasting Commission. The then Prime Minister declared that the Commission's purpose was to inform, entertain and 'serve all sections and satisfy the diverse needs of the public'. The Australian Broadcasting Commission became the Australian Broadcasting Corporation in 1983 with the passage of the *Australian Broadcasting Corporation Act 1983* (ABC Act).

2.2 Today, the ABC provides four national radio services, one national television service simulcast in analog and digital, two digital television multi-channel services, nine metropolitan and 48 regional radio stations, international radio and television services and an on-line service, as well as ABC Enterprises and Symphony Australia. The ABC is one of Australia's core cultural institutions.

The ANAO audit

2.3 The audit was undertaken by the ANAO following advice from the Joint Committee of Public Accounts and Audit (JCPAA) to the Auditor-General requesting assurance that ABC programming adequately reflects the ABC's Charter was an audit priority of Parliament. The focus of the audit was on the governance arrangements of the ABC Board and management that enable the ABC to demonstrate the extent to which it is achieving its Charter obligations, and other related statutory requirements, efficiently and effectively.

2.4 The audit examined ways in which the ABC aligns its strategic directions with its Charter requirements for programs broadcast on radio, television and on-line and assures itself, and Parliament, about the achievement of its Charter obligations. The audit did not examine the operations of ABC Enterprises or symphony orchestras that operate as ABC–owned subsidiary companies.

Audit findings

2.5 Inter alia, Audit Report No.40 2001-2002, Corporate Governance in the ABC found that:

- There was significant scope for the ABC to improve its strategic planning and measurement so that the Corporation can demonstrate how well it is performing against its Charter requirements.
- The arrangements for strategic direction setting were undergoing considerable change at the time of the audit. While the ANAO supported the initiatives being implemented by the Board and ABC management that were designed to improve the effectiveness of the strategic planning process, successful implementation will require a culture throughout the organisation that supports such changes.
- Past ABC Corporate Plans have not clearly informed stakeholders of the ABC's corporate objectives, priorities or performance indicators.
- Board policies and practices were generally in accord with better practice, including the ANAO's *Corporate Governance Better Principles and Practices Guide* or steps have recently been taken to more closely align them with the Guide.
- The organisation structure that had recently been established positions the Corporation well to implement the Board's strategic directions. The internal control and accountability arrangements have been strengthened as part of the planning framework and a new internal

budget setting process more closely aligned with Corporate Plan objectives and strategies should enable the Board and the Managing Director to take strategic and informed decisions on the allocation of resources against defined priorities and performance standards.

- The performance information used by management and published in key accountability documents could have been more extensive. Although the ABC collects a wide range of data, there are significant gaps and the data could be used more strategically. For the new planning and reporting framework to be fully effective, work is required to collect and integrate valid and reliable performance information, including financial information, that is aligned with the new Corporate Plan. Improvement is also required in the use of audience research data.
- The initiatives that have been taken recently, if accompanied by the commitment and support of the Board, ABC management and staff, should enable the ABC to assure Parliament, through the responsible Minister, that it is meeting its Charter obligations, efficiently and effectively.

The JCPAA Review

At the public hearing, the JCPAA took evidence on the following issues:

- corporate planning
- schedule management policy and procedures
- measuring and reporting corporate performance
- external accountability

Corporate planning

2.6 Effective corporate planning, which takes account of the ABC's Charter obligations, audience research, and the effective and efficient use of human and financial resources, is essential to an appropriately functioning independent broadcaster.

2.7 The audit report found that, while there were significant improvements in the Corporate Plan 2001-2004 over previous Corporate Plans there was still work to be done in monitoring and evaluation of the ABC's performance against the Charter. In particular the ANAO found that, although a wide range of performance data was collected, there were significant gaps in the data.[1] In addition, the data that was collected could be used in a more strategic way.[2]

2.8 Section 6 of the ABC Act sets out the Charter of Corporation which requires the ABC to provide an innovative and comprehensive broadcasting service of a high standard that informs, entertains and reflects the cultural diversity of the Australian community, including regional and metropolitan residents, young people and older Australians.[3]

2.9 The Committee agreed with ANAO that, if performance was more closely measured against the Charter, and if there were a clear link between resourcing decisions and the Charter, there would be a greater assurance for the Parliament that the Charter was being fulfilled. [4]

2.10 The Committee noted that what data was available indicated that the ABC had some difficulty in meeting its Charter obligations in relation to adults 25-39 years of age and rural and regional Australians.[5]

2.11 The ABC advised the Committee that it placed a great emphasis on rural Australia.[6] In contrast, the Committee notes that objective performance data in relation to regional and rural audiences is not as readily available as data in relation to metropolitan areas and it is therefore not possible to determine whether the ABC is effective in meeting its obligations in this area. [7]

2.12 The ABC also advised that it continued to be concerned about the lower level of support from youth age groups although this was a problem common to free-to-air broadcasters.[8]

Committee Comments

2.13 It is clear to the Committee that the lack of objective data, particularly in relation to audience reach in regional and rural Australia, hampers effective Corporate Planning in these areas.

1 ANAO, Audit Report No. 40, *Corporate Governance in the Australian Broadcasting Corporation* 2001-2002, p. 13.

2 ANAO, Audit Report No. 40, 2001-2002, p. 13.

3 ANAO, Audit Report No. 40, 2001-2002, p. 56.

4 ANAO, Audit Report No. 40, 2001-2002, p. 61.

5 *Transcript, 23 August 2002,* pp. 3-4.

6 Heriot, *Transcript*, p. 7.

7 ANAO, Audit Report No. 40, 2001-2002, p. 162.

8 Heriot, *Transcript*, p. 7.

2.14 The ABC accepts there are deficiencies in its data collection. The Committee considers that there is a particular lack of meaningful data in relation to young people, in particular those young people in regional and rural Australia.

2.15 The Committee considers that enhancement of data collection and analysis would assist the ABC in targeting the youth audience more effectively, particularly youth in regional and rural Australia.

2.16 The Committee also considers that more focussed data collection in rural and regional Australia would assist the ABC in planning to meet its Charter obligations in this area.

Recommendation 1

2.17 **The Committee recommends that the Australian Broadcasting Corporation develop and implement a process for measuring performance data in urban, regional and rural Australia which provides timely and effective information in relation to its fulfilment of Charter obligations.**

Recommendation 2

2.18 **The Committee recommends that the Australian Broadcasting Corporation, as a matter of priority, develop and implement a process for using performance data to inform Corporate planning.**

Schedule Management Policy and Procedures

2.19 As an independent broadcaster complying with Charter requirements the ABC needs to have a diversity of programming in order to achieve its objectives.

2.20 The ABC does not collect as much data on rural and regional areas, listeners, and viewers as it does on metropolitan areas.[9] This can have the

9 ANAO, Audit Report No. 40, 2001-2002, pp. 162, 163.

unintended effect of a more urban focus to programming and resourcing decisions.

2.21 The ABC also has different commissioning processes for television and radio.[10] While the radio commissioning process appears to allow for clear identification of targets and measurement of outcomes, there is no integrated information process in television. [11]The Committee welcomes the cross media review currently being undertaken which may rationalise these processes.

2.22 The ABC acknowledges that services such as Radio Australia present a particular difficulty because of a lack of indicative performance information.[12] The ABC acknowledged that there is significant internal debate about prioritisation and utilisation of resources. [13] However, the Committee formed the view that clear performance, reach and effectiveness data would enable the ABC to make informed decisions on the prioritisation and utilisation of resources in accordance with its Charter.[14]

2.23 The Committee also noted that direct consideration of Charter obligations does not appear to be an essential part of scheduling decisions.

Committee Comment

2.24 The Committee concluded that indicative performance information is essential to a measurement of compliance with the Charter obligations.[15]

2.25 In addition, consideration of Charter obligations as part of the overall strategic planning process would enhance the ABC's performance in this area.

2.26 The Committee also concluded that performance reporting should be closely linked to reporting against Charter obligations.

Measuring and Reporting Corporate Performance

2.27 The Committee noted that the Dix report recommended the ABC adopt output budgeting in 1981.[16] Despite this recommendation and subsequent

10 Heriot, *Transcript*, p. 3.
11 Heriot, *Transcript*, p. 3.
12 Heriot, *Transcript*, p. 4.
13 Heriot, *Transcript*, p. 5.
14 *Transcript*, p. 7.
15 *Transcript*, p. 12.
16 *Transcript*, p. 10.

recommendations by the ANAO output budgeting is not expected to be implemented until 2003.[17]

2.28 In response, the ABC observed that there have been both cultural and technological difficulties in implementing these recommendations[18].

2.29 The Committee also noted that there is no specific method of reporting against the Charter, or otherwise measuring the performance of the ABC against the Charter.

Committee Comments

2.30 The Committee concluded that the performance reporting of the ABC needs to be improved in order to enhance the ABC's accountability to Parliament and ensure fulfilment of its Charter obligations.

Recommendation 3

2.31 **The Committee recommends that the Australian Broadcasting Corporation specifically report on its performance against Charter obligations in its annual report to Parliament.**

External accountability

2.32 In reply to the Committee's observation that the ABC exhibited shortcomings in external accountability, the ABC acknowledged that:

> We are still going through a period in the corporation of educating ourselves, in a collective sense, to some of the contemporary expectations of governance and accountability. We are accountable for a great deal in the organisation but we also live, as you know, in a changing environment of expectations. It is a continuous dynamic, a contest of ideas.[19]

2.33 The Committee observed that, although significant performance data was contained in the ABC's annual report, the data could have been more complete and presented in ways which more fully informed the

17 *Transcript*, pp. 10-11.

18 *Transcript*, pp. 10, 11, 12.

19 Heriot, *Transcript*, p. 5.

Parliament about performance both against the Charter and against accepted standards of Corporate Governance.

2.34 The ABC suggested that the delay in implementing integrated financial and performance information was dependent on the implementation of new information technology.[20] The Committee is not satisfied, however, that this is an adequate explanation for the deficiencies and delays in implementing an integrated reporting system.

2.35 The ABC assured the Committee that it was attempting to improve the quality of its external reporting.

Committee Comment

2.36 The performance reporting and external accountability of the ABC has been subject to scrutiny for some time. That it has taken 22 years to implement the recommendations of the Dix report, for example, indicates that there may be underlying cultural resistance to accountability which must be addressed. It is encouraging to see the ABC making positive progress in that regard. However, the Committee concluded that the ABC must devote considerable effort in improving its reporting across the board, including aligning financial and output budgeting information.

20 Heriot, *Transcript*, p. 11.

3

Audit Report No. 51, 2001–2002

Research Project Management

Commonwealth Scientific Research and Industrial Organisation (CSIRO)

Introduction

Background

3.1 CSIRO is a large national research organisation employing over 6500 staff organised in 21 divisions across 66 sites in Australia. Its primary functions are to carry out scientific research to assist Australian industry; to contribute to the national and international objectives and responsibilities of the Commonwealth Government; and to encourage or facilitate the application and use of the results of its own or any other scientific research.

3.2 In 2000–2001 CSIRO spent around $700 million on its research and development activities. Its funding comes mainly from Commonwealth budget appropriation funds–around 67 per cent in 2000–2001. The remaining funding is revenue from external parties.

3.3 CSIRO estimates that it manages around 3000 research projects each year. These projects are intended to provide:

- benefit to Australia's industry and economy;
- environmental benefit to Australians;
- social benefits to Australians; and
- support Australia's national and international objectives through excellence in science and technology and in the provision of advice and services.

There are three main types of projects:

- appropriation projects, which are funded solely from appropriation sources, have no external client and for which intellectual property (IP) is held fully by CSIRO;
- co-investment projects, funded by a mix of appropriation and external revenues, and IP is usually shared; and
- consulting projects, which are intended to be fully funded by external clients and where IP is usually held by the client.

3.4 These projects vary widely in size, duration and topic. Most are small but the three hundred largest projects account for half of all expenditure. Around half the projects are applied research.

The ANAO Audit

3.5 The objective of the audit was to assess the effectiveness of CSIRO in administering research projects to deliver required results. In particular, the audit examined:

- structures for project management in CSIRO;
- the alignment of projects with strategic objectives;
- the adequacy of project planning;
- the monitoring and reviewing of project performance; and
- CSIRO's approach to assessing project outcomes.

3.6 The audit focused on research activities that were either formally designated as projects, or managed as projects and on relevant supporting administrative and information systems. The audit did not assess the quality of scientific analysis or outcomes, although it did address CSIRO's assessment of project outcomes.

Audit Findings

3.7 CSIRO has an international reputation for scientific excellence, with external reviews indicating it delivers positive returns to the Australian community. It has wide experience in managing research projects. However, further strengthening of several aspects of project management arrangements is required in order to provide appropriate assurance that research projects are conducted in a cost-effective manner. This is particularly the case for research activities funded by appropriation moneys.

3.8 CSIRO's framework for project management has been upgraded in recent years and is supported by related corporate policies and divisional practices. However, there are insufficient corporate standards and guidance on project management; and some existing policies are not well implemented.

3.9 CSIRO places strong emphasis on aligning its research portfolio with industry-based Sector priorities, with supporting processes to properly allocate funds to programs, sub-programs and projects. The prioritisation of individual projects was supported by systematic criteria in some areas of CSIRO, but not in others. The extent of supporting documentation varied across divisions.

3.10 All co-investment and consulting projects examined by the ANAO met corporate requirements for documented project plans/proposals, including a project budget. However, there are no similar requirements for appropriation projects and only a third of such projects included a plan while only half had a budget. In addition the omission from project budgets of corporate overheads; the diversity of practice in pricing projects; and the absence of structured, project level, risk assessments need to be addressed by CSIRO.

3.11 There is a range of processes to regularly monitor and review project progress which have a particular focus on maintaining scientific quality, and are robust. However, processes to monitor changes to project scope and risks were not well documented and less systematic and transparent, particularly for appropriation projects. CSIRO's ability to monitor and review project costs and timeliness was significantly reduced by inadequate or inconsistent data in key management information systems.

3.12 CSIRO has a policy of undertaking systematic post project review, with a focus on the more 'significant' projects. However, this policy is not widely implemented, thus reducing CSIRO's ability to assess outcomes of individual projects and to identify lessons for management improvement.

3.13 Limitations in the conduct of project completion reviews and management information meant that the ANAO could only draw on limited data on cost and timeliness results. These data, whilst being subject to a number of caveats, suggest costs are exceeding contracted revenue for many projects. Occasionally, appropriation funds have been used to fund overspends in consulting or co-investment projects. As well, project milestones are often met later than planned. A more systematic collection and analysis of such data would provide greater insight into these important aspects of project performance.

Committee Concerns

3.14 At the public hearing on 23 August 2002 the Committee inquired into several areas of CSIRO's project management. These were:

- Development of Project Management expertise;
- Variability in quality of Project Management;
- Cross-subsidisation of externally funded projects;
- Costing practices ; and
- The Control of Intellectual property.

Development of project management expertise

3.15 The Committee was concerned about the apparent lack of project management expertise throughout CSIRO. CSIRO spends more than $700 million dollars in research and development each year and so project management is an important function for the cost effective expenditure of Commonwealth resources.

3.16 At the hearing CSIRO advised that it had addressed the lack of project management expertise with considerable training and development efforts.[1]

1 Transcript, pp. 18-19.

Committee Comment

3.17 The Committee notes that many of the differences in management practices between projects are cultural differences within the various divisions of the CSIRO. A key challenge for the CSIRO is to ensure that project management across the organisation improves in a systematic and structured way.

3.18 The Committee considers that CSIRO needs to pay attention to establishing and implementing consistent practices across the organisation, in order to facilitate consistent and coherent project management.

Variability in quality of project management

3.19 The Committee was concerned by the variability in project management standards between projects. For example, the ANAO found that externally funded projects were more likely to have effective project management than internally funded projects.[2]

3.20 The CSIRO attributed this to the long term nature of the internally funded projects and the differing demands of industry in externally funded projects. However, the Committee noted that, if the model applied to externally funded projects was applied to those funded entirely by appropriations, a number of the disparities would be resolved.

3.21 The CSIRO advised the committee that:

> Generally speaking, when a project is formulated for an industrial partnership, there are pretty clear guidelines. Even then, obviously a project can blow out. When, however, it is about the creation of new knowledge, then it really is quite difficult to predict exactly how a project will come out. Handling contingencies is one of those difficulties that we have in the day-to-day life of our senior managers.[3]

3.22 The Committee considers, however, that the disparities demonstrate a lack of depth in project management skills across the CSIRO.

3.23 The CSIRO acknowledges that there needs to be considerable cultural change in order for effective project management to become a corporate benchmark.[4]

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2 ANAO, Audit Report No. 51, Research Project Management, p. 13.

3 Sandland, *Transcript*, p. 22.

4 Sandland, *Transcript*, p. 19.

Committee Comment

3.24 The Committee notes that there has been significant effort expended by CSIRO in improving project management of all projects. However, project management within CSIRO would be enhanced by a consistency of project management practices across divisions and across projects and training in a consistent project management methodology.

Recommendation 4

3.25 **The Committee recommends that the Commonwealth Scientific and Industrial Research Organisation develop and implement a consistent and coherent model of project management across the organisation.**

Cross-subsidisation of externally funded projects

3.26 The Committee noted that a number of projects which were to be externally funded were subsidised unintentionally from appropriations due to insufficient accounting and costing rigour.

3.27 In response the CSIRO advised that since 1 July 2002 the corporate overheads have been allocated on a project by project basis.[5]

Costing practices

3.28 The CSIRO advised the Committee that:

> I think it would be fair to say that probably we are adopting a more prescriptive approach from a corporate perspective in terms of definitions of projects and how people should use the systems. I think the audit finding was that we do have a project support system that identifies costs and other aspects of each project but we have not actually been prescriptive across all of those business units as to how they ought to use that system.[6]

3.29 However, the Committee noted that there were still significant difficulties in determining the true costs of a project. The Committee noted other evidence by the CSIRO that there is some disparity between what is

5 Garrett, *Transcript*, p. 22.

6 Garrett, *Transcript*, p. 18.

happening in a particular project and the information available through financial and project systems.[7]

3.30 In part, this anomaly should be addressed by the work that CSIRO is planning to undertake in the next twelve months in relation to project management processes. However, the Committee considers that more attention should be paid to accurate, complete and competent costing of projects.

The Control of intellectual property

3.31 The ANAO noted that the pricing structure for consulting projects depended, in part, on the amount of intellectual property retained by CSIRO, reflecting the value of the project to CSIRO.[8] However, the ANAO observed that there were no clear guidelines on valuing intellectual property leading to a diversity of practice.[9]

3.32 CSIRO also advised that there was a diversity of practice regarding the retention of intellectual property depending on the funding source of the project and any specific agreements with project partners.[10]

3.33 The Committee urged CSIRO to develop clear policy guidelines for the retention of IP which are more consistent across various types of projects.[11] In this regard the committee drew the CSIRO's attention to the system in place at Purdue University in Indiana where a single non-negotiable policy is in place which sees intellectual property where the company retains one third, the university one third and the researcher one third. [12]

Recommendation 5

3.34 **The Committee recommends that the Commonwealth Scientific and Industrial Research Organisation develop and implement clear and consistent policy guidelines for the retention of intellectual property.**

7 Garrett, *Transcript*, p. 25.
8 ANAO, Audit Report No. 51, p. 63.
9 ANAO, Audit Report No. 51, p. 63.
10 Sandland, *Transcript*, p. 24.
11 *Transcript*, p. 24.
12 *Transcript*, p. 24.

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Audit Report No. 57, 2001-2002

Management Framework for Preventing Unlawful Entry into Australian Territory

Introduction

Background

4.1 Current government policy is to facilitate the lawful international movement of people while regulating the entry and presence of non-citizens in Australia. Under Australia's *Migration Act 1958,* which is administered by the Department of Immigration and Multicultural and Indigenous Affairs (DIMIA), people who are not Australian citizens are required to hold a current visa to enter and stay in Australia.

4.2 A non-citizen who is in Australia without a valid visa is defined as an unlawful non-citizen. DIMIA classifies unlawful non-citizens into the following categories:

- Unauthorised arrivals – persons who arrive without the correct documentation;
- Overstayers – persons who enter the country legally and later become unlawful by overstaying their visas; and

- Persons who are breaching visa condition – persons whose visas have been cancelled for reasons such as working without permission.[1]

4.3 In response to a significant increase in the number of unauthorised arrivals and illegal immigration activity in early 1999, the Government developed a whole of government strategy, which involved a number of measures to prevent unlawful entry into Australia.[2]

4.4 The Australian National Audit Office (ANAO) categorised these measures as offshore, border and onshore measures. The basis of the ANAO classification relates to where the primary activity for individual measures takes place.[3]

4.5 Offshore measures can be viewed as the first line of defence in protecting the integrity of the Australian border. These measures mainly seek to detect, disrupt and deter potential unauthorised arrivals from travelling to and entering Australia. These measures include:

- the placement of additional Principal Migration Officers (Compliance) (PMO(C)s) in source and transit countries to detect people attempting to travel to Australia illegally, strengthen information gathering, and combat document and identity fraud and people smuggling;
- the placement of additional Airline Liaison Officer (ALOs) to work with airlines in key transit countries to intercept potential unauthorised arrivals en-route to Australia;
- the establishment of a joint Australian Federal Police (AFP)-DIMIA People Smuggling Strike Team to investigate, detect and disrupt organised people smuggling;
- the imposition of penalties on commercial carriers who bring unauthorised or inadequately documented passengers to Australia;
- the implementation of an overseas information campaign to deter people smugglers and potential unauthorised arrivals from travelling to Australia;

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1 ANAO, Audit Report No. 57, *Management Framework for Preventing Unlawful Entry into Australian Territory*, 2001–2002, Commonwealth of Australia, p. 10.

2 Agencies other than DIMIA involved in the strategy include the Australian Customs Service (ACS), the Australian Federal Police (AFP), the Australian Quarantine and Inspection Service (AQIS), the Department of Foreign Affairs and Trade (DFAT), the Department of Defence (Defence), Coastwatch, the Department of the Prime Minister and Cabinet (PM&C) and the Attorney-General's Department (A-GD).

3 ANAO, Audit Report No. 57, 2001–2002, p. 11.

- the provision of offshore humanitarian processing, technical training and support, economic assistance, and negotiation of bilateral return and readmission agreements with key source and transit countries; and
- the international engagement with other countries, United Nations High Commission for Refugees (UNHCR), International Organisation for Migration (IOM) and in multicultural fora which enables Australia to participate in the development of a global approach and to influence international policy.[4]

4.6 These measures are designed to have a positive impact on the level of unlawful entry and, as a result, the downstream border processing, detention costs, and onshore compliance costs incurred by the Commonwealth.[5]

The ANAO audit

4.7 The objective of the audit was to assess DIMIA's management of offshore measures to prevent and detect unlawful entry to Australia, and to identify any opportunities for improvement.

4.8 The audit did not cover the processing arrangements referred to as the Pacific Strategy, introduced as part of legislative changes in September 2001. Nor did it cover the range of measures used to prevent unlawful entry at the border and to detect unlawful non-citizens onshore.[6]

Audit findings

4.9 Audit Report No. 57, 2001-2002, *Management Framework for Preventing Unlawful Entry into Australian Territory*, found that:

- DIMIA did not have a formal risk identification, monitoring and management process in place at the corporate or operational levels. In addition there had been no systematic or pro-active approach to identify, manage and monitor the various risks associated with administering measures to prevent, detect and disrupt unlawful entry;
- there were no formal guidance documents available at the operational level;
- objectives and expected outcomes were not always clear, impacting on DIMIA's ability to account for its performance;

4 ANAO, Audit Report No. 57, 2001–2002, p. 11.

5 ANAO, Audit Report No. 57, 2001–2002, p. 11.

6 ANAO, Audit Report No. 57, 2001–2002, p. 36.

- the Intelligence Analysis Section did not have a database to store, manage and analyse information, leading to reliance on the corporate memory of staff and an inability to access or retrieve information easily;
- DIMIA had still to develop a comprehensive performance information framework to support its internal monitoring and external reporting requirements.[7]

The JCPAA's review

4.10 On 23 August 2002, the Joint Committee of Public Accounts and Audit held a public hearing to review the progress made by DIMIA in relation to the implementation of the ANAO's recommendations.

4.11 The Committee took evidence on the following issues:

- planning and administration; and
- DIMIA's intelligence function.

Planning and administration

4.12 Planning is an essential element of an effective corporate governance framework and efficient and effective administration. The audit report stated that sound planning arrangements in DIMIA were particularly important given the dynamic environment in which the department operates and the number of external agencies involved.[8]

4.13 The ANAO found that DIMIA did not have a formal risk identification, monitoring and management process in place at corporate or operational levels. Nor was there a systematic or pro-active approach to identify, manage and monitor the various risks associated with administering measures to prevent, detect and disrupt unlawful entry. The ANAO noted that DIMIA was in the process of developing a risk management strategy which was intended to be fully operational in 2003.[9]

4.14 The audit report also found that, while DIMIA had reflected details of government policy on unlawful entry in a variety of public documents, there would be benefit in its articulating in detail to staff how individual

7 ANAO, Audit Report No. 57, 2001–2002, pp. 15-17.
8 ANAO, Audit Report No. 57, 2001–2002, p. 38.
9 ANAO, Audit Report No. 57, 2001–2002, p. 48.

measures fitted into DIMIA's approach to prevention of unlawful entry. No formal guidance documents were available at the operational level.[10]

4.15 It was not evident to the ANAO that there had been any attempt at integrating the planning approaches of the two branches with primary responsibility for managing and monitoring the majority of measures to prevent unlawful entry.[11]

4.16 The Committee invited DIMIA to detail any issues it wished to raise in relation to the audit recommendations.[12]

4.17 DIMIA responded by giving an overview of its reaction to the audit report:

> The recommendations of the report relate to the processes of internal governance. We accept those recommendations and we are putting considerable resources into addressing them. I would observe that we were already putting some resources into them at the time of the audit and had made considerable investments in this area before the audit report was tabled.
>
> … it is our view that as an organisation DIMIA had made considerable positive steps towards more effective corporate governance.[13]

4.18 It was DIMIA's view that within the areas covered by the audit there had been substantial increases in the level of unauthorised arrivals which, at the time, impacted upon its ability to make improvements in corporate governance:

> … if an organisation is going through a particularly challenging and difficult period, it is difficult to focus to the extent that might otherwise be desirable upon formal strategic planning and documentation processes.[14]

4.19 DIMIA stated that its priority during the period of increased levels of unauthorised arrivals was dealing with the significant challenge to the border integrity of Australia and not developing strategic plans and documenting relationships:

> We do not question the significance of undertaking those actions for good corporate governance and, indeed, that is why we are

10 ANAO, Audit Report No. 57, 2001–2002, p. 48.
11 ANAO, Audit Report No. 57, 2001–2002, pp. 48-9.
12 *Transcript*, 23 August 2002, p. 29.
13 D. Moorhouse, DIMIA, *Transcript*, 23 August 2002, p. 29.
14 Moorhouse, *Transcript*, 23 August 2002, p. 29.

> investing significant resources in that area. We would have felt more fairly treated if there had been a more substantial acknowledgment of the strategy that we were undertaking and the achievements that we have made.[15]

4.20 The Committee sought comment from the ANAO.[16]

4.21 The ANAO acknowledged that DIMIA had had an enormous workload and had worked under a lot of pressure and would have been pleased with its results in preventing unauthorised entry. The ANAO considered that DIMIA probably would have liked to have seen some greater acknowledgment of those achievements in the [audit] report.[17]

4.22 The ANAO continued:

> Our audit had a particular focus. We did make the point that we felt that [DIMIA] did place too much emphasis on the ability of individuals to respond effectively to particular situations based on their skills and experience rather than to rely on accepted government practices. The very clear message in the report from our point of view was that you cannot continue to rely on individuals responding to situations or it is risky doing that; you need to put in place sound and accepted governance arrangements as well.[18]

4.23 The ANAO considered that it and DIMIA were not too far apart in terms of the governance issues raised by the audit report.[19]

4.24 The Committee drew attention to audit recommendation no. 1, which concerned the development of an integrated approach to the implementation and management of measures to prevent unlawful entry into Australia. The Committee asked DIMIA how implementation of the recommendation would improve its performance.[20]

4.25 DIMIA replied that its agreement with the recommendation acknowledged the sophistication of the challenge being faced:

> We have people involved in the people-smuggling business who are … smart people who are well resourced and involved in a very profitable business. Therefore, there is a high level of organisation

15 Moorhouse, *Transcript*, 23 August 2002, p. 30.
16 *Transcript*, 23 August 2002, p. 31.
17 I. McPhee, ANAO, *Transcript*, 23 August 2002, pp. 30-1.
18 McPhee, *Transcript*, 23 August 2002, p. 31.
19 McPhee, *Transcript*, 23 August 2002, p. 31.
20 *Transcript*, 23 August 2002, p. 38.

> behind attempts to bring unlawful or unauthorised people to Australia.[21]

4.26 DIMIA told the Committee that it recognised the value of the ANAO's recommendation and acknowledged that in facing such well organised and well resourced opponents there was no room for complacency:

> We have to adopt the best practice in relation to strategic planning …. and I believe the recommendations by the ANAO will give us some guidance in that regard.[22]

4.27 DIMIA drew attention to its level of achievement in relation to establishing an outcome and output framework and in implementing accrual accounting and output based budgeting:

> As an organisation, we have been at the front of the pack in relation to those sorts of measures. I acknowledge that in the area that we are discussing today some of the next steps have been delayed. ….
>
> Frankly, our resources were very much directed towards dealing with the particular challenge that we were facing as a country. …. as soon as we have had a chance to turn to it, that is where we have been putting our resources.[23]

4.28 The ANAO commented that it did not disagree with DIMIA's evidence in terms of what it was doing and where it might be going in the future. It acknowledged the good initiatives that DIMIA had put in place. The ANAO emphasised that the audit report provided DIMIA with a stimulus to focus on the governance issues and asked for more discipline in the management framework going forward.[24]

People Smuggling Strike Team

4.29 In 1999 the Australian Federal Police (AFP) and DIMIA established a People Smuggling Strike Team (PST) to investigate, detect and disrupt organised people smuggling.[25]

4.30 The audit report stated that while the PST had had some successes, at the time of the audit the AFP and DIMIA had not developed a strategy or framework for investigating organised people smuggling:

21 D. Moorhouse, DIMIA, *Transcript*, 23 August 2002, p. 38.
22 Moorhouse, *Transcript*, 23 August 2002, p. 38.
23 Moorhouse, *Transcript*, 23 August 2002, pp. 39-40.
24 McPhee, *Transcript*, 23 August 2002, pp. 38-9.
25 ANAO, Audit Report No. 57, 2001–2002, p. 11.

> This contributed to a lack of clarity across both organisations concerning the objective, scope and focus of the PST; limited ability to provide assurance of PST performance; insufficient development of processes and procedures to support investigations and whole of government interactions; and limited intelligence to drive and support investigations.[26]

4.31 The AFP advised the ANAO that it had initiated and drafted a PST Memorandum of Understanding (MOU) between itself and DIMIA which outlined procedures on such things as: prioritisation of investigations; liaison intelligence management; and financial issues. It also provided measurement for outputs, and onshore and offshore performance measures.[27]

4.32 The Committee asked DIMIA why the MOU had not yet been signed.[28]

4.33 DIMIA replied that it had made considerable amendments and suggestions to the AFP who had taken on the task of drafting and finalising the MOU.[29]

4.34 In response to the Committee's querying the delay, DIMIA said:

> It is an issue of getting two operational agencies to come to terms with having a joint agency strike team, which is a relatively unique structure in a lot of ways. …. Both agencies have wanted to be very clear in the MOU about what the roles are of both agencies but, in the same context, how the agencies are brought together to manage that joint task force. ….
>
> The MOU is specifically to do with the operations of the joint agency strike team, whose focus is on the prosecution of the criminal elements within people smuggling.[30]

4.35 DIMIA noted that for some time it had had a broad-based client service agreement with the AFP that covered how the two agencies as a whole dealt with each other.[31]

4.36 The Committee sought comment from DIMIA on whether it thought that its overall management practices had had some impact on its capacity to complete the MOU with the AFP.[32]

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26 ANAO, Audit Report No. 57, 2001–2002, p. 46.

27 ANAO, Audit Report No. 57, 2001–2002, p. 46.

28 *Transcript*, 23 August 2002, p. 31.

29 N. Siegmund, DIMIA, *Transcript*, 23 August 2002, p. 31.

30 Siegmund, *Transcript*, 23 August 2002, pp. 31-2.

31 Siegmund, *Transcript*, 23 August 2002, p. 32.

4.37 DIMIA conceded that it may have done:

> … the two financial years 2000-01 and 1999-2000 saw record numbers … of unauthorised arrivals entering Australia so we were very focused on trying to deal with that, more so than we were on finalising the MOU. So, yes, it would have had an impact in that sense.[33]

Committee comments

4.38 The Committee notes that DIMIA has relied heavily on individuals in its agency and their intuitive risk management, but is now developing a risk management strategy which is expected to be completed in mid 2003.

4.39 The Committee's impression is that DIMIA has been somewhat slower than other agencies to adopt some of the new approaches to management in terms of risk management, governance, planning and linking operational plans to strategic plans.

4.40 To achieve organisational objectives and better outcomes, the Committee considers that DIMIA needs to pay far greater attention to framework issues, and not focus only on implementation of policy and its response to business pressures.

4.41 At the same time, the Committee is aware that DIMIA was subjected to a great deal of pressure due to the recent increase in the level of unauthorised arrivals and acknowledges its effective response.

DIMIA's intelligence function

4.42 The intelligence function is the key departmental mechanism for identifying current and emerging trends and risks, and supporting the department's executive and operational areas in the development of risk management strategies and measures. The National Crime Authority's (NCA's) definition of intelligence is 'insight or understanding on the nature and / or extent of a current or future threat, developed through the careful analysis of available information that provides direction for effective action'.[34]

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32 *Transcript*, 23 August 2002, p. 40.

33 Siegmund, *Transcript*, 23 August 2002, p. 40.

34 ANAO, Audit Report No. 57, 2001–2002, p. 50.

4.43 DIMIA's intelligence function forms part of a wider whole of government intelligence collection and coordination effort to detect and deter unauthorised arrivals, particularly by boat.[35]

4.44 The audit report found that although the Intelligence Analysis Section provided tactical and operational intelligence support for the department, there would be benefit in the department's developing a strategic intelligence capability to provide insight and understanding, including advice on current and emerging trends relating to unlawful entry.[36]

4.45 The audit noted that much of the information required to facilitate an understanding of the nature and extent of the wider unauthorised migration problem, including the identification of current and emerging trends and threats, already existed, but had not been utilised to inform management of emerging strategic issues.[37]

4.46 The Committee asked whether it would have been possible to have implemented some of the management practices recommended in the audit report prior to the upsurge in activity levels that eventuated.[38]

4.47 DIMIA replied that it would have been possible to have undertaken the implementation of its intelligence function faster, but that it was important to build that capacity in a structured way:

> … it is important to acknowledge that you have got to make some first steps. If we are talking about a strategic intelligence capacity within the organisation, the first thing one needs is an intelligence collection network. You have got to have some information to deal with first. We started putting in place our immigration compliance officer network in the early nineties. We have gradually built on that network and now have … 24 staff offshore.[39]

4.48 DIMIA stated that in recent years it had established a better structured, resourced and more focused intelligence analysis capacity:

> … it is important that you have the collection network, the analysis capacity and then move on to using that intelligence available to you in a strategic way and become an intelligence driven organisation.[40]

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35 ANAO, Audit Report No. 57, 2001–2002, p. 50.

36 ANAO, Audit Report No. 57, 2001–2002, p. 55.

37 ANAO, Audit Report No. 57, 2001–2002, p. 55.

38 *Transcript*, 23 August 2002, p. 39.

39 Moorhouse, *Transcript*, 23 August 2002, p. 39.

40 Moorhouse, *Transcript*, 23 August 2002, p. 39.

4.49 In response to the Committee's question on whether there was any scope for modelling in DIMIA's relationships with other agencies, DIMIA replied that it considered modelling of value. It said that it was looking to other organisations such as the Australian Customs Service (ACS), which had a developed intelligence capacity, to provide models in terms of how to proceed with the development of its strategic intelligence capacity:

> We will certainly be focusing on learning what we can, both from the audit report and other organisations.[41]

4.50 The Committee noted the audit comment that there was a reliance on current personnel and asked DIMIA if there was a time frame for putting the necessary information technology (IT) resources in place to support the intelligence function.[42]

4.51 DIMIA stated that it was in the process of introducing an intelligence database IT system:

> … that has been a very important resource for us and we have pressed forward with respect to obtaining it. It is a complicated [issue] as well, because there are obvious issues of security on the IT side with all the complexities of having a database brought in to an agency that already has quite a substantial IT system in place.[43]

4.52 In reference to the issue of relying on individuals, DIMIA acknowledged that in setting up the intelligence analysis section it had deliberately recruited intelligence professionals in order to develop a tactical and operational intelligence response as quickly and effectively as possible. DIMIA considered that it was now able to move to a strategic level, namely, how to utilise intelligence to best arm the agency for whatever lay ahead.[44]

Committee comments

4.53 The Committee notes that the Director of DIMIA's Intelligence Analysis Section has been given the task of developing a strategic intelligence function as part of the development and expansion of the departmental intelligence capability.

41 Moorhouse, *Transcript*, 23 August 2002, pp. 40-1.
42 *Transcript*, 23 August 2002, p. 43.
43 Siegmund, *Transcript*, 23 August 2002, p. 43.
44 Siegmund, *Transcript*, 23 August 2002, pp. 43-4.

4.54 It also notes that the Intelligence Analysis Section has developed a framework for the information collection process which will inform a revised collection priorities plan.[45]

Recommendation 6

4.55 **The Committee recommends that the Department of Immigration and Multicultural and Indigenous Affairs make better use of its information sources, evaluate the effectiveness of its current operations, and coordinate the sharing of information with other agencies.**

45 DIMIA, Submission no. 4 p. 3.

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Audit Report No. 63, 2001-2002

Management of the DASFLEET Tied Contract

Introduction

Background

5.1 Until July 1997, a former Department of Administrative Services (DAS) business unit, DASFLEET, supplied passenger and commercial vehicles to the majority of Commonwealth bodies, with the total active fleet managed by the business unit comprising over 16 000 vehicles. The book value of the fleet was approximately $376 million as at January 1997 and DASFLEET returned a net operating profit in its last year of Commonwealth ownership of just over $23 million.[1]

5.2 The Government announced in the August 1996 Budget its intention to realise the Commonwealth's investment in the vehicles then owned and managed by DASFLEET. The Government indicated that this would be accomplished either by a trade sale of the whole business or by external refinancing of the vehicles. Sale and refinancing tender processes were

1 ANAO, Audit Report No. 63, 2001–2002, *Management of the DASFLEET Tied Contract*, Commonwealth of Australia, p. 27.

conducted in tandem by the then Office of Asset Sales (OAS)[2] and its Business Adviser (Barings)[3]

5.3 Two bids for refinancing of DASFLEET's vehicles were received on 29 April 1997 and three bids for the purchase of the DASFLEET business were received on 26 May 1997. The bids for both options were then assessed. On the basis of advice provided by Barings on 9 June 1997, the Office of Asset Sales and IT Outsourcing (OASITO) on the same day recommended to the then Minister for Finance that DASFLEET be sold rather than refinanced and asked that the Minister 'endorse our recommendation of Macquarie Bank as the party with whom we should pursue final negotiations'. The then Minister for Finance agreed to OASITO's recommendation and there were no further negotiations with the second ranked bidder after 9 June 1997.[4]

5.4 Following a number of negotiated changes to the Sale Agreement and the Tied Contract, the then Minister for Finance and the then Minister for Administrative Services announced that DASFLEET was to be sold to Macquarie Fleet. The Sale Agreement was signed on 17 July 1997 and the Tied Contract on 1 September 1997.[5]

5.5 A number of commercial disputes arose out of the 1997 sale of DASFLEET to Macquarie Bank and the operation of the five-year Tied Contract with Macquarie Fleet Leasing (Macquarie Fleet) [Macquarie Fleet Leasing is a wholly owned subsidiary of Macquarie Bank and is the entity which signed the Tied Contract]. These disputes were the subject of substantial negotiation between the Commonwealth and Macquarie Fleet and an independent arbitration process.[6]

5.6 In August 1999, the Joint Committee of Public Accounts and Audit (JCPAA) commenced a review of Audit Report No. 25 1998-99, *DASFLEET Sale*. The Committee held a public hearing on 13 August 1999 and a further hearing on 26 August 1999. The Committee was advised at the hearings that commercial disputes had arisen in relation to both the Sale Agreement and the Tied Contract and that the matters were proceeding to

2 The Office of Asset Sales (OAS) was established in October 1996 to manage the Commonwealth Government's major asset sales and it reported directly to the Minister for Finance. In November 1997, OAS become the Office of Asset Sales and IT Outsourcing (OASITO). On July 1 2001, the agency became known as the Office of Asset Sales and Commercial Support (OASACS).

3 ANAO, Audit Report No. 63, 2001–2002, p. 9. OASITO's Business Adviser was Baring Brothers Burrows & Co., Limited.

4 ANAO, Audit Report No. 63, 2001–2002, p. 35.

5 ANAO, Audit Report No. 63, 2001–2002, pp. 35-7.

6 ANAO, Audit Report No. 63, 2001–2002, p. 10.

arbitration. In light of the evidence provided by the Department of Finance and Administration (DoFA) and the then Office of Asset Sales and IT Outsourcing (OASITO), the Committee resolved to temporarily suspend its review until the arbitration was complete.

5.7 Settlement of the disputes with Macquarie Fleet / Macquarie Bank occurred on 5 July 2001.[7]

The ANAO audits

5.8 The objectives of Audit Report No. 25, 1998-1999 were to review the efficiency and effectiveness of the conduct of the sales process for DASFLEET.[8]

5.9 The objectives of Audit Report No. 63, 2001-2002 were to:

- assess the effectiveness of DoFA's management of the Commonwealth's exposure under the DASFLEET Tied Contract;
- assess the effectiveness of DoFA's monitoring of performance of the DASFLEET Tied Contract; and
- review the action taken by DoFA in response to Recommendation No. 6 of Audit Report No. 25, 1998-1999 that it undertake a comprehensive risk assessment of the Commonwealth's exposure under the Tied Contract.[9]

ANAO findings

5.10 Audit Report No. 25, 1998-1999 found that:

- despite the closeness of the two highest bidders for DASFLEET, the second ranked bid was not fully evaluated;
- despite the complexity of the transaction, coupled with the scale and nature of the financial analysis used to judge the relative merits of the bids, OASITO had not placed itself in a position to ensure that the ultimate decision maker could rely on the information about each tender contained in the evaluation report;
- action was not taken to identify and specifically quantify the financial risks in the five year Tied Contract associated with the Commonwealth

7 ANAO, Audit Report No. 63, 2001–2002, p. 75.
8 ANAO, Audit Report No. 25, *DASFLEET Sale*, 1998–1999, Commonwealth of Australia, p. 26.
9 ANAO, Audit Report No. 63, 2001–2002, p. 32.

accepting exposure to the variations in the RBA assessment of the required risk weighting for capital adequacy purposes;

- the RBA classified leases entered into under the Tied Contract as finance leases; and
- the financial implications of the five year Tied Contract were such that the Commonwealth was exposed to a range of commercial risks including increased leasing charges to agencies and potential responsibility for the cost of terminating the contract.[10]

5.11 Audit Report No. 63, 2001-2002 found, *inter alia*, that:

- in the course of the arbitration process, and in light of the Arbitrator's October 2000 Interim Award, it became clear that, through the operation of the residual risk management mechanism, the Commonwealth did indeed effectively bear all the risk for the vehicles leased under the Tied Contract with Macquarie Fleet;
- due to serious issues in relation to the Tied Contract and the completion statements for the Sale Agreement arising almost immediately after the commencement of the Tied Contract, DoFA was not in a position to be able to effectively monitor Macquarie Fleet's performance under the Contract, or to effectively manage the Commonwealth's exposure under the Contract;
- DoFA was engaged in strenuous negotiations with Macquarie Fleet until late May 2001 and commissioned substantial expert advice from its advisers to inform it on the legal, commercial and financial consequences of not only the proposals from Macquarie Fleet for settlement but also the alternative options in relation to the Tied Contract;
- DoFA prepared a detailed business case to support the final settlement proposal, which was submitted to the then Minister on 6 June 2001;
- DoFA actively monitored expenditure on advisers in relation to the DASFLEET disputes (DoFA advised that the total external provider costs for the management of the Tied Contract and the disputes on it and the Sale Agreement totalled more than $9.6 million to 31 October 2001, including nearly $7 million for professional advice. DoFA's estimate of its total staff costs for managing the disputes between August 1997 and October 2001 was $1.5 million, but could not accurately determine the amount of staff costs related to the

10 ANAO, Audit Report No. 25, 1998-1999, pp. 11, 12-13, 47.

management of the disputes and the amount incurred for the normal contract management activities required);

- as a result of arbitration and the whole of dispute settlement completed by DoFA for the disputes with Macquarie Fleet / Macquarie Bank, the total potential exposure of the Commonwealth to possible payments to Macquarie Fleet was reduced from around $100 million originally claimed by Macquarie Fleet to around $50 million; and
- lessons learnt from the commercial disputes arising from the Tied Contract with Macquarie Fleet were generally implemented by DoFA in negotiating the whole of dispute settlement and the Amended Tied Contract with Lease Plan Australia.[11]

The JCPAA's Review

5.12 At the public hearing on 20 September 2002, the Joint Committee of Public Accounts and Audit took evidence on the following issues:

- Commonwealth exposures; and
- Commonwealth costs.

Commonwealth exposures

Sale of DASFLEET

5.13 On the basis of advice provided by Barings in June 1997, OASITO recommended to the then Minister for Finance that DASFLEET be sold rather than refinanced. The Information Memorandum issued to prospective purchasers advised that offers were to assume that vehicle leasing arrangements post sale would be conducted on an operating lease basis.[12]

5.14 Further negotiations were held with Macquarie Bank and a sale agreement was signed between the Commonwealth and Macquarie Fleet for the sale of DASFLEET for $407.9 million.[13]

11 ANAO, Audit Report No. 63, 2001–2002, pp. 13, 15, 75, 82.
12 ANAO, Audit Report No. 63, 2001–2002, p. 35.
13 ANAO, Audit Report No. 63, 2001–2002, p. 9.

5.15 It has become clear that, through the operation of the residual risk management mechanism, the Commonwealth did indeed effectively bear all the risk for the vehicles leased under the Tied Contract with Macquarie Fleet.[14]

5.16 The Committee drew attention to advice it had received during the 1999 public hearings from the then CEO of OASITO, Mike Hutchinson, who stated that the vehicle leases were operating leases in the accounts of the agencies, and that only part of the transaction, the head agreement, was itself a finance lease.[15]

5.17 Evidence given by Macquarie Bank to the arbitration was that it:

> … regarded the transaction from a financial perspective as a loan and therefore if we didn't receive back all the moneys that we were advancing, part of which would be through the Reserve Account mechanism, then that would be, you know, we wouldn't be getting part of our principal back.[16]

5.18 The Committee then asked DoFA whether there was still any question in its mind as to what type of lease it had entered into under the Tied Contract.[17]

5.19 DoFA replied that it was clear with hindsight, having read all the documents, that it was a finance lease:

> … it is clear to me, reviewing this, that we were entering into a finance lease. I understand that it is treated as a finance lease in the accounts of the Commonwealth for a whole of government approach.[18]

5.20 The Committee asked the ANAO whether it was true that the tender documents indicated that the government expected an operating lease with the accompanying understanding that the Commonwealth would be transferring risk for the operation of its vehicle fleet to the lessor rather than accepting the risk as the lessee.[19]

5.21 The ANAO agreed that this had been the stated intent.[20]

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14 ANAO, Audit Report No. 63, 2001–2002, p. 15.

15 *Transcript*, 20 September 2002, p. 47; *Transcript*, 13 August 1999, p. 9.

16 ANAO, Audit Report No. 63, 2001–2002, p. 15.

17 *Transcript*, 20 September 2002, p. 47.

18 Hodgson, *Transcript*, 20 September 2002, p. 47.

19 *Transcript*, 20 September 2002, p. 47.

20 Cochrane, *Transcript*, 20 September 2002, p. 47.

5.22 In response to the Committee's question as to whether it would have been clear to DoFA from the original contract and Barings' advice that the Commonwealth was entering into a finance lease, DoFA stated:

> I think it is very unclear from the documents exactly what was intended or what the outcome would be.[21]

Contract issues

5.23 The Committee was advised by DoFA that the lack of clarity in the DASFLEET sale was due to the level of complexity in the contract. The Committee asked whether the contract needed to be that complex.[22]

5.24 DoFA replied:

> My personal view is no, it did not have to be that complex. I am not sure why it was set up in such a complex way. I think, trying to understand what was in the mind of various people at the time, that there was a concern that the government may have been giving away some benefits in the deal and it wanted to make sure it had an opportunity to claw back those benefits. By that I mean the increase in vehicle value over time if there was any, or the increase over the intended benchmark. In an attempt to try and cover that off, I think what was ended up being negotiated was a very complex …. Contract which was very difficult to administer and difficult to interpret.[23]

5.25 The Committee asked whether other existing contracts had been reviewed to ensure that the Commonwealth's interests were protected.[24]

5.26 DoFA advised that its internal audit function had carried out a review of all contracts entered into and any issues identified were addressed:

> It was clear from very early on that [the DASFLEET sale] contract was difficult. There were differences of view as to what the contract meant. It was not a sleeper; it did not creep up on the people involved; it was clear from very early on that it was difficult to administer.[25]

21 Hodgson, *Transcript*, 20 September 2002, p. 47.
22 *Transcript*, 20 September 2002, p. 48.
23 Hodgson, *Transcript*, 20 September 2002, p. 48.
24 *Transcript*, 20 September 2002, p. 55.
25 Hodgson, *Transcript*, 20 September 2002, p. 55.

5.27 The Committee noted that the tender information provided to the Commonwealth in relation to the DASFLEET sale was very limited and asked the ANAO whether there had been transparency.[26]

5.28 The ANAO replied:

> [The ANAO] could not understand [the tender documents], and we tried for months to work out what the standard Commodore or Ford vehicle price was that was being bid. ….
>
> We could not relate material from the tender into the contract in respect of what was being charged.[27]

5.29 The Committee drew attention to its contract management inquiry[28] where it took evidence that one organisation had for some years established a procedure with its construction contracts where tenderers were required to produce to the purchaser their full costing sheets within 24 hours of the close of tenders. The Committee asked DoFA whether it had ever considered implementing full disclosure by tenderers.[29]

5.30 In response, DoFA stated that its standard practice was to ask for a detailed breakdown of the costs so that tender costs, expected completion times and personnel requirements formed part of the tender.

5.31 The Committee suggested to DoFA that it consider the benefits of requiring fuller disclosure for tenders.

Risk weighting

5.32 The DASFLEET Tied Contract specifically required the Commonwealth to bear the risk associated with any decision of the prudential regulator (initially the RBA) to assess a different capital adequacy requirement for the DASFLEET transaction to the 10 per cent requirement assumed by Macquarie Fleet in its bid for DASFLEET. This was not a requirement of any of the other bidders for DASFLEET.[30]

5.33 At the time, the RBA's capital adequacy guidelines allowed assets of a bank, which represented government risk, to be risk weighted at 10 per cent for capital adequacy purposes. A loan to a corporate was risk rated at 100 per cent. In early September 1997, Macquarie Bank advised OASITO

26 *Transcript*, 20 September 2002, pp. 51-2.

27 Cronin, *Transcript*, 20 September 2002, p. 62.

28 JCPAA, Report 379, *Contract Management in the Australian Public Service*, October 2000, Commonwealth of Australia.

29 *Transcript*, 20 September 2002, p. 61.

30 ANAO, Audit Report No. 63, 2001–2002, p. 16.

that the RBA had indicated that it would treat the transaction as being weighted not a 10 per cent but rather at 100 per cent.[31]

5.34 During negotiation with Macquarie Fleet in June 1997, the risk that the RBA would determine a capital adequacy requirement for the DASFLEET transaction different to that assumed by Macquarie Fleet in its offer was transferred to the Commonwealth. This issue was not specifically mentioned in the main body of the brief to the then Minister for Finance on 30 June 1997 which recommended that he agree to the sale of DASFLEET to Macquarie Fleet and enter into the Tied Contract with Macquarie Fleet. However, Barings' advice which was attached to the brief, noted this as a risk event.[32]

5.35 At no time did OASITO seek advice from the RBA as to its view of the commercial risk associated with the transaction and how it was likely to assess the transaction for capital adequacy purposes.[33]

5.36 OASITO told the ANAO that it had a risk management strategy designed to secure for the Commonwealth the benefits of an expected 10 per cent RBA weighting, while affording Macquarie protection against an adverse outcome that was assessed as unlikely:

> The capacity of the Commonwealth to negotiate or effectively cancel the transaction in the event that a 10 per cent weighting did not apply was designed to manage the relevant regulatory risk. That is the way any other purchaser of services would need to deal with regulatory uncertainty. OASITO did not seek to place the Commonwealth in a more advantageous position because the RBA happens to be a Commonwealth agency.[34]

5.37 On 15 October 1997 OASITO advised the then Minister for Finance that:

> The Commonwealth is contractually obliged to pay higher lease charges to compensate for the cost to Macquarie of holding a higher level of deposits for capital adequacy purposes, unless an alternative can be agreed to maintain the 10 per cent risk weighting.[35]

5.38 The margin increase (from 0.45 per cent per annum to 1.95 per cent per annum) suggested by Macquarie would have increased average lease rates

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31 ANAO, Audit Report No. 63, 2001–2002, p. 37.

32 ANAO, Audit Report No. 63, 2001–2002, pp. 37-8.

33 *Transcript*, 20 September 2002, p. 58.

34 ANAO, Audit Report No. 25, 1998-1999, p. 50.

35 ANAO, Audit Report No. 63, 2001–2002, p. 39.

and resulted in additional costs over the Contract's life of some $25 million.[36]

5.39 In February 1998, OASITO (on behalf of the Commonwealth) and Macquarie Bank made a joint submission to the RBA on the issue of the appropriate capital risk weighting for capital adequacy purposes that should apply to the DASFLEET Tied Contract transaction. The joint submission noted that a finance lease, where the lessor has recourse to the lessee for the full lease receivable, was risk weighted at 10 per cent for government lessees.

5.40 The parties argued that in their opinion 'the Tied Contract leasing arrangement is, in substance, a finance lease which should be risk weighted at 10 per cent'. The joint submission set out the details of the parties' case for why Macquarie Bank (and Macquarie Fleet) had full recourse to the Commonwealth for the entire lease receivable.[37]

5.41 The RBA agreed in June 1998 that a 10 per cent risk weighting would apply to individual leases entered into under the Tied Contract with Macquarie Fleet and which were due to expire before the Tied Contract matured. However, for vehicle leases that were to expire beyond that date, the RBA considered that a 100 per cent risk weighting would apply. Accordingly, the Commonwealth remained exposed to an increase in Macquarie Fleet's margin for those vehicle leases due to expire after 31 August 2002.[38]

5.42 It was the Committee's opinion that a reasonable person would accept that a risk rating of 10 per cent would tend to indicate with whom the risk lay, and expressed surprise that the risk rating seemed not to have alerted the Commonwealth to the nature of the contract into which it was entering.[39]

5.43 DoFA commented in response it considered that the mistake was that the Commonwealth took the risk of that variation without really understanding the potential for that variation to move so dramatically.[40]

5.44 The Committee asked DoFA why neither OASITO nor Barings had bothered to approach the RBA to get its views on the likely risk weighting to be assigned to the contract before advice was sent to the then Minister.[41]

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36 ANAO, Audit Report No. 63, 2001–2002, p. 38.

37 ANAO, Audit Report No. 63, 2001–2002, p. 40.

38 ANAO, Audit Report No. 63, 2001–2002, p. 16.

39 *Transcript*, 20 September 2002, p. 49.

40 Hodgson, *Transcript*, 20 September 2002, p. 50.

41 *Transcript*, 20 September 2002, p. 58.

5.45 In reply, DoFA stated that it would have looked at the rules and regulations surrounding capital adequacy requirements and applied them. If there were any questions flowing from that, DoFA advised that it would have approached the RBA for its views.[42]

5.46 The ANAO commented that Macquarie Bank's bid offered a margin rate one-fifth of that offered by the second ranked tenderer, Lease Plan, which had to relate to how the transaction was treated on its books:

> If Macquarie did not have it on their books then they did not have to claim much of a margin in terms of their capital adequacy. If Lease Plan were carrying it on its books, which it expected to, it had to fully fund that. That is the heart of the problem, and it goes right through to the selection: did [the Commonwealth] actually select the best candidate in terms of a risk return trade-off …? That process of not knowing what the RBA was doing and not knowing the deal then set in train all the other events.[43]

5.47 The Committee advised DoFA that OASITO had told the ANAO that it did not accept that it stood in a reporting line between advisers and the Minister and did not evaluate Barings' advice before it was passed to the Minister. The Committee sought DoFA's comments on OASITO's position, and asked whether DoFA accepted that it had a role in advising the Minister on broad issues such as the sale of an asset.[44]

5.48 DoFA replied that it certainly had a role in advising the Minister on such issues:

> Certainly the Department of Finance and Administration has always adopted a policy of standing between advice given and the minister and of advising the minister independently if that is appropriate.[45]

5.49 In response to the Committee's question as to why OASITO had a different view, the ANAO stated:

> … our report merely records the fact that OASITO had a much different view of their approach, which surprised us to some extent, because we though that OASITO should have taken a bit

42 Pahlow, *Transcript*, 20 September 2002, p. 58.

43 Cronin, *Transcript*, 20 September 2002, p. 59.

44 *Transcript*, 20 September 2002, p. 46.

45 Hodgson, *Transcript*, 20 September 2002, p. 46.

> more interest in the advice it was receiving from its advisers before passing it on to the minister.[46]

Value for money

5.50 The bids for DASFLEET were assessed by Barings on the basis of a Relative Whole of Government (RWOG) approach which took into account, amongst other things, the initial lump sum offer price and the future vehicle lease and fleet management rates. The future vehicle lease rates are primarily determined by the estimated residual values of the vehicles and the cost of funds; the latter comprises the benchmark leasing rate and a lender's margin.[47]

5.51 In assessing the bids, Barings used a 6.2 per cent benchmark cost of funds to which was added the bidders' various margins. By far the largest component of the cost of funds arises from the benchmark rate as opposed to the lenders' margin rate.[48]

5.52 The aim of a RWOG analysis was to ensure that the sale outcome generated the most favourable net present value (NPV) return to the Commonwealth. The Macquarie Bank bid was considered by Barings to generate the highest NPV to the Commonwealth based on all inputs to the RWOG analysis. The Macquarie Bank bid had the largest up front payment and the lowest cost of funds for the vehicles leased but it had a higher fleet management rate than that proposed by the second ranked bidder (Lease Plan).[49]

5.53 Barings advised that Macquarie Bank's bid provided for an estimated overall financial outcome of a net present value (NPV) over 6 years of $116 million, $6 million better than the bid from Lease Plan.[50]

5.54 Barings advised the ANAO that 'the Commonwealth and its advisers had more than sufficient grounds on which to make the decision to continue negotiations with the winning bidder'.[51]

5.55 The ANAO pointed out in its earlier audit report that there were risks for the Commonwealth in accepting a qualified or conditional bid too early:

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46 Cochrane, *Transcript*, 20 September 2002, pp. 46-7.

47 ANAO, Audit Report No. 25, 1998-1999, p. 35-6.

48 ANAO, Audit Report No. 25, 1998-1999, p. 36.

49 ANAO, Audit Report No. 25, 1998-1999, p. 36.

50 ANAO, Audit Report No. 25, 1998-1999, pp. 40-1.

51 ANAO, Audit Report No. 25, 1998-1999, p. 41.

> The preferred bidder may seek, during these negotiations, to reduce the margin by which they won the bid through reducing their effective price by modifying the risk allocation between themselves and the Commonwealth.[52]

5.56 During the hearing, the Committee asked the ANAO about the alternative bidder to Macquarie Bank.[53]

5.57 The ANAO replied:

> Lease Plan were actually offering a genuine operating lease. That explains the large difference in the funding margin [of its bid]. If you take that out, Lease Plan had significantly cheaper components in terms of the vehicle operatings.[54]

5.58 When the Committee asked the ANAO whether the Commonwealth would have been better off under the Lease Plan arrangements, the ANAO pointed out that the Amended Tied Contract was now with Lease Plan. [55]

> Following the settlement of the disputes and the novation of the Tied Contract to Lease Plan Australia, Macquarie Fleet no longer has any involvement in the provision of fleet leasing services under the Tied Contract.[56]

5.59 In response to further Committee questioning on whether the Commonwealth had received value for money from the DASFLEET sale, DoFA stated that it had not undertaken that analysis:

> My understanding from reading previous transcripts of evidence is that Mr Hutchinson [the former CEO] from OASITO estimated [the profit] to be $88 million … in present value terms. We have not done the analysis but my gut feeling is that we have not eaten into $878 million in terms of amounts either received from or paid to Macquarie Bank.
>
> We estimate settlement and all amounts paid – adjustments to sale proceeds, both disputed and non-disputed – to be less than $50 million.[57]

52 ANAO, Audit Report No. 25, 1998-1999, p. 42.
53 *Transcript*, 20 September 2002, p. 51.
54 Cochrane, *Transcript*, 20 September 2002, p. 51.
55 Cronin, *Transcript*, 20 September 2002, p. 51.
56 ANAO, Audit Report No. 63, 2001–2002, p. 77.
57 Pahlow, *Transcript*, 20 September 2002, pp. 52-3.

5.60 The Committee sought to confirm with DoFA that it considered the Commonwealth to be some $38 million better off as a result of the DASFLEET sale.[58]

5.61 DoFA responded that, on the basis of the information provided by OASITO, $38 million was the approximate benefit to the Commonwealth.[59]

5.62 The Committee noted that DASFLEET's net operating profit in the last year of Commonwealth ownership was some $23 million. The Committee. inquired whether OASITO, in its calculations that the benefit to the Commonwealth from the disposal of DASFLEET was an estimated $88 million in present value terms, took into account the net operating profit of DASFLEET over the term of the contract.[60]

5.63 DoFA took the question on notice and later advised that the scoping study estimates took into account projected DASFLEET levels of annual profit or loss.[61]

Committee comment

5.64 The Commonwealth considered that in disposing of DASFLEET it had engaged in a trade sale of the DASFLEET business together with a five year Tied Contract for the provision of vehicles leasing and fleet management services to Commonwealth Public Account (CPA) agencies. The alternative of externally refinancing the fleet had been specifically explored and rejected.[62]

5.65 It became clear during the arbitration process that, contrary to the Commonwealth's view, Macquarie Bank had bid for DASFLEET on the basis that some $15 million of the total price tendered was for the purchase of the business and the remaining $392.9 million related to the sale and leaseback of the vehicle fleet.[63]

5.66 This resulted in Macquarie Bank's providing external refinancing of the Commonwealth's fleet at an interest rate approximately 67 basis points higher than that at which the Commonwealth could have funded the fleet itself (equivalent to the 5-week Treasury note rate). The ANAO estimated

58 *Transcript*, 20 September 2002, p. 53.

59 Pahlow, *Transcript*, 20 September 2002, p. 53.

60 *Transcript*, 20 September 2002, pp. 53-4.

61 DoFA, Submission No. 8**,** p. 4.

62 ANAO, Audit Report No. 63, 2001–2002, p. 15.

63 ANAO, Audit Report No. 63, 2001–2002, p. 15.

the difference between the Commonwealth's funding the refinancing of the vehicle fleet itself compared to refinancing it through the Tied Contract with Macquarie Fleet was around $6.9 million over the total life of the Tied Contract.[64]

5.67 The Committee considers that the government's objective was to sell the DASFLEET business as well as the risk of that business. The Commonwealth's perception early in the sale was that the majority of the risk was being borne by Macquarie Fleet.

5.68 The different mechanisms for sharing risk offered by the bidders were reflected in their differing margins over the benchmark leasing rate cost of funds. The margin rate offered by Macquarie Bank in its May 1997 binding offer was one-fifth of that offered by the next highest bidder, Lease Plan, in the first year of the transaction. In the case of the Macquarie Bank bid for DASFLEET, there was a direct linkage between the interest rate payable by the Commonwealth, as customer, on the leasing of the fleet and the regulatory risk weight determined by the RBA for the transactions.[65]

5.69 A short time after the sale, to avoid a change in the RBA's risk weighting from 10 per cent to 100 per cent and the consequent additional cost impact to the Commonwealth of some $25 million, the Commonwealth and Macquarie Bank together put a submission to the RBA, and it was agreed that the transaction represented, at a whole of government level, a finance lease.

5.70 It is clear to the Committee from evidence uncovered by the audit that Macquarie Bank viewed the arrangement from the beginning as a risk free investment. In short, Macquarie Bank had a very good understanding of the contract and the Commonwealth did not.

5.71 When the arbitrator looked at the commercial disputes in relation to the Tied Contract, one of the elements he took into account was the fact that the RBA, the Commonwealth and Macquarie Bank were in agreement that the arrangement was a finance lease and that the risk was with the Commonwealth. The arbitrator considered that this fact supported the arguments that Macquarie Bank was making about the purchase price of the vehicles et cetera. This led to an interim decision by the arbitrator which was not the outcome that the Commonwealth had been seeking from the arbitration process.

64 ANAO, Audit Report No. 63, 2001–2002, pp. 15-16.

65 ANAO, Audit Report No. 25, 1998-1999, p. 50.

5.72 The Committee considers that OASITO should have ensured that the RBA was approached prior to the DASFLEET sale for formal confirmation of how the RBA would treat the transaction for risk weighting purposes.

5.73 Macquarie Bank's bid of May 1997 for DASFLEET indicated that its lower transaction funding rate was based on the RBA assessing the transaction for capital adequacy purposes at the rate of 10 per cent. OASITO chose the Macquarie Bank tender and the low interest rate, but failed to realise that the lower risk weighting indicated that the risk would remain with the Commonwealth.

5.74 When the capital adequacy ratio was assessed by the RBA at 100 per cent if the risk was to lie with Macquarie Bank, the Commonwealth had to convince the RBA that it bore all the risk to ensure that its lower transaction funding rate remained intact. To have done otherwise would have resulted in the Commonwealth paying Macquarie Bank some $25 million in higher lease charges.

5.75 The Committee cannot understand how an assessment of a capital adequacy requirement of 10 per cent did not alert OASITO as to where the risk of the transaction would lie.

5.76 The two highest bidders for DASFLEET were close in financial terms having regard both to the up front lump sum offered and the ongoing charges proposed. Macquarie Fleet Leasing intended to sub-contract fleet management to a company (Serco) which had no fleet management experience. The second ranked bidder, Lease Plan, was Australia's largest fleet management company. Despite this, no further negotiations were held with the second ranked bidder after mid June 1997.[66]

5.77 The Committee agrees with the ANAO that in evaluating bids in such a competitive process, negotiations should be continued until one bid is identified as clearly presenting a superior outcome in terms of the overall risk and return. In the Committee's view, if this process had been carried out, the Commonwealth would have stood a much improved chance of receiving value for money from the DASFLEET sale.

5.78 The Committee notes that at several points, advice from Barings came to OASITO and was forwarded on the same day to the then Minister with a recommendation for action.

5.79 The Committee considers that there was effectively no capacity in that circumstance to review the advice before making a recommendation to the Minister.

66 ANAO, Audit Report No. 25, 1998-1999, p. 42.

5.80 The role of the Public Service in such a process is to act as a means of value adding. Business advisers provide advice, and if public servants are involved, it is their role to evaluate that advice and to check that the decision maker has an appropriate basis on which to make an informed decision and take a recommended course of action.

5.81 The Committee finds it unacceptable that OASITO did not evaluate Barings' advice and that OASITO did not accept that it stood in a reporting line between advisers and its Minister.

Commonwealth costs

5.82 As a result of the arbitration process and the Interim Award, the total potential exposure of the Commonwealth to possible payments to Macquarie Fleet was reduced from around $100 million originally claimed by Macquarie Fleet to around $50 million. Various attempts at negotiating a resolution of the DASFLEET matter had occurred over the course of the disputes, most significantly between June 2000 and the 26 October 2000 handing down of the Interim Award. However, when a settlement could not be secured prior to the Arbitrator's decision on the Interim Award, both parties withdrew all settlement offers. Negotiations were recommenced between the parties in early November 2000.[67]

5.83 On 3 February 2001, the then Minister approved the' whole of dispute' settlement framework approach subject to substantial improvements being obtained in the settlement offer from Macquarie Fleet and DoFA obtaining comprehensive legal advice to underpin any view that a commercially sound settlement had been arrived at. The ANAO stated that DoFA had been engaged in strenuous negotiations with Macquarie Fleet until late May 2001. Offers and counter-offers were exchanged between the parties. At the same time, DoFA commissioned substantial expert advice from its advisers to inform it on the legal, commercial and financial consequences of not only the proposals from Macquarie Fleet for settlement but also the alternative options of termination of the Tied Contract or continuation of the continuation of arbitration, litigation and performance of the Tied Contract by Macquarie Fleet.[68]

5.84 Macquarie Fleet's letter of commercial intent of 23 May 2001 led to the negotiation of a final settlement agreement. DoFA prepared a detailed

67 ANAO, Audit Report No. 63, 2001–2002, p. 75.

68 ANAO, Audit Report No. 63, 2001–2002, p. 75.

business case to support the final settlement proposal, which was submitted to the then Minister on 6 June 2001. The business case outlined the dispute, activities aimed at resolving the dispute and the proposed settlement. All material supporting documents were attached, including drafts of the detailed sign-offs to be provided by DoFA's advisers, including the Department's Probity Adviser. On 29 June 2001, the then Minister approved the settlement basis and signed an instrument authorising a senior DoFA officer to approve and exercise the settlement documentation.[69]

5.85 Following the settlement of the disputes and the novation of the Tied Contract to Lease Plan Australia, Macquarie Fleet no longer had any involvement in the provision of fleet leasing services under the Tied Contract. The Commonwealth has assumed the full residual risk on the vehicles currently on lease as at the date of settlement. New leases entered into under the Amended Tied Contract are operating leases and the Commonwealth bears no residual risk on these vehicles.[70]

5.86 As part of the settlement principles, the Commonwealth paid Macquarie Fleet $15.7 million and Macquarie Fleet paid the Commonwealth $8 million, resulting in a net payment by the Commonwealth to Macquarie Fleet of $7.7 million.[71]

5.87 The complex commercial disputes that arose in connection with the DASFLEET transaction resulted in substantial additional costs to the Commonwealth. Costs were incurred in the attempt to monitor and manage the Tied Contract, in the attempts to resolve the commercial disputes, and by both DoFA and the Office of Asset Sales and Commercial Support (OASACS) for legal and commercial advisers and other experts in relation to the Tied Contract and Sale Agreement disputes.[72]

5.88 In July 1999, management of the two disputes was combined under DoFA's administration. From July 1999, OASACS met half the costs incurred by DoFA in the management of the disputes.[73]

5.89 The ANAO stated in its report that DoFA had actively monitored expenditure on advisers in relation to the DASFLEET disputes but had advised that it was unable to determine accurately the amount of the costs that related to the management of the disputes and the amounts incurred

69 ANAO, Audit Report No. 63, 2001–2002, p. 75.
70 ANAO, Audit Report No. 63, 2001–2002, pp. 77-8.
71 ANAO, Audit Report No. 63, 2001–2002, p. 72.
72 ANAO, Audit Report No. 63, 2001–2002, p. 81.
73 ANAO, Audit Report No. 63, 2001–2002, p. 81.

for the normal contract management activities required. DoFA advised that this was due to the overwhelming effect of the disputes on the management of the Tied Contract.[74]

5.90 The Committee asked DoFA about the possibility of quantifying the total cost of the DASFLEET sale exercise, including the additional costs incurred by the disputes.[75]

5.91 DoFA responded that to cost the whole exercise would itself incur a further large cost. However, DoFA indicated to the Committee that it had an estimate of the hours spent on the disputes and in-house costs.[76]

5.92 DoFA later confirmed in a submission to the Committee that its records did not differentiate between contract administration and dispute administration. DoFA's estimate of its staff salary cost between August 1997 and October 2001 for staff engaged in the management of the Tied Contract and the handling of the DASFLEET dispute was $1.5 million.

5.93 DoFA noted that it had assumed that the total costs of the dispute process should reasonably include the costs of DoFA staff associated with the management of the DASFLEET dispute and the costs associated with DoFA's retention of external expertise. DoFA estimated these costs to be $11.2 million.[77]

5.94 The ANAO report noted that OASACS' staff costs for the period September 1997 to October 2001 were estimated by DoFA to be $0.72 million.[78]

5.95 The Committee asked DoFA why the resolution of the disputes with Macquarie Fleet took so much longer to achieve than either DoFA or OASITO officials forecast when they appeared before the Committee in August 1999.[79]

5.96 In response, DoFA stated that the unfavourable interim ruling 'meant that we did not want to just accept that and pay that money; we wanted to pursue it further. So [resolution of the disputes] took longer than would have been the case. When we got into the issues … they were more complex, the views on either side were more entrenched than was

74 ANAO, Audit Report No. 63, 2001–2002, p. 82-3.
75 *Transcript*, 20 September 2002, p. 63.
76 *Transcript*, 20 September 2002, p. 63.
77 DoFA, Submission No. 8**,** pp. 5-6.
78 ANAO, Audit Report No. 63, 2001–2002, p. 83.
79 *Transcript*, 20 September 2002, p. 64.

originally thought and there was more interrelationship between the issues'.[80]

Barings' advice

5.97 The Committee asked DoFA whether it had looked at the written advice on the sale of DASFLEET provided by Barings at the time.[81]

5.98 DoFA replied:

> The simple answer to your question is no. When I took responsibility for this area it was for the management of the current contract that the Commonwealth had entered into. Although at that stage we were heavily in dispute, I [apprised] myself of what most of the issues in the dispute were rather than going back to see what advice had been given at the time. Quite extensive work has been done by various teams that have looked at what the intent was at the time, what was agreed and what was thought to be agreed.[82]

5.99 The Committee advised that it was trying to obtain an appraisal of the quality of Barings' advice in view of the circumstances and asked the ANAO to comment.[83]

5.100 The ANAO noted that it had not audited the advice given by Barings but stressed that procedures had to be improved to ensure that better work from consultants was obtained.[84]

5.101 The ANAO noted that a distinguishing feature of the sale was that there was no tender evaluation committee, which was a common feature of activities where tenders are being sought:

> As a standard rule, [the ANAO] supports this concept of having this evaluation, because you would have had people in from the then Department of Administrative Services who had a lot of experience in running and managing the fleet, you would have had people in from the then Office of Asset Sales and you would have had advisers, and together you would go through the tender in a systematic way and work out whether in fact the Commonwealth got advice. [OASITO] did not have a tender

80 Hodgson, *Transcript*, 20 September 2002, p. 64.

81 *Transcript*, 20 September 2002, p. 54.

82 Hodgson, *Transcript*, 20 September 2002, p. 54.

83 *Transcript*, 20 September 2002, p. 54.

84 Cochrane, *Transcript*, 20 September 2002, p. 54.

> evaluation committee in place for [the DASFLEET sale] so the information went … straight from the adviser through to the minister.[85]

5.102 The Committee asked DoFA what contractual arrangements with advisers it now had, what terms and conditions were imposed and whether the advisers were indemnified.[86]

5.103 DoFA replied that it did not indemnify advisers for bad advice:

> If [advisers] give us bad advice, we have the right to pursue them for the consequences of that bad advice. ….
>
> That is contractual. That is the way we approach the contracting of our advisers.[87]

5.104 In response to the Committee's question on how many advisers had been pursued for bad advice, DoFA stated:

> I am not aware of any but that does not mean to say they have not been. ….
>
> I was not involved in Barings.
>
> I have been very happy with the quality of advice that I have received in the time that I have been responsible for [DASFLEET sale issues].[88]

5.105 The Committee asked DoFA whether DoFA, on behalf of the Commonwealth, had ever sought to recover any moneys from Barings.[89]

5.106 DoFA replied that it had not done so, but that there had been a 'serious look at whether we could sue Barings for bad advice':

> There was legal advice sought as to whether that was a course of action which would be productive. The advice we received said it would be difficult to succeed in such a case. The main reason it would be difficult to succeed was that it would be difficult to identify exactly the loss incurred by the Commonwealth as a result of the bad advice and, therefore, difficult to assess what you would actually sue them for and how the court could assess what

85 Cronin, *Transcript*, 20 September 2002, p. 55.
86 *Transcript*, 20 September 2002, p. 57.
87 Hodgson, *Transcript*, 20 September 2002, p. 57.
88 Hodgson, *Transcript*, 20 September 2002, p. 57.
89 *Transcript*, 20 September 2002, p. 59.

> damage had been done to the Commonwealth as a result of bad advice.[90]

5.107 DoFA claimed that it would be difficult within a whole-of-dispute settlement to clearly say, 'this bit of it relates to any settlement of the issue related specifically to any questionable advice by Barings'.[91]

5.108 The ANAO stated that if the question arose of losses on the sale, had it been undertaken one way as against the other, it did not think that it would be possible to determine an actual dollar loss. However, the ANAO stated that it had not sought advice on the question of whether loss recovery should have been pursued in this case.[92]

5.109 After the public hearing, the Committee wrote to DoFA requesting that DoFA supply a copy of the legal advice on which it had relied and a copy of the request for advice and any associated briefing material prepared to assist in briefing counsel.

5.110 DoFA declined to supply the legal advice but provided a summary paragraph which it included in its reply:

> In conclusion there are a number of difficulties or potential obstacles which may arise in seeking to establish in court the loss suffered by the Commonwealth, and the cause of that loss, in any action for breach of contract or negligence arising out of the Purchase Price of Vehicles issues. The nature and scope of the factual inquiry that the Commonwealth would need to undertake, the expense involved in obtaining the necessary evidence (both expert and lay), and the uncertainty that those investigations would ultimately establish loss, suggest that, the costs of those investigations may exceed the likely benefit to be gained by their pursuit. Although the Commonwealth would likely incur less expense in attempting to establish loss based on the known quantity of costs paid by the Commonwealth, for the legal and expert advice received in relation to the DASFLEET dispute, the Commonwealth will face similar difficulties in attempting to prove causation to those described above (i.e. that those costs were incurred by reason of the breach of contract, or negligence, of the Commonwealth's former advisers).[93]

90 Hodgson, *Transcript*, 20 September 2002, p. 59.

91 Hodgson, *Transcript*, 20 September 2002, p. 60.

92 Cochrane, *Transcript*, 20 September 2002, pp. 60, 64.

93 DoFA, Submission No. 8**,** p. 7.

5.111 DoFA advised the Committee that its request for a legal opinion was made orally to its legal advisers, Phillips Fox Lawyers, and that no departmental briefing, discussion paper or letter was provided to assist in briefing counsel.[94]

Committee comment

5.112 It is quite clear to the Committee that in the case of the DASFLEET sale, OASITO did not understand the contract. With hindsight, it is easy to say that it should have, but it did not. As a result, the Commonwealth had a poorly constructed and complex contract and a total misunderstanding of the nature of the arrangement it was entering into.

5.113 The Commonwealth's understanding of the DASFLEET sale contract appears to have emerged over several years. The ANAO told the Committee that DoFA has worked hard to try to effect some remedy for the Commonwealth but was left in a very difficult position. In the end, DoFA's efforts in the settlement process reduced the Commonwealth's potential exposure by a very significant amount.

5.114 It is clear that there have been substantial costs to the Commonwealth in connection with the DASFLEET transaction which were not envisaged at the start of the sale process. The Commonwealth paid $7.7 million to Macquarie Fleet as part of the final settlement, external provider costs and DoFA staff costs for the management of the Tied Contract and DASFLEET Dispute totalled $11.1 million and OASACS' staff costs were $0.72 million.

5.115 At the hearing the Committee requested advice from DoFA regarding the cost of the dispute process. While DoFA was able to provide an estimate of costs, the Committee notes that DoFA's records do not differentiate between contract administration costs and dispute costs.

5.116 The Committee is of the view that effective record keeping and administrative practices would allow for that differentiation to be made. The Committee considers that in this regard DoFA's practices and procedures were inadequate.

Recommendation 7

5.117 **The Committee recommends that the Department of Finance and Administration improve its record management practices with regard to**

94 DoFA, Submission No. 8, p. 7.

dispute resolution activities.

5.118 Given the complexity of the leasing arrangements and the potential for significant risk to Commonwealth revenue, the Committee considers it undesirable that DoFA’s request for a legal opinion was made orally. The Committee considers that in future DoFA’s requests for legal opinions should be written requests to enable the context of legal advice to be properly ascertained when decisions are reviewed.

Recommendation 8

5.119 **The Committee recommends that in future the Department of Finance and Administration’s requests for legal opinions are written requests.**

Summary

5.120 The Committee is concerned about the following aspects of the DASFLEET transaction:

- that OASITO did not evaluate Barings’ advice before passing it to the Minister;
- that OASITO did not accept that it stood in a reporting line between advisers and its Minister;
- that OASITO did not adequately pursue negotiations with the second ranked bidder;
- that OASITO failed to realise that a capital adequacy requirement of 10 per cent indicated that the risk of the transaction would lie with the Commonwealth;
- that the Commonwealth did indeed effectively bear all the risk for the vehicles leased under the Tied Contract, when this was not the original intention of the sale;
- that the Commonwealth ended up with a finance lease when its expressed intention was to have an operating lease;
- that the Commonwealth did not understand the nature of the contract which it was entering into;

- that the Commonwealth incurred substantial costs in connection with the DASFLEET sale that were not envisaged at the start of the sale process.

Bob Charles MP
Chairman
12 December 2002

A

Appendix A—Conduct of the Committee's review

Selection of audit reports

The Auditor-General presented 29 reports in the Fourth Quarter of 2001–2002. These were:

- No. 39 Performance Audit
  Management of the Provision of Information to Job Seekers
  Department of Employment and Workplace Relations
- No. 40 Performance Audit
  Corporate Governance in the Australian Broadcasting Corporation
  Australian Broadcasting Corporation
- No. 41 Performance Audit
  Transactional Banking Practices in Selected Agencies
- No. 42 Performance Audit
  Integrity of the Electoral Roll
  Australian Electoral Commission
- No. 43 Performance Audit
  Indigenous Education Strategies
  Department of Education, Science and Training
- No. 44 Performance Audit
  Australian Defence Force Fuel Management
  Department of Defence

- No. 45 Assurance and Control Assessment Audit
Recordkeeping
- No. 46 Performance Audit
Management of an IT Outsourcing Contract
Department of Veterans' Affairs
- No. 47 Performance Audit
Administration of the 30 per cent Private Health Insurance Rebate
Department of Health and Ageing, Health Insurance Commission, Australian Taxation Office, Department of Finance and Administration, Department of the Treasury
- No. 48 Assurance and Control Assessment Audit
Regional Assistance Programme
Department of Transport and Regional Services
- No. 49 Performance Audit
The Management of Commonwealth National Parks and Reserves 'Conserving our Country'
Department of Environment and Heritage
- No. 50
A Preliminary Examination into the Allocation of Grant Funding for the Co-Location of National General Practice Organisations
- No. 51 Performance Audit
Research Project Management
Commonwealth Scientific and Industrial Research Organisation (CSIRO)
- No. 52 Financial Control and Administration Audit
Internal Budgeting
- No. 53 Assurance and Control Assessment Audit
Goods and Services Tax Administration by Commonwealth Organisations
- No. 54 Performance Audit
Drug Detection in air and Containerised Sea Cargo and Small Craft
Australian Customs Service
- No. 55 Performance Audit
Administration of Tobacco Excise
Australian Taxation Office
- No. 56 Performance Audit
Workforce Planning in the Department of Immigration and Multicultural and Indigenous Affairs

- No. 57 Performance Audit
  Management Framework for Preventing Unlawful Entry into Australian Territory
  Department of Immigration and Multicultural and Indigenous Affairs
- No. 58 Performance Audit
  Defence Property Management
  Department of Defence
- No. 59 Performance Audit
  AusAID Contract Management
  Australian Agency for International Development
- No. 60 Performance Audit
  Costing of Operational Activities and Services follow-Up Audit
  Centrelink
- No. 61 Information Support Services
  Managing People for Business Outcomes
  Benchmarking Study
- No. 62 Information Support Services
  Benchmarking the Finance Function follow-up Report
  Benchmarking Study
- No. 63 Performance Audit
  Management of the DASFLEET Tied Contract
- No. 64 Performance Audit
  Management of Learning and Development in the Australian Public Service
- No. 65 Performance Audit
  Management of Commonwealth Superannuation Benefits to Members
- No. 66 Performance Audit
  Aviation Safety Compliance Follow-up Audit
  Civil Aviation Safety Authority

The Joint Committee of Public Accounts and Audit discussed the above audit reports and considered whether the issues and findings in the reports warranted further examination at a public hearing. In making this assessment the Committee considered, in relation to each audit report:

- the significance of the program or issues canvassed in the audit report;
- the significance of the audit findings;
- the response of the audited agencies, as detailed in each audit report, and

- the extent of any public interest in the audit report.

Following this consideration, the Committee decided to take evidence at public hearings on the following audit reports:

- Audit Report No. 40, *Corporate Governance in the Australian Broadcasting Corporation*

  Australian Broadcasting Corporation

- Audit Report No. 51, *Research Project Managemen*t

  CSIRO

- Audit Report No. 57, *Management Framework for Preventing Unlawful Entry into Australian Territory*
  Department of Immigration and Multicultural and Indigenous Affairs

- Audit Report No. 63*, Management of the DASFLEET Tied Contract*
  Department of Finance and Administration. .

The evidence

The Committee held public hearings in Canberra on 23 August 2002 and 20 September 2002. The transcript of evidence taken at the hearings is reproduced at Appendix C.

B

Appendix B—Submissions & Exhibits

Submissions

No.	Individual/Organisation
1	Australian Federal Police
2	CSIRO
3	Australian Broadcasting Corporation
4	Department of Immigration and Multicultural and Indigenous Affairs
5	Australian Customs Service
6	Australian National Audit Office
7	CSIRO
8	Department of Finance and Administration
9	Department of Immigration and Multicultural and Indigenous Affairs

Exhibits

No.	Individual/Organisation and Title
1.	Australian Customs Service, *Intelligence Doctrine*
2.	Australian Customs Service, *Customs Planning Guide*
3.	Australian Customs Service, *Corporate Plan 2001-2004*
4.	CPA Australia, *Case Studies in Public Sector Risk Management*, Public Sector Centre of Excellence

C

Appendix C—Transcript of evidence