

<b>Submission</b> <b>No 1</b>
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**FOLLOW UP OF THE AUDITOR-GENERAL'S  
PERFORMANCE AUDITS SEPTEMBER 2010 - FEBRUARY  
2011**

**Organisation:** NSW Treasury  
**Name:** Mr Philip Gaetjens  
**Position:** Secretary  
**Telephone:** 02-9228 4788  
**Date Received:** 21/03/2012

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**Theme:**

**Summary**



Contact: Peter Wade  
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Our Reference: EA1662015

Mr Jonathan O'Dea  
Chair  
Legislative Assembly Public Accounts Committee  
Parliament of New South Wales  
Macquarie Street  
SYDNEY NSW 2000

7 8 MAR 2012

Dear Mr O'Dea

**Auditor-General's Report on NSW Lotteries Sale Transaction**

I refer to your request for a submission outlining Treasury's response to the Auditor-General's performance audit of the NSW Lotteries transaction, tabled November 2010.

Treasury's response to the audit is published in the Auditor-General's report, and a copy is attached for your reference. In Treasury's view, the Auditor-General's recommendations reflect good practice for asset sale transactions, and as such none of the recommendations were rejected. Some of the recommendations were however considered to be largely superfluous as Treasury had in fact followed them in the Lotteries transaction. Nevertheless, Treasury undertook to remain mindful of the recommendations in future transactions.

Since the audit of the NSW Lotteries transaction was tabled, there are two major asset transaction processes for which Treasury was/is directly responsible to the Treasurer:

- the sale of WSN Environmental Solutions, which was completed in 2011
- the proposed lease of Port Botany, which was foreshadowed in the September 2011 State Budget.

The WSN transaction process was well advanced by the time Treasury received the Lotteries audit report. But to the extent possible, the recommendations from the Lotteries audit were adopted for the WSN transaction (details are in the attached table).

The potential long-term lease of Port Botany is currently in the very early scoping study phase, and as such the Lotteries audit is of limited relevance at this early stage. As the Port Botany project progresses, the recommendations from the Lotteries audit will be applied at the appropriate time.

Treasury has also been mindful of the Lotteries audit recommendations and sought to promote them as appropriate where it has participated on steering committees for other asset sales, such as the 2010 electricity transactions and the long term lease of the Sydney desalination plant, which is currently in progress.

As requested, I attach a completed template report of Treasury's response to the audit.

Should you wish to discuss this matter, please contact Richard Timbs, Executive Director, on 9228 3340.

Yours sincerely

A handwritten signature in black ink, appearing to be 'P. Gaetjens', with a stylized flourish at the end.

Philip Gaetjens  
Secretary

Cc: The Hon. Mike Baird MP

## PERFORMANCE AUDIT - NSW Lotteries Sales Transactions

### IMPLEMENTATION OF RECOMMENDATIONS

RECOMMENDATION	ACCEPTED OR REJECTED	ACTIONS TO BE TAKEN	DUE DATE	STATUS (completed, on track, delayed) and COMMENT	RESPONSIBILITY (section of agency responsible for implementation)
<p>1 Where the Government chooses to conduct a process on the basis that "proponents could not rely on any statement by or on behalf of the State during the process" this point is continuously reinforced to proponents</p>	<p>Already adopted</p>	<p>Treasury will continue to be mindful of this recommendation for future transactions.</p>	<p>Ongoing</p>	<p>On track. The recommendation was adopted for the WSN Environmental Solutions transaction. As with the NSW Lotteries transaction, the legal advisers ensured that the non-reliance point was continuously reinforced to proponents.</p>	<p>Treasury Transactions Unit</p>
<p>2 The Process Letter clearly states that the Government's representatives involved in the transaction process cannot fetter the discretion or decision of a Minister</p>	<p>Accepted</p>	<p>The recommendation will be taken into account for future transactions.</p>	<p>Ongoing</p>	<p>On track. The November 2010 process letter for the WSN Environmental Solutions transaction included a statement to the effect that Government representatives could not fetter Ministerial decision-making.</p>	<p>Treasury Transactions Unit</p>

## PERFORMANCE AUDIT - NSW Lotteries Sales Transactions

### IMPLEMENTATION OF RECOMMENDATIONS

RECOMMENDATION	ACCEPTED OR REJECTED	ACTIONS TO BE TAKEN	DUE DATE	STATUS (completed, on track, delayed) and COMMENT	RESPONSIBILITY (section of agency responsible for implementation)
<p><b>3</b> Key terms are clearly defined and consistently applied to avoid ambiguity and confusion</p>	<p>Already adopted</p>	<p>This recommendation will continue to be taken into consideration for future transactions</p>	<p>Ongoing</p>	<p>On track - This recommendation was adopted for the WSN Environmental Solutions transaction. Significant care was exercised to ensure that the terms used in the process letters were well defined to limit any chance of confusion.</p>	<p>Treasury Transactions Unit</p>
<p><b>4</b> Significant decisions, advice and analysis of issues during the transaction process are formally documented and retained to improve accountability and transparency</p>	<p>Accepted</p>	<p>Treasury will continue to ensure that the highest standards of accountability, transparency and probity are applied to future transactions.</p>	<p>Ongoing</p>	<p>On track. This recommendation was adopted for the WSN Environmental Solutions transaction. Care was taken to ensure that all significant decisions, advice and analysis of issues during the transaction process were formally documented.</p>	<p>Treasury Transactions Unit</p>
<p><b>5</b> Significant guidance or advice to potential bidders is provided in writing</p>	<p>Accepted</p>	<p>To be adopted by Treasury for any future transactions.</p>	<p>Ongoing</p>	<p>On track. This recommendation was adopted for the WSN Environmental Solutions transaction.</p>	<p>Treasury Transactions Unit</p>

## PERFORMANCE AUDIT - NSW Lotteries Sales Transactions

### IMPLEMENTATION OF RECOMMENDATIONS

RECOMMENDATION	ACCEPTED OR REJECTED	ACTIONS TO BE TAKEN	DUE DATE	STATUS (completed, on track, delayed) and COMMENT	RESPONSIBILITY (section of agency responsible for implementation)
<p>6 Arrangements for dealing with intellectual property that may be contained in bids are clearly defined and communicated at the start of the process</p>	<p>Already adopted</p>	<p>To continue to be taken into consideration by Treasury for future transactions.</p>	<p>Ongoing</p>	<p>On track. The drafting of the process letters for the WSN Environmental Solutions transaction was consistent with this recommendation.</p>	<p>Treasury Transactions Unit</p>



The  
Treasury

Mr Peter Achterstraat  
Auditor-General  
The Audit Office of New South Wales  
GPO Box 12  
SYDNEY NSW 2001

Dear Mr Achterstraat

**Performance Audit of NSW Lotteries Transaction**

Thank you for providing me with the *Performance Audit - NSW Lotteries Sale Transaction*. This letter sets out NSW Treasury's comments on the report, pursuant to section 38C of the *Public Finance and Audit Act 1983*.

**Summary**

NSW Treasury is proud of the outstanding result achieved through the sale of NSW Lotteries. The sale price achieved was considerably in excess of both retention value to Government and the market expectations at the time.

We welcome the key findings of the Performance Audit, which are:

- "I found no evidence to indicate that the successful bid was inconsistent with the rules detailed in the Process Letter"
- "I found no evidence to indicate that all bidders were not provided with the same information in relation to unclaimed prizes"
- "...I found no evidence to indicate that the value of unclaimed prizes was not properly assessed, based on the assumptions used"
- "I found no evidence to indicate that the inclusion of unclaimed prizes in the successful bid was precluded by the Public Lotteries Act 1996."

We note the audit conclusion that:

- "Nothing has come to my attention in this audit of the NSW Lotteries Sale Transaction to indicate that there has been any waste of public resources or lack of financial prudence."

We also note the recommendations contained in the report. In our view, some of the recommendations are largely superfluous because the recommended course of action is consistent with what actually took place in the Lotteries transaction process. However, we will remain mindful of these matters in future transactions. We address each of the audit recommendations later in this letter.

The comments concerning an absence of documentation and record-keeping are acknowledged but not accepted by NSW Treasury and its Advisers. The members of the Review Committee and Steering Committee considered they had all relevant and appropriate information and briefing materials so as to allow them to make a recommendation on all aspects of the transaction and to properly discharge their duties.

To clarify what appeared to be some confusion at the Audit Office about the nature of the Audit and the legislative support for same, NSW Treasury obtained legal advice on the matter which was supplied to the Audit Office.

### **Scope of the Audit is very narrow**

We consider the scope of the Report to be too narrow in focus for a Performance Audit of a major asset sale. The Report appears to be focused almost exclusively on a number of unsubstantiated and unsourced assertions which were aired primarily through the media at the time of the transaction. Consequently, the Report does not cover major and important aspects of the transaction process.

The content of the Report does not reflect the comprehensive transaction process and it is essentially silent on the excellent value for money outcome for taxpayers. Specifically, topics which we believe the Report could have addressed but does not are:

- whether the transaction result delivered good value for money having regard to the objectives of the transaction
- Government's residual risk position following the Transaction
- execution risk(s)
- adherence to the Selection Plan and decision making to specified key decision criteria
- achievement of Government's stated transaction objectives
- confirmation that the best bid was selected according to the review criteria (as assessed by the Audit Office under their independent review)
- the existence and application of an appropriate probity framework within which the transaction activities were undertaken.

### **Audit Process**

To assist the Audit Office in its review NSW Treasury made available the Selection Plan outlining details as to how the review of offers was to be performed, all offer documentation received (including financial models provided by each proponent), all transaction documentation and the Evaluation Report prepared for the transaction Steering Committee by the Review Committee.



In addition to making available all the relevant information, senior members of NSW Treasury and its financial, legal and probity advisers who were directly involved in the Transaction including the evaluation of offers met with the Audit Office on several occasions to discuss the Transaction process and findings of the Review Committee.

To our knowledge the Audit Office did not interview as part of its audit of the Transaction representatives from Communities NSW, the regulator of the NSW Lotteries business, or senior Communities NSW personnel that participated as members of the Review Committee and Steering Committee.

In some areas the supporting discussion in the Report seems inconsistent with the key findings and conclusions.

### **Tatts Group's offer provided best value**

The NSW Lotteries transaction delivered an excellent financial return for taxpayers, unlocking over a billion dollars which has been used to strengthen the State's finances. The transaction proceeds were nearly double the retention value and significantly exceeded market expectations. Reports by analysts at the time valued NSW Lotteries between \$500m and \$630m, yet the transaction ultimately achieved a price of \$850m, plus the undisclosed additional cash extraction, which is referred to in the Report.

We note the Report's observation that Tatts Group's base and alternative offers were both assessed as the best against all the evaluation criteria. However, the discussion about Tatts Group having the lowest forecast duties is very simplistic. The Review Committee's assessment included a detailed review of each proponent's business plan, including the duty forecasts. In that regard we make the following points:

- It needs to be understood that no proponents were guaranteeing payment of a future duty stream – these future revenue streams would have been entirely at risk to Government. Only the up-front payments were certain.
- The merits and achievability of each proponent's business plan were considered relative to each other and in the context of the upfront payments, key financial assumptions, potential regulatory implications, certainty of funding and the contractual terms of each offer.

### **Treasury and its Advisers dispute claims of an absence of documentation**

The Report cites an absence of documentation supporting decisions. Any suggestion of an absence of documentation is not accepted by either NSW Treasury or its Advisers.

The valuation and legal issues relating to unclaimed prizes were considered and fully assessed by the Review Committee (with the benefit of supporting experts advice) as part of recommending the Tatts Group's alternative offer to the Steering Committee.

Material in relation to the valuation of unclaimed prizes was prepared for the Review Committee, which combined with the detailed verbal briefings provided by the Financial Adviser, was sufficient so as to allow the Review Committee to make a recommendation in this respect.

Further, the comments about an absence of documentation seem somewhat inconsistent with the key finding that “I found no evidence to indicate that the value of unclaimed prizes was not properly assessed, based on the assumptions used.”

As part of its offer, Tatts Group provided a fully-integrated financial model that had been independently audited by a reputable advisory firm. This enabled evaluation of the value of unclaimed prizes to be analysed and commented on.

In relation to documentation as to the legality of the treatment of unclaimed prizes, we note the Report’s observation that there were contemporaneous emails demonstrating that the approach adopted was satisfactory in a legal sense. Furthermore, a partner from the State’s legal adviser, provided real-time advice directly to the Review Committee and Steering Committee during the evaluation process.

### **Unclaimed prizes were part of a package deal that represented good value for money**

The Report notes that the successful offer from Tatts Group was \$147m - \$188m higher than its base offer and included among other things the conditional retention of unclaimed prizes.

In assessing the value for money from Tatts Group’s alternative offer, it is important to note that the conditions attached to the use of unclaimed prizes were such that they will be used to generate higher sales. This in turn generates higher duty payments to the Government. Whilst, under the transaction, the Government has foregone the unclaimed prizes that could otherwise have been paid into the Consolidated Fund, this is offset to a large degree by the higher expected duties that stem from allowing unclaimed prizes to be reinvested in the business. NSW Lotteries’ previous experience and management team supported the view that the use of unclaimed prizes to promote lotteries results in higher duty payments to the Government.

The Report correctly notes that the net cost to Government of allowing Tatts Group to retain unclaimed prizes, after allowing for the increased duties, was assessed as \$20m - \$40m. This range was determined based on sensitivity tests that were performed around a number of assumptions relevant to the valuation of unclaimed prizes and increased duties.

The additional value offered by Tatts Group, noted in the Report to be in the range of \$147m - \$188m, compares very favourably with the assessed net cost associated with unclaimed prizes of \$20m - \$40m. The attractive value for money proposition was demonstrably obvious to the Review Committee, even after allowing for the fact that unclaimed prizes was not the only condition attached to Tatts Group’s alternative offer.

The analysis provided by the financial adviser for the audit supports the Review Committee’s assessment of unclaimed prizes. In this regard we note the observation in the Report that “the conclusions drawn by the Review Committee were not unreasonable.”

The observation that “statements from officials involved in the sale clearly said that unclaimed prizes would be transferred to the Government” is correctly qualified by the observation that

the context for communication with bidders was one where it was also made clear that the Minister's discretions in relation to such matters could not be fettered. Further, the Treasurer's letter appended to the Report makes very clear what proponents were (and were not) told about unclaimed prizes by NSW Treasury and its Advisers.

### **Response to Recommendations**

1. *Where the Government chooses to conduct a process on the basis that "proponents could not rely on any statement by or on behalf of the State during the process" this point is continuously reinforced to proponents.*

In our view this message was provided continuously to proponents throughout the transaction process, with statements to this effect appearing in the Request for Qualifications, Process and Confidentiality Deed and Management Presentation. The State's legal adviser has also advised that this point was made continuously to all proponents at meetings on the transaction structure and transaction documents.

2. *The Process Letter clearly states that the Government's representatives involved in the transaction process cannot fetter the discretion or decision of a Minister.*

The State's legal adviser has advised that this point was emphasised to all proponents at meetings on the transaction structure and transaction documents. It is also documented in the Communities NSW regulatory presentation. However, we accept that it could also have been referred to in the Process Letter. The recommendation will be taken into account for future transactions.

3. *Key terms are clearly defined and consistently applied to avoid ambiguity and confusion.*

In our view, the content of the final offers received clearly indicates that each proponent understood the terms used in the Process Letter. In this regard, we do not agree with the observation in the Report that terms used in the Process Letter were "not well defined" or "had the potential to cause some confusion". Nevertheless, this recommendation will be taken into consideration for future transactions.

4. *Significant decisions, advice and analysis of issues during the transaction process are formally documented and retained to improve accountability and transparency.*

Treasury and its Advisers do not accept that there is an absence of documentation or any lack of accountability and transparency in relation to the NSW Lotteries transaction.

In our view, significant decisions, advice and analysis of issues in relation to the NSW Lotteries transaction were adequately dealt with and documented in the Review Committee's report and other material and correspondence.

We consider that the probity requirements of accountability and transparency have been fully met on the basis that the process followed in making a recommendation to the Treasurer, and the roles and responsibilities of the various parties involved, is documented in the Review Committee's report.

Treasury will continue to ensure that the highest standards of accountability, transparency and probity are applied in future transaction processes.

5. *Significant guidance or advice to potential bidders is provided in writing*

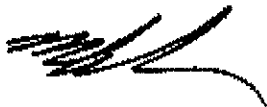
This recommendation is supported. Care will need to be taken to ensure that any written guidance or advice could not be interpreted as fettering Ministerial decision-making.

6. *Arrangements for dealing with intellectual property that may be contained in bids are clearly defined and communicated at the start of the process*

The Process Letter undertook that the content of binding offer documents would be kept confidential, unless Government reporting, audit or legal requirements necessitated disclosure. This confidentiality undertaking included any intellectual property contained in proponents' offers. The position regarding intellectual property is clear. We consider the recommendation to be largely superfluous, but it will be taken into consideration for future transactions.

Thank you for giving us the opportunity to comment on the Report.

Yours sincerely

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Secretary  
19 November 2010