

# Unsolicited proposal process for the lease of Ausgrid

11 DECEMBER 2018



NEW SOUTH WALES AUDITOR-GENERAL'S REPORT

PERFORMANCE AUDIT

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In accordance with section 38E of the *Public Finance and Audit Act 1983*, I present a report titled **'Unsolicited proposal process for the lease of Ausgrid'**.

A handwritten signature in black ink, appearing to read 'Margaret Crawford'.

**Margaret Crawford**

Auditor-General  
11 December 2018

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## **Section one**

Unsolicited proposal  
process for the lease of  
Ausgrid





# Executive summary

Ausgrid is a distributor of electricity to eastern parts of Sydney, the Central Coast, Newcastle and the Hunter Region.

In June 2014, the then government announced its commitment to lease components of the state's electricity network as part of the Rebuilding NSW plan. Implementation of the policy began after the government was re-elected in 2015. Between November 2015 and August 2016, the NSW Government held a competitive tender process to lease 50.4 per cent of Ausgrid for 99 years. The NSW Government abandoned the process on 19 August 2016 after the Australian Treasurer rejected two bids from foreign investors, for national security reasons. That day, the Premier and Treasurer released a media statement clarifying the government's objective to complete the transaction via a competitive process in time to include the proceeds in the 2017–18 budget.

On 31 August 2016, the state received an unsolicited proposal from IFM Investors and AustralianSuper to acquire an interest in Ausgrid under the same terms proposed by the state during the tender process. In October 2016, the government accepted the unsolicited proposal.

This audit examined whether the unsolicited proposal process for the partial long-term lease of Ausgrid was effectively conducted and in compliance with the government's 2014 Unsolicited Proposals: Guide for Submission and Assessment (Unsolicited Proposals Guide or the Guide).

The audit focused on how the government-appointed Assessment Panel and Proposal Specific Steering Committee assessed key requirements in the Guide that unsolicited proposals must be demonstrably unique and represent value for money.



## Conclusion

**The evidence available does not conclusively demonstrate the unsolicited proposal was unique, and there were some shortcomings in the negotiation process, documentation and segregation of duties. That said, before the final commitment to proceed with the lease, the state obtained assurance that the proposal delivered value for money.**

It is particularly important to demonstrate unsolicited proposals are unique, in order to justify the departure from other transaction processes that offer greater competition, transparency and certainty about value for money.

The Assessment Panel and the Proposal Specific Steering Committee determined the Ausgrid unsolicited proposal was unique, primarily on the basis that the proponent did not require foreign investment approval from the Australian Treasurer, and the lease transaction could be concluded earlier than through a second tender process. However, the evidence that persuaded the Panel and Committee did not demonstrate that no other proponent could conclude the transaction in time to meet the government's deadline.

It is not appropriate to determine an unsolicited proposal is unique because it delivers an earlier outcome than possible through a tender process. The Panel and Committee did not contend, and it is not evident, that the unsolicited proposal was the only way to meet the government's transaction deadline.

The evidence does not demonstrate that the proponent was the only party that would not have needed foreign investment approval to participate in the transaction. It also does not demonstrate that the requirement for foreign investment approval would have reduced the pool of foreign buyers to the degree that it would be reasonable to assume none would emerge.

The Panel, Committee and financial advisers determined that the final price represented value for money, and that retendering offered a material risk of a worse financial outcome. However, an acceptable price was revealed early in the negotiation process, and doing so made it highly unlikely that the proponent would offer a higher price than that disclosed. The Department of Premier and Cabinet (DPC) and NSW Treasury were not able to provide a documented reserve price, bargaining strategy or similar which put the negotiations in context. It is not evident that the Panel or Committee authorised, justified or endorsed negotiations in advance.

Key aspects of governance recommended by the Guide were in place. Some shortcomings relating to role segregation, record keeping and probity assurance weakened the effectiveness of the unsolicited proposal process adopted for Ausgrid.



## 1. Key findings

### Uniqueness

The Unsolicited Proposals Guide says the 'unique benefits of the proposal and the unique ability of the proponent to deliver the proposal' must be demonstrated.

The conclusion reached by the Panel and Committee that the proposal offered a 'unique ability to deliver (a) strategic outcome' was primarily based on the proponent not requiring foreign investment approval from the Australian Treasurer, and allowing the government to complete the lease transaction earlier than by going through a second tender process.

It is not appropriate to determine an unsolicited proposal is unique because it delivers an earlier outcome than possible through a tender process. The Panel and Committee did not contend, and it is not evident, that the unsolicited proposal was the only way to meet the government's transaction deadline.

The evidence does not demonstrate that the proponent was the only party that would not have needed foreign investment to participate in the transaction. Nor does it demonstrate that the requirement for foreign investment approval would have reduced the pool of foreign buyers to the degree that it would be reasonable to assume none would emerge.

That said, the Australian Treasurer's decision to reject the two bids from the previous tender process created uncertainty about the conditions under which he would approve international bids. The financial advisers engaged for the Ausgrid transaction informed the Panel and Committee that:

- it was not likely another viable proponent would emerge soon enough to meet the government's transaction deadline
- the market would be unlikely to deliver a better result than offered by the proponent
- going to tender presented a material risk of a worse financial result.

The Unsolicited Proposals Guide says that a proposal to directly purchase or acquire a government-owned entity or property will generally not be unique. The Ausgrid unsolicited proposal fell into this category.

### Value for money

The Panel and Committee concluded the price represented value for money based on peer-reviewed advice from their financial advisers and knowledge acquired from previous tenders. The financial advisers also told the Panel and Committee that there was a material risk the state would receive a lower price than offered by the unsolicited proposal if it immediately proceeded with a second market transaction.

The state commenced negotiations on price earlier than the Guide says they should have. Early disclosure of a price that the state would accept reduced the likelihood of achieving a price greater than this. DPC says the intent of this meeting was to quickly establish whether the proponents could meet the state's benchmark rather than spending more time and resources on a proposal which had no prospect of proceeding.

DPC and NSW Treasury were not able to provide a documented reserve price, negotiation strategy or similar which put the negotiations and price achieved in context. It was not evident that the Panel or Committee authorised, justified or endorsed negotiations in advance. However, the Panel and Committee endorsed the outcomes of the negotiations.

The negotiations were informed by the range of prices achieved for similar assets and the specific bids for Ausgrid from the earlier market process.

### Governance

The Government established a governance structure in accordance with the Unsolicited Proposals Guide, including an Assessment Panel and Proposal Specific Steering Committee. The members of the Panel and Steering Committee were senior and experienced officers, as befitted the size and nature of the unsolicited proposal.



The separation of negotiation, assessment and review envisaged by the Guide was not maintained fully. The Chair of the Assessment Panel and a member of the Steering Committee were involved in negotiations with the proponent.

The Department of Premier and Cabinet (DPC) and NSW Treasury could not provide comprehensive records of some key interactions with the proponent or a documented negotiation strategy. The absence of such records means the Department cannot demonstrate engagement and negotiation processes were authorised and rigorous.

The probity adviser reported there were no material probity issues with the transaction. The probity adviser also provided audit services. This is not good practice. The same party should not provide both advisory and audit services on the same transaction.



## 2. Recommendations

**The Department of Premier and Cabinet should ensure future Assessment Panels and Steering Committees considering a proposal to acquire a government business or asset:**

1. recognise that when considering uniqueness they should:
  - require very strong evidence to decide that both the proponent and proposal are the only ones of their kind that could meet the government's objectives
  - give thorough consideration to any reasonable counter-arguments against uniqueness.
2. rigorously consider all elements of the Unsolicited Proposals Guide when determining whether a proposal should be dealt with as an unsolicited proposal, and document these deliberations and all relevant evidence
3. do not use speed of transaction compared to a market process as justification for uniqueness
4. document a minimum acceptable price, and a negotiating strategy designed to maximise price, before commencing negotiations
5. do not communicate an acceptable price to the proponent, before the negotiation stage of the process, and then only as part of a documented bargaining strategy
6. maintain separation between negotiation, assessment and review in line with the Unsolicited Proposals Guide
7. keep an auditable trail of documentation relating to the negotiation process
8. maintain separation between any probity audit services engaged and the probity advisory and reporting services recommended in the current Guide.



# 1. Introduction

## 1.1 Overview

Ausgrid is a distributor of electricity to eastern parts of Sydney, the Central Coast, Newcastle and the Hunter Region. The network area spans 22,275 km, includes more than 200 large electricity substations, 30,000 small distribution substations and 500,000 power poles.

**Exhibit 1: Ausgrid electricity network**



Source: Ausgrid.

In October 2016, the government accepted an unsolicited proposal from IFM Investors Pty Ltd and AustralianSuper Pty Ltd to acquire a 50.4 per cent interest in the 99-year lease of Ausgrid.

The timeline from when the government announced its decision to lease the electricity network to when it entered into a binding agreement for the unsolicited proposal is outlined below in Exhibit 2.

## Exhibit 2

June 2014	the government announced its commitment to lease 49 per cent of the State's electricity network over 99 years to unlock \$20 billion for critical infrastructure across New South Wales, as part of the Rebuilding NSW plan
November 2015	the government initiated a competitive tender process for the 99-year lease for a 50.4 per cent interest in Ausgrid, with an expected completion in the third quarter of 2016
July 2016	the competitive tender process resulted in two separate binding bids from Chinese and Hong Kong consortia
19 August 2016	the Australian Government Treasurer made an order under the <i>Foreign Acquisitions and Takeovers Act 1975</i> prohibiting the proposed acquisition of Ausgrid by foreign investors under the current proposed structure, noting it would be contrary to the national interest
19 August 2016	the government announced it would relaunch the transaction process, noting strong market interest
31 August 2016	the government received the unsolicited proposal and began the evaluation process
23 September 2016	the government announced it had received an unsolicited proposal for the partial long-term lease of Ausgrid from an all-Australian consortium, AustralianSuper and IFM Investors, and noted preparations to re-launch the Ausgrid transaction were continuing
20 October 2016	the government announced it had entered into a binding agreement with IFM Investors and AustralianSuper, delivering \$16.189 billion in gross proceeds to the State and implying an enterprise value of \$20.748 billion

Note: Enterprise Value (EV) is a measure of a company's total value. It looks at the entire market value rather than just the equity value, so all ownership interests and asset claims from both debt and equity are included. EV can be thought of as the effective cost of buying a company.

Source: Audit Office research 2018.

## 1.2 Unsolicited proposals in New South Wales

In January 2012, the NSW Government released the whole-of-government Unsolicited Proposals: Guide for Submission and Assessment of Unsolicited Proposals. DPC is the lead agency for receiving and coordinating consideration of unsolicited proposals. The Guide was updated in 2014 and again in 2017.

The 2014 version of the Guide, which was in place during assessment of the Ausgrid unsolicited proposal describes an unsolicited proposal as:

An approach to Government from a Proponent with a proposal to:

- Build and/or finance infrastructure, and/or
  - Provide goods or services
- where Government has not requested the proposal.

The Guide also states:

(Unsolicited) proposals are by definition outside the normal planning and procurement processes of Government

The unsolicited proposals process is not a substitute for routine competitive procurement by Government.

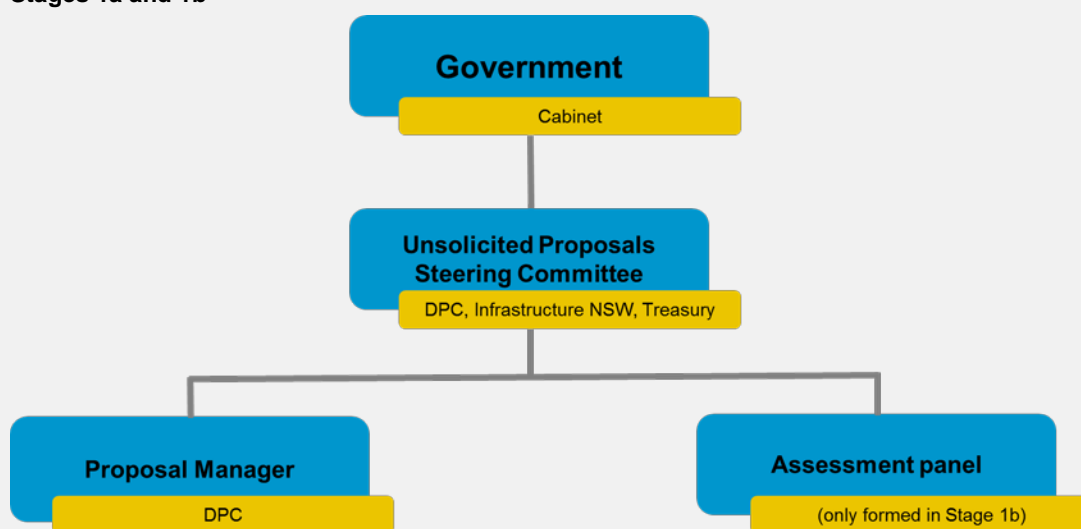
### Exhibit 3: About unsolicited proposals

The NSW Government's 2014 Unsolicited Proposals Guide details a four-stage assessment process to inform the evaluation of such proposals. The Guide requires all unsolicited proposals to be assessed against the following criteria:

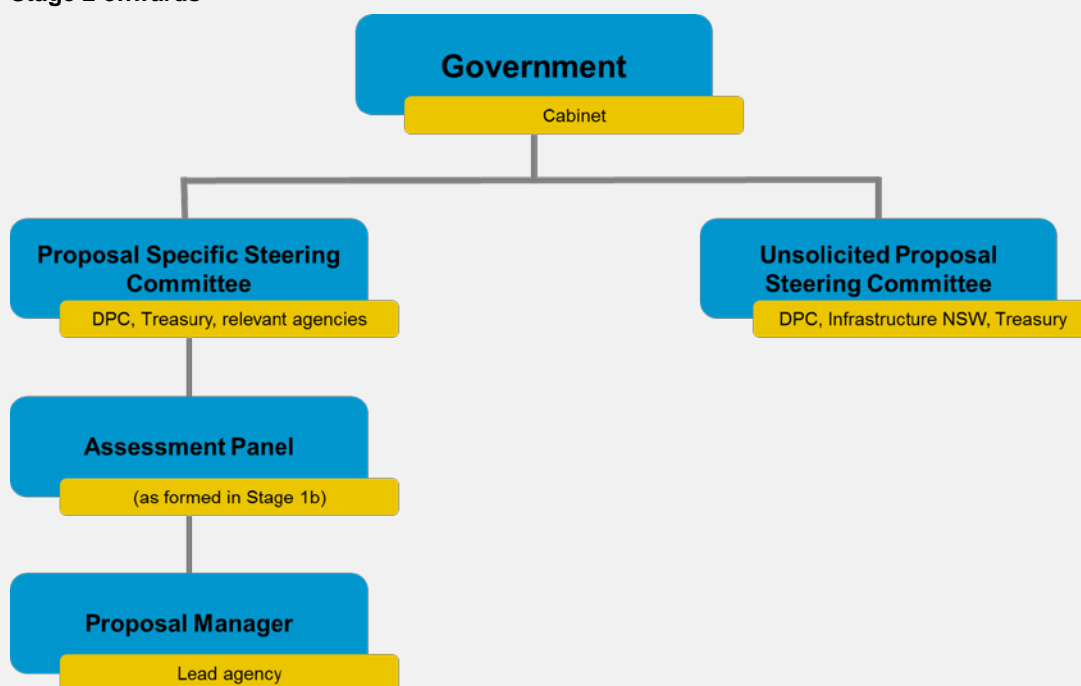
- uniqueness
- value for money
- whole of government impact
- return on investment
- capability and capacity
- affordability
- risk allocation.

The Guide recommends the following governance arrangements to assess unsolicited proposals:

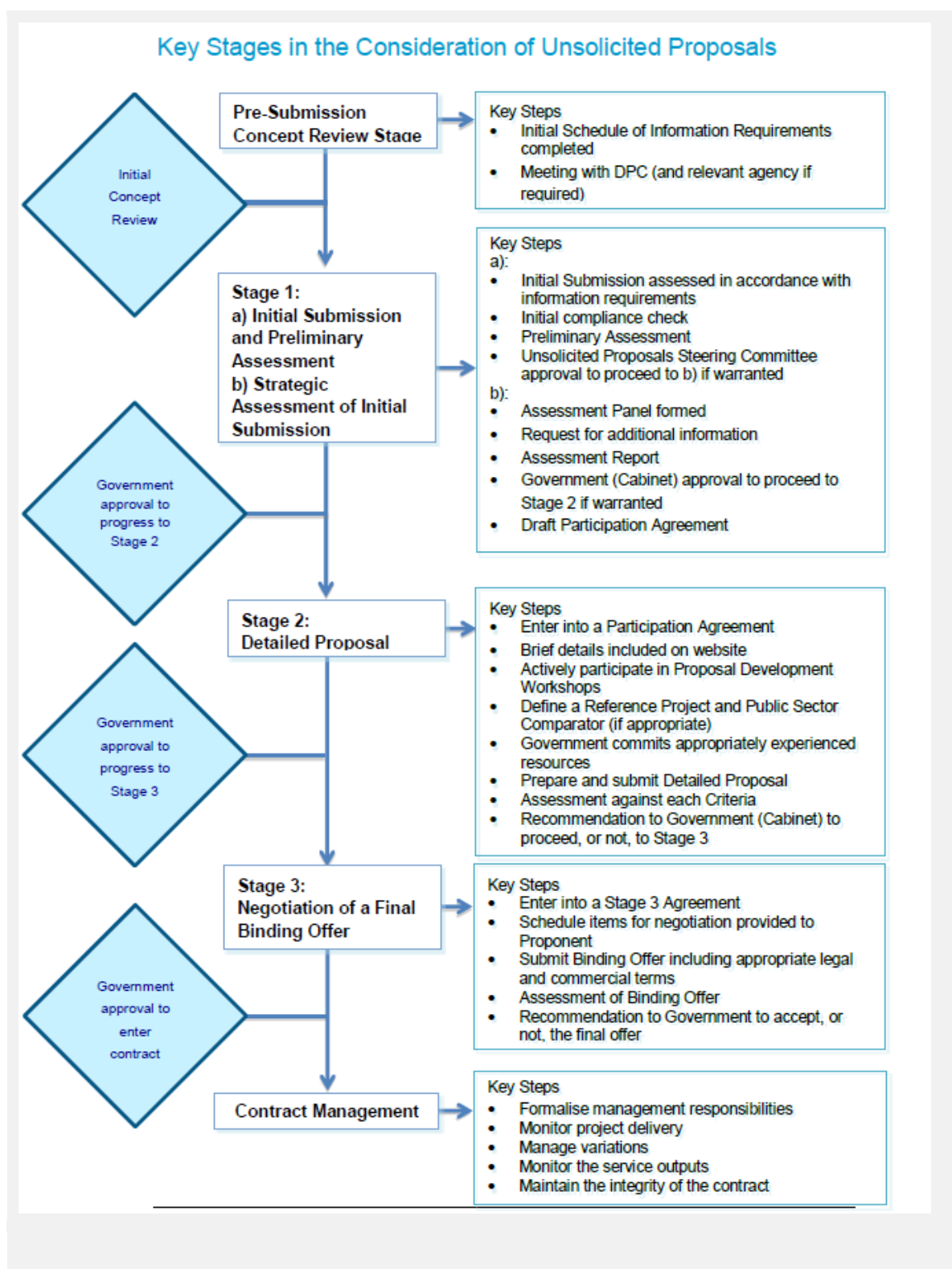
#### Stages 1a and 1b



#### Stage 2 onwards



Source: Audit Office of NSW diagram prepared from Unsolicited Proposals: Guide for Submission and Assessment 2014.



Source: Unsolicited Proposals: Guide for Submission and Assessment 2014.

### 1.3 Ausgrid unsolicited proposal

On 31 August 2016, IFM Investors Pty Ltd and AustralianSuper Pty Ltd submitted an indicative non-binding unsolicited proposal for a prospective long-term lease of 50.4 per cent of Ausgrid.

On 20 October 2016, DPC published a summary of assessment of the unsolicited proposal for the partial long-term lease of Ausgrid which confirmed its acceptance by the NSW Government.

#### **Exhibit 4: Summary of the NSW Government's reasons for accepting the Ausgrid unsolicited proposal**

- The proposal served the Government's objective of unlocking value from electricity networks to invest in other forms of infrastructure.
- The Assessment Panel and Steering Committee determined that the proposal satisfied all assessment criteria.
- The transaction did not require Foreign Investment Review Board approval, providing greater transaction execution certainty and an accelerated timeframe for completion of the transaction.
- The final binding offer reflected the governance, regulatory and commercial arrangements sought by the state.
- The price reflected an enterprise value for Ausgrid of \$20.7 billion and a multiple of 1.41x the June 2016 actual Regulated Asset Base (RAB).
- Early completion of the Ausgrid transaction delivered results for NSW taxpayers far earlier than undertaking a new competitive bid process.

Note: The 'regulated asset base' (RAB) is calculated annually. It is achieved by determining the stock of network assets at the start of a regulatory period, and rolling this forward year by year, adjusting for depreciation (which lowers the RAB), CPI inflation and expected capital expenditure in that year (which increase the RAB).

Source: DPC 2016.



## 2. Uniqueness



### The reasons for accepting that the proposal and proponent were unique are not compelling.

The Unsolicited Proposals Guide says the 'unique benefits of the proposal and the unique ability of the proponent to deliver the proposal' must be demonstrated.

The conclusion reached by the Panel and Committee that the proposal offered a 'unique ability to deliver (a) strategic outcome' was primarily based on the proponent not requiring foreign investment approval from the Australian Treasurer, and allowing the government to complete the lease transaction earlier than by going through a second tender process.

It is not appropriate to determine an unsolicited proposal is unique because it delivers an earlier outcome than possible through a tender process. The Panel and Committee did not contend, and it is not evident, that the unsolicited proposal was the only way to meet the government's transaction deadline.

The evidence does not demonstrate that the proponent was the only party that would not have needed foreign investment approval to participate in the transaction. Nor does it demonstrate that the requirement for foreign investment approval would have reduced the pool of foreign buyers to the degree that it would be reasonable to assume none would emerge.

That said, the Australian Treasurer's decision to reject the two bids from the previous tender process created uncertainty about the conditions under which he would approve international bids. The financial advisers engaged for the Ausgrid transaction informed the Panel and Committee that:

- it was not likely another viable proponent would emerge soon enough to meet the government's transaction deadline
- the market would be unlikely to deliver a better result than offered by the proponent
- going to tender presented a material risk of a worse financial result.

The Unsolicited Proposals Guide says that a proposal to directly purchase or acquire a government-owned entity or property will generally not be unique. The Ausgrid unsolicited proposal fell into this category.

#### Recommendations:

DPC should ensure future Assessment Panels and Steering Committees considering a proposal to acquire a government business or asset:

- recognise that when considering uniqueness they should:
  - require very strong evidence to decide that both the proponent and proposal are the only ones of their kind that could meet the government's objectives
  - give thorough consideration to any reasonable counter-arguments against uniqueness.
- rigorously consider all elements of the Unsolicited Proposals Guide when determining whether a proposal should be dealt with as an unsolicited proposal, and document these deliberations and all relevant evidence
- do not use speed of transaction compared to a market process as justification for uniqueness.

### 2.1 The standard for uniqueness

#### The proposal's benefits must be unique and the proponent must have the unique ability to deliver the proposal

The Unsolicited Proposals Guide says there must be 'demonstration of unique benefits of the proposal and the unique ability of the proponent to deliver the proposal'. In particular, the following are to be demonstrated:

Can this proposal be readily delivered by competitors? If the answer is yes, then what, if any justification would the Government have to the public for not seeking best value through a competitive tender process?



Does the proponent own something that would limit the Government from contracting with other parties if the Government went to tender?

Are there other attributes which may not necessary stand alone as unique but, when combined, create a “unique” proposal?

This may include genuinely innovative ideas, including financial arrangements or solutions that are otherwise unlikely to be defined and put to market.

## 2.2 The Panel and Committee's assessment of uniqueness

**The Panel and Committee determined the proposal was unique primarily because it did not require foreign investment approval and could be finalised quickly**

In using the unsolicited proposals process to assess the proponent's bid, the Panel and Committee were required to objectively assess 'uniqueness' per the Guide.

The Panel and Committee formed a view that the proposal offered a 'Unique ability to deliver (a) strategic outcome'. The Panel determined the bid met the uniqueness test, the Committee agreed, and their conclusion was accepted by the government.

This assessment was made on the basis that the proposal did not require foreign investment approval and would allow the government to complete the lease transaction earlier than by going through a second tender process.

The Australian Treasurer's decision to reject the two bids arising from the previous tender process created uncertainty about under what conditions he would approve international bids. The state commissioned advice and was informed that:

- it was not likely another viable proponent would emerge soon enough to achieve the government's objective for transaction proceeds to be included in the 2017–18 budget
- the pool of potential bidders would be small due to the uncertainty over Australian Government requirements
- the market was not likely to deliver a better financial result than offered by the proponent
- there was a material risk of a worse financial result.

The state formed a view that clarity about requirements of the Australian Treasurer may not be available in the required timeframes, whereas a proposal from a domestic consortium which did not require foreign investment approval offered more certainty. This was based on market soundings and a series of interactions with the Foreign Investment Division of the Australian Treasury that explored a range of options for international involvement. As put by the financial advisers:

the pool of foreign investors who are likely to receive FIRB [foreign investment] approval to invest in Ausgrid is materially constrained.

The financial advisers also told the Panel and Committee that rejecting the proposal from IFM Investors and AustralianSuper could lead to a worse financial result, noting that:

Notwithstanding there is a possibility a bidder could submit a higher bid towards the upper end of the range of relevant comparables, this outcome would need to be risk-adjusted when considering the relative attractiveness and value for money for the State given the significant risks to such a valuation being delivered.



The state also assessed that the Ausgrid unsolicited proposal provided an opportunity to conclude a transaction in a shorter timeframe than could be offered by other proponents. Assessment Panel reports said:

Feedback from prospective bidders to date has indicates [sic] that it will take them some time to form consortia (particularly in the absence of clear FIRB [foreign investment] guidance). The current timetable for a competitive transaction process would see reaching the financial close in around April 2017

Following the announcement of Stage 2 of the Ausgrid unsolicited proposal, a number of parties approached the State to represent their interest in Ausgrid. However, none were in a position to provide a proposal that was unconditional on FIRB [foreign investment] approval, or that could be completed with certainty and in a short time frame, with the benefits that brings to the State. No other proposals have been received.

The state's probity adviser raised no probity issues with the process adopted for the assessment of uniqueness.

## 2.3 Arguments against uniqueness

### **The argument that the proposal and proponent were unique is not compelling**

It is particularly important to demonstrate unsolicited proposals are unique because they do not provide the same level of transparency and fairness available through competitive mechanisms.

The evidence that persuaded the Panel and Committee did not demonstrate sufficiently that no other proponent could conclude the transaction in time to meet the government's deadline. The same Panel reports that concluded the proposal and proponent were unique leave open the possibility of another bidder:

...a number of parties approached the State to represent their interest in Ausgrid

feedback from prospective bidders to date indicates that it will take them some time to form consortia

The current timetable for a competitive transaction process would see reaching the financial close in around April 2017.

### **It is not evident that the proponent was the only possible domestic bidder**

While the financial advisers said it was not likely another domestic bid would be viable, they did not rule out the possibility of another potential domestic bidder. They identified other potential Australian bidders who might be interested including some who indicated that they were actively considering participation following the Premier and Treasurer's announcement that they would relaunch a competitive process. Some of these potential bidders said they were holding discussions with other potential partners.

### **It is not evident that a domestic bid was the only viable option**

Evidence does not show categorically that the requirement for foreign investment approval would limit foreign interest in the asset to the degree that a domestic buyer could, by virtue of being domestic, be considered 'unique'.

The conditions under which the Australian Treasurer would approve international bids were uncertain. However, the evidence available to the audit does not demonstrate that a bid requiring foreign investment approval could not have met the state's needs and that an all-Australian bid was the only viable option for the transaction.

Evidence shows that:

- the Foreign Investment Division of the Australian Treasury was working on solutions to allow foreign investment in Ausgrid that may have been acceptable to both the Australian and NSW Government
- the state contemplated the possibility that an acceptable foreign bid may emerge during the unsolicited proposal negotiations
- while no consortia had formed, parties told the financial advisers that they were in discussions with potential partners, although concerned that the compressed timetable may impact on their ability to participate.

It is not evident that potential proponents needed so much more time that a transaction with them could not be completed in time to include proceeds in the 2017–18 budget.

DPC advises that it was not possible to provide audit with some critical information which led the Committee to believe an all-Australian consortium was the only option. The Australian Government provided confidential briefings to the Treasury Secretary, and the Secretary of DPC, regarding its requirements for approving the lease. No records were kept due to the sensitive and confidential nature of these meetings. This audit could only rely on the documents provided to it by DPC, NSW Treasury or which were publicly available.

The state's apparent pessimism on the market also contrasts with the:

- 19 August 2016 media release of the Premier and Treasurer which noted 'strong market interest for this valuable asset'
- 23 September 2016 media release of the Premier which attributes the following quote to the Treasurer, 'this unsolicited proposal is another indication of the strong market interest for Ausgrid'.

**It is not appropriate to conclude that an unsolicited proposal is unique because it delivers an earlier outcome than possible through a tender process**

The argument that the unsolicited proposal would allow the government to complete the lease transaction earlier than by going through a second tender process is obvious, but not an appropriate reason to determine a proposal as unique.

A media statement by the then Premier and Treasurer released on 19 August 2016 clarified the government's policy objective for the sale to be completed in time for the 2017–18 budget, although at that stage via a competitive process.

The unsolicited proposal mitigated the risk that the sale would not be completed in time for the 2017–18 budget.

The Panel and Committee did not argue, and it is not evident, that the unsolicited proposal was the only way to meet the government's deadline.

## The Ausgrid proposal had characteristics that the Guide describes as generally not unique

The guide outlines some circumstances where proposals are generally not unique. Two of these are relevant to the Ausgrid lease.

### Exhibit 5: Proposals that are generally not unique

Unsolicited Proposals Guide extract	Audit Office comment
Proposals for projects where the tender process has formally commenced, whether published or not.	The state initiated the leasing process in November 2015. On 19 August 2016, the day the Australian Government announced its decision to reject the bids put forward by NSW, the Premier and Treasurer announced the immediate relaunch of a competitive process to lease Ausgrid. The unsolicited proposal was received on 31 August 2016.
Proponents seeking to directly purchase or acquire a Government-owned entity or property, unless the proposal presents a unique opportunity to Government, the Government is unlikely to enter into such an arrangement without an open tender process.	The proponent sought to directly purchase or acquire the Ausgrid lease. Ausgrid was a Government-owned entity. While the Guide left it open for the state to sell or lease an asset, this provision highlights the need for compelling uniqueness arguments.

Source: Guide for Submission and Assessment of Unsolicited Proposals, DPC, 2014 and Audit Office analysis.

## The absence of alternative bids does not demonstrate uniqueness

DPC argues that uniqueness was shown by no other party lodging a formal proposal following announcement of the unsolicited proposal. This argument is not compelling.

It was less than a month between the government announcing it had received the unsolicited proposal and announcing its acceptance.

Further, some potential bidders may have been influenced by the statement of the Treasurer in a media release on 23 September 2016 that:

while the Government would give the [unsolicited] proposal full consideration, preparations to re-launch the Ausgrid transaction were continuing.

DPC also argues that uniqueness was shown by no other party subsequently indicating they were in a position to acquire the lease. However, there is no obvious reason a potential bidder would benefit by doing so.



## 3. Value for money



**The process to obtain assurance that the final price represented value for money was adequate. However, the negotiation approach reduced assurance that the bid price was maximised.**

The Panel and Committee concluded the price represented value for money, based on peer-reviewed advice from their financial advisers and knowledge acquired from previous tenders. The financial advisers also told the Panel and Committee that there was a material risk the state would receive a lower price than offered by the unsolicited proposal if it immediately proceeded with a second market transaction.

The state commenced negotiations on price earlier than the Guide says they should have. Early disclosure of a price that the state would accept reduced the likelihood of achieving a price greater than this. DPC says the intent of this meeting was to quickly establish whether the proponents could meet the state's benchmark rather than spending more time and resources on a proposal which had no prospect of proceeding.

DPC and NSW Treasury were not able to provide a documented reserve price, negotiation strategy or similar which put the negotiations and price achieved in context. It was not evident that the Panel or Committee authorised, justified or endorsed negotiations in advance. However, the Panel and Committee endorsed the outcomes of the negotiations.

The negotiations were informed by the range of prices achieved for similar assets and the specific bids for Ausgrid from the earlier market process.

### **Recommendations:**

DPC should ensure any future Assessment Panels and Steering Committees considering a proposal to acquire a government business or asset:

- document a minimum acceptable price, and a negotiating strategy designed to maximise price, before commencing negotiations
- do not communicate an acceptable price to the proponent, before the negotiation stage of the process, and then only as part of a documented bargaining strategy.

### 3.1 The Panel and Committee's assessment of value for money

**The Panel and Committee concluded the final price was value for money, based on expert advice and knowledge acquired from previous tenders**

The Assessment Panel and Proposal Specific Steering Committee both determined the price achieved by the state was 'value for money'. These decisions were informed by the prior Ausgrid tender, and other recent electricity transactions.

The state's financial advisers concluded the final proposal represented value for money, as did the qualified consultant who 'peer reviewed' their advice. The price was also above retention value.

According to ICAC, when conducting a direct negotiation, it is standard practice to engage an independent expert to provide an estimate of the market or fair price. The financial advisers and peer reviewer were independent of the proponent. The financial advisers' contract included incentives for the transaction's financial results, but the peer reviewer was independent and only paid for his advice.

## Exhibit 6: Summary of the state's value for money arguments

The Panel and Committee concluded that:

- the proposed transaction represented value for money having regard to relevant valuation benchmarks including indicative and binding bids received in recent New South Wales electricity transactions.
- the unsolicited proposal aligned to the government's plans and priorities
- the proponent accepted the regime that the government had worked through during the market process and brought knowledge gained from their involvement in the TransGrid transaction
- the proponent had demonstrated its capacity and capability as owners and lessees of major infrastructure assets including Port Botany and Port Kembla, Melbourne Airport, Brisbane Airport and one of the largest electricity network assets in Germany (amongst others)
- there were significant time value of money benefits to the state.

DPC advises that there was a small window where residual competitive tension could be used to secure value for money for the state because there:

- had been a recently completed and well-contested competitive bidding process that had created a sense of high value in the market
- was as yet limited information in the market about the severity of likely future restrictions required to receive foreign investment approval, although the difficult position of the state would have soon been understood by future participants.

DPC further makes the point that a new tender process would have been time-consuming and costly. It says it would have extended the period in which the state was exposed to market and business performance risks, including delivery of Ausgrid's transformation program and the ongoing regulatory appeals process. According to DPC, further delay would have also resulted in the need to re-do due diligence and financial reports.

Source: Audit Office summary of comments and documents provided by DPC 2018.

### **The Panel and Committee were advised that a second market transaction risked a poorer financial outcome than the unsolicited proposal**

The state received advice from its financial advisers that there was a material risk that it would receive a lower price than offered by the unsolicited proposal if it immediately proceeded with a second market transaction. Key factors included:

- concerns that offshore bidders' ability to obtain foreign investment approval to participate in the transaction was likely to lead to a much smaller pool of bidders
- terms that may have been acceptable to the Australian Treasurer for overseas participants may have been commercially unattractive to potential investors, and priced accordingly
- given the significant equity funding required for Ausgrid, a competitive process with bidders that would not need Australian Government approval could have resulted in the proponent being the only bidder.

In addition:

- the proponent indicated it may not match its unsolicited proposal offer in the event of a relaunched competitive process
- DPC advised that potential participants would have been aware that the most aggressive bidders were no longer permitted to participate.

The Panel and Committee's view that a second market transaction risked a poorer financial outcome than the unsolicited proposal was supported by:

- feedback gained from market soundings undertaken at the time, and within the timeframe available to the advisers
- NSW Treasury's understanding of the likely restrictions on foreign investors investing in Ausgrid obtained from its consultation with the Australian Government, including the Foreign Investment Division of the Australian Treasury, on potential alternative structures
- the findings of a peer review by a qualified consultant.

## 3.2 Negotiating the price

**Early disclosure of an acceptable price may have reduced the chance the proponent would offer a higher price than disclosed**

The then Treasury Secretary met with the proponent on 14 September 2016 to discuss the price offered by the proponent in its initial proposal (1.3 times RAB). He was accompanied by the Proposal Manager/Head of the Assessment Panel and the Probity Adviser.

DPC and NSW Treasury were not able to provide minutes of the meeting, but provided speaking notes which were given to the Treasury Secretary to refer to in the meeting.

The speaking notes and submissions to us from DPC indicate the Treasury Secretary was to tell the proponent that:

- he was offering his personal views on the initial offer and was not making any commitment on behalf of the government
- he thought the initial offer of 1.3 times RAB was insufficient, and that an offer of 1.4 times RAB would be needed for him to support further consideration of the proposal
- 1.4 times RAB translated to \$21.358 billion based on forecast RAB.

DPC says the intent of this meeting was to quickly establish whether the proponents could meet the state's benchmark rather than spending more time and resources on a proposal which had no prospect of proceeding (and the proposal would not have proceeded at 1.3 times RAB). DPC also argues the disclosure did not compromise the state's negotiating position, saying the state would have divulged this information at some point anyway.

As it transpired:

- later the same day (14 September 2016) the proponent revised its proposal to match exactly the dollar price suggested by the Treasury Secretary, describing this as accepting the 'counter proposal'. There is no evidence that the state sought to correct the impression held by the proponent that this was a specific counter-proposal to their initial offer.
- the next day (15 September) the state entered a Participation Agreement based on the revised proposal and in line with the recommendation of the Steering Committee.

The Steering Committee, in its meeting on 15 September 2016, and based on the revised proposal, agreed a process whereby the proponent:

- had one week of limited interim due diligence, during which time they had access to the Information Memorandum, vendor due diligence reports, the financial model and key transaction documentation
- would then provide a confirmed proposal which would be reviewed by the Assessment Panel and Steering Committee in order to approve (or otherwise) proceeding to Stage 2 (due 23 September 2016).

**RAB was lower than expected, and negotiations delivered a confirmed offer with a higher multiple of RAB but lower monetary price than represented by the revised offer**

The actual RAB was released during the week of limited interim due diligence. It was lower than forecast. The proponent apparently planned to base its confirmed proposal on 1.4 times the actual RAB. A confirmed proposal on this basis would have been materially lower in dollar terms than the revised proposal.

Shortly before the proponent was due to submit their confirmed proposal (22 September 2016), the Treasury Secretary and Proposal Manager discussed the price with the proponent.

DPC and NSW Treasury were not able to provide minutes of the meeting, but provided speaking notes which were given to the Treasury Secretary to refer to in this discussion.

The speaking notes suggest the Treasury Secretary intended to say to the proponent that he and the Proposal Manager:

- would recommend the proposal proceed to the next stage if the proponent's offer 'split the difference' between the dollar value agreed on 14 September 2016 (based on 1.4 times forecast RAB) and the dollar value resulting from 1.4 times actual RAB
- were unsure the proposal would proceed to the next stage quickly or at all if the proponent submitted a price based on 1.4 times actual RAB.

Later that day, the proponent submitted its confirmed proposal at 1.41 times the actual RAB. This confirmed proposal was above the dollar price that would have arisen from 1.4 times the actual RAB but materially below the dollar price put forward in the revised proposal (14 September 2016).

**Exhibit 7: Summary of enterprise valuation negotiation**

Date	Event	EV based on RAB	EV (\$ billion)
31 August 2016	Proponent's initial proposal	1.3 x Actual RAB	Not included in proposal
14 September 2016	Value suggested by Treasury Secretary	1.4 x Forecast RAB	21.358
14 September 2016	Proponent's revised proposal	1.4 x Forecast RAB	21.358
22 September 2016	Proponent's planned confirmed proposal	1.4 x Actual RAB	20.562
22 September 2016	Value suggested by Treasury Secretary	Not discussed	20.960
22 September 2016	Proponent's confirmed proposal	1.41 x Actual RAB	20.748

Meetings of both the Panel and the Committee the day after (23 September 2016) endorsed the price achieved through these negotiations. The financial advisers and peer reviewer said the lower dollar price was still value for money.

The state's probity adviser raised no issues with the negotiation process and concluded the overall Ausgrid unsolicited proposal process was sound from a probity perspective.

**Shortcomings in the negotiation process means it cannot be assured that optimal value for money was achieved**

The Guide requires the state to optimise value for money. The lack of documentation supporting and recording negotiations, together with the early disclosure of what may have been the minimum acceptable price, means DPC and Treasury did not assure that value for money was optimised.

As mentioned above, DPC and NSW Treasury were not able to provide minutes of these key negotiations.

No evidence was provided to show that the Panel or Committee authorised, justified or endorsed these negotiations in advance.

DPC and NSW Treasury were also not able to provide a documented reserve price (i.e. a price that if not achieved would have resulted in a return to the tender process instead), negotiation strategy or similar which would have allowed us to view the negotiations in context.

We know that the multiple of RAB for both the revised and confirmed proposals fell within the range of prices recently achieved for similar assets, were informed by the specific bids for Ausgrid from the earlier market process, and exceeded retention value. That said, the state did not have to disclose that price when it did. No evidence was provided to show that the price disclosed had beforehand been assessed by experts as the top end of reasonable expectations.

The meeting on 14 September 2016 occurred during Stage 1a and before uniqueness was determined. In our view, discussing price at this meeting was not in accordance with the Guide.

The Guide envisages officers 'requesting further information from the Proponent if required. This may involve clarification meetings with the Proponent in order to promote clarity of Government requirements' during stage 1 and before uniqueness is determined. DPC says the meeting of 14 September 2016 served this purpose and was therefore in accord with the Guide.

However, the Guide also says this 'will not be an opportunity to negotiate the details of the proposal. This opportunity will arise in later stages if the proposal proceeds past the Stage 1 Assessment.' Given a price was put to the proponent in response to the proponent's initial offer, we consider this to be a negotiation. Further, the revised offer was also endorsed the next day by the Panel and Steering Committee.

DPC further says the meeting was not a negotiation because the price suggested was no more than the personal view of the then Treasury Secretary of what may be acceptable, who told the proponent that he could not make a commitment on behalf of the Government. On the other hand, he attended the meeting in his role as Treasury Secretary, he was a member of the Steering Committee, and he was in the company of the Proposal Manager (and Chair of the Assessment Panel) when he made his view on price known.





## 4. Governance



**Key aspects of governance recommended by the Guide were in place, but there were some shortcomings around role segregation, record keeping and probity assurance.**

The state established a governance structure in accordance with the Unsolicited Proposals Guide, including an Assessment Panel and Proposal Specific Steering Committee. The members of the Panel and Steering Committee were senior and experienced officers, as befitted the size and nature of the unsolicited proposal.

The separation of negotiation, assessment and review envisaged by the Guide was not maintained fully. The Chair of the Assessment Panel and a member of the Steering Committee were involved in negotiations with the proponent.

DPC could not provide comprehensive records of some key interactions with the proponent or a documented negotiation strategy. The absence of such records means the Department cannot demonstrate engagement and negotiation processes were authorised and rigorous.

The probity adviser reported there were no material probity issues with the transaction. The probity adviser also provided audit services. This is not good practice. The same party should not provide both advisory and audit services on the same transaction.

### **Recommendations:**

DPC should ensure any future Assessment Panels and Steering Committees considering a proposal to acquire a government entity or asset:

- maintain separation between negotiation, assessment and review in line with the Unsolicited Proposals Guide
- keep an auditable trail of documentation relating to the negotiation process
- maintain separation between any probity audit services engaged and the probity advisory and reporting services recommended in the current Guide.

### 4.1 Governance structure

#### **The state established an Assessment Panel and Proposal Specific Steering Committee**

The Unsolicited Proposals Guide says:

Fair and impartial treatment will be a feature of each stage of the assessment process. The process will feature a clearly defined separation of duties and personnel between the assessment and approval functions.

The governance structure outlined in the Guide is designed to deliver arms-length review of the Assessment Panel's recommendations, and mitigates the risk of bias.

The 2006 ICAC Guidelines for Managing Risks in Direct Negotiations (ICAC Guidelines) reinforce that segregating duties is good practice for all contracting situations, and that different aspects of a project should be performed by different staff and key decisions should not be made unilaterally.

In accordance with the Unsolicited Proposals Guide, DPC set up an Assessment Panel and a Proposal Specific Steering Committee. Under this arrangement the:

- Assessment Panel assesses the proposal and makes recommendations to the Steering Committee
- Steering Committee provides oversight of the process, reviews the recommendations and arguments of the Assessment Panel and makes recommendations to the government.

In the case of Ausgrid, as might be expected given its potential value, senior and experienced officers were on the Panel and Committee.

### **The separation of negotiation, assessment and review envisaged by the governance structure was not maintained fully in practice**

The separation of roles at the core of this governance model and described in the Guide was not maintained fully in design or practice.

While no minutes are available, other evidence suggests the Treasury Secretary expressed his view on an acceptable price to the proponent on 14 September 2016, while in the company of the Proposal Manager. Both these officers negotiated with the proponent on 22 September 2016. The Proposal Manager was Chair of the Panel and the Treasury Secretary was a member of the Committee.

DPC says that most members of the Assessment Panel and the Steering Committee were not involved in negotiations or interactions with the proponent, so separation was adequate. The probity adviser agreed.

In our view, full separation would have given greater confidence in the process.

## **4.2 Record keeping**

### **There were gaps in record keeping**

The *State Records Act 1998* requires important records of matters such as this transaction to be kept properly. This is reinforced by the 2006 ICAC Guidelines which note that:

...keeping an auditable trail of documentation relating to the project and negotiation process enhances an agency's position against criticism concerning problems that may arise during a project.

The 2018 ICAC Guidelines on direct negotiations highlight the importance of keeping records on 'progress of the negotiation process and the reasoning behind key decisions made'.

The probity plan for the electricity networks transaction prepared by the probity adviser spoke to the importance of keeping records sufficient to facilitate an independent audit review subsequent to the transaction. This included records of negotiations and other interactions with bidders.

DPC and NSW Treasury did not provide audit with comprehensive records of some key interactions with the proponent. DPC and NSW Treasury advise that they could not locate minutes of the meetings with the proponent on 14 September 2016 and 22 September 2016. DPC provided speaking notes it advises were used by the Treasury Secretary for these meetings, but these were not described or notated as minutes at the time and do not record any comments or positions expressed by the proponent.

No records were provided to show the Treasury Secretary had prior authorisation to disclose a specific price at the meeting of 14 September 2016, or the state's endorsement of that price. The price was consistent with benchmarks established by the state, but no bargaining strategy or other records were provided to show why this specific price was settled upon as appropriate to suggest at this meeting and for the state to accept the next day.

The probity adviser was satisfied as to the probity associated with maintaining accountability and transparency. The adviser's final report noted:

- roles and responsibilities and decision-making processes were defined
- all key decisions were made by the appropriate people and properly recorded
- relevant information regarding the unsolicited proposal was made publicly available.

DPC provided to audit Steering Committee agenda and Assessment Panel reports to the Steering Committee, and formal communication with the proponent. Minutes of the Assessment Panel and Steering Committee were kept and these appropriately recorded decisions about the proposal.

However, these did not record in detail the analysis or discussions around negotiations and acceptable price so are not a substitute for other documents audit expected to see.

The absence of key records means DPC and NSW Treasury cannot demonstrate engagement and negotiation processes were authorised and rigorous.

## 4.3 Probity assurance

### **Probity assurance was obtained, but there were some shortcomings**

The state contracted a probity adviser not otherwise involved with the project. The company provided probity advice on the entire energy asset disposal program, including both the prior tender and unsolicited proposal process for Ausgrid.

The company provided a probity report at the end of the Ausgrid transaction, which raised no material probity concerns with the Ausgrid unsolicited proposals process. The adviser:

- had 'not observed or been made aware of any breaches of the general probity requirements for the Project'
- was 'not aware of any material probity risks to achieve compliance with the Unsolicited Proposals Guide for Submission and Assessment (February 2014)'
- was 'satisfied as to the probity applied in regards to the Unsolicited Proposal Process for the Partial Long Term Lease of Ausgrid.'

The probity adviser also provided probity audit services. It is not appropriate for a probity adviser (who has worked alongside the project team to provide assurance) to conduct a probity audit, as it creates a risk of self-review and therefore weakens the perception of independence.

Separation of probity advice from probity audit is a fundamental assurance principle. As noted in the NSW Government's 'Board Direction 2013-05 Engagement of probity advisers and probity auditors', the principal role of a probity adviser is to provide advice and solutions throughout a procurement or sale transaction. Conversely, a probity auditor is primarily engaged after the fact, to verify that processes followed during a procurement or sale are consistent with government regulations and best practice principles.

It is appropriate for the probity adviser to prepare a probity report for the Steering Committee or DPC summarising their actions and observations. The current Unsolicited Proposals Guide offers more clarity about the role of the probity adviser, including the provision of a probity report, than the 2014 version. The probity adviser for the Ausgrid transaction prepared such a report, but referred to its work as a probity audit and was engaged to provide both advisory and audit services.

In some cases, there may be value in conducting a probity audit. In these circumstances DPC should not engage the same company or person to provide both probity advice and probity audit services.



## **Section two**

### Appendices





# Appendix one – Response from agency

## Response from Department of Premier & Cabinet



Premier  
& Cabinet

Treasury

Reference: A2772899

Ms Margaret Crawford  
Auditor-General of NSW  
Audit Office of NSW  
Level 15, 1 Margaret Street  
Sydney NSW 2000

Dear Ms Crawford

Thank you for your letter of 13 November 2018 and the opportunity to respond to the Performance Audit Report, "Unsolicited proposal process for the lease of Ausgrid".

I am pleased the audit found that the process for assuring the price was value for money was adequate, and the Department of Premier and Cabinet's (DPC) record keeping appropriately recorded decisions about the proposal.

As previously advised, we continue to differ on the other conclusions in the report.

The evidence before the Assessment Panel and Steering Committee provided compelling reasons to conclude that the proponents were uniquely placed to deliver the proposal and achieve value for money for NSW citizens. There was no other buyer and price thresholds were exceeded.

An independent probity advisor oversaw the assessment and concluded that it was conducted in accordance with the Unsolicited Proposal (USP) Guidelines and probity principles.

Assessment of the proposal was also consistent with the Independent Commission Against Corruption guidelines on direct negotiations, which permit direct dealing after an unsatisfactory competitive process if the agency does not expect repeating the process would produce a better result.

In addition, a more recent review by independent financial consultants further verified that value for money was achieved and it was unlikely that the proceeds from another sale process would have exceeded the price achieved.

The Audit Report has made a number of recommendations for future proposals seeking to acquire a Government business or asset. DPC will of course continue to work towards improving the USP process.

I would like to thank the Audit Office for its efforts in examining the Ausgrid USP.

Yours sincerely

**Tim Reardon**  
Secretary  
Department of Premier and Cabinet

4 December 2018

cc. Ms Claudia Migotto, Assistant Auditor-General, Performance Audit

**Michael Pratt AM**  
Secretary  
NSW Treasury

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Tel: (02) 9228 5555 ■ [www.dpc.nsw.gov.au](http://www.dpc.nsw.gov.au)



## Appendix two – NSW Government's summary of assessment of the Ausgrid unsolicited proposal

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The NSW Government has accepted an unsolicited proposal from IFM Investors Pty Ltd and AustralianSuper Pty Ltd to acquire a 50.4 per cent interest in the 99 year lease of Ausgrid. The unsolicited proposal was received following a competitive process for Ausgrid that did not proceed to completion due to a decision of the Commonwealth Treasurer not to provide foreign investment approvals.

Proceeding with the proposal has been assessed as in the interest of NSW citizens and consistent with the State's policies on unsolicited proposals and major transactions:

- The unsolicited proposal assessment process takes into account the alignment of proposals with Government plans and priorities. The Ausgrid Unsolicited Proposal serves the Government's objective of unlocking value from electricity networks to invest in other forms of infrastructure.
- The proposal was assessed in accordance with the NSW Government's Unsolicited Proposals Guide for Submission and Assessment (February 2014), as well as the evaluation criteria used in the recent Ausgrid bidding process. The Assessment Panel and Steering Committee determined that the proposal satisfied the assessment criteria.
- The transaction does not require Foreign Investment Review Board approval. This provides greater transaction execution certainty and an accelerated timeframe for completion of the transaction.
- The final binding offer is unconditional and reflects the governance, regulatory and commercial arrangements sought by the state.
- The price reflects an enterprise value for Ausgrid of \$20.7 billion and a multiple of 1.41x the June 2016 actual Regulated Asset Base (RAB) (expected to be published in November 2016). This is a strong result and represents value for money for NSW, having regard to:
  - relevant valuation benchmarks, including offers received in previous bidding processes for electricity networks; and
  - the state's retention value.
- Early completion of the Ausgrid transaction delivers results for NSW taxpayers far earlier than undertaking a new competitive bid process and allows the Endeavour Energy process to be launched sooner.
- The proposal by the proponents will support the value of the state's retained interest in Ausgrid.

Assessment of the unsolicited proposal was undertaken by:

- an Assessment Panel comprising executives from the Department of Premier and Cabinet (Chair), NSW Treasury and the Department of Industry, Skills and Regional Development; and
- a Steering Committee comprising the Secretary of the Department of Premier and Cabinet (Chair), the Secretary of NSW Treasury, the Secretary of the Department of Industry, Skills and Regional Development and the Crown Solicitor.

Source: DPC 2016.





## Appendix three – The definition and nature of unsolicited proposals

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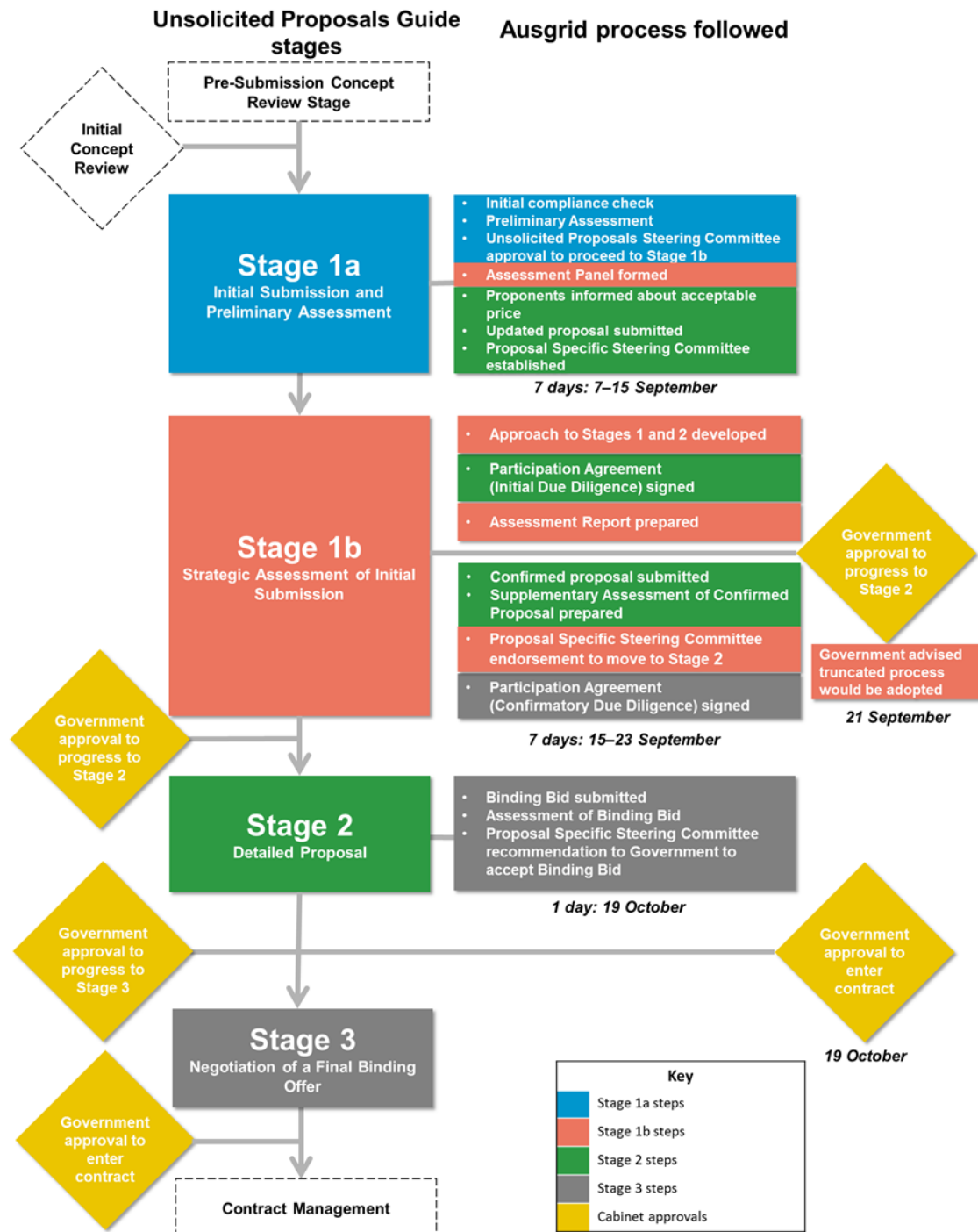
Unsolicited Proposals Guide extract	Audit Office comment
An unsolicited proposal is an approach to Government from a Proponent with a proposal to deal directly with the Government over a commercial proposition, where the Government has not requested the proposal.	Nothing came to the audit's attention to suggest that the specific proposal submitted by IFM and AustralianSuper was requested by government.  However, the government had sought proposals from the market for the lease of Ausgrid. It initiated the leasing transaction in November 2015. On 19 August 2016, the day the Australian Government announced its decision to reject the NSW Government's preferred proposals, the Premier and Treasurer announced the immediate relaunch of a competitive process to lease Ausgrid.
The unsolicited proposals process is not a substitute for routine competitive procurement by Government.	The NSW Government had sought bids to lease Ausgrid through a competitive process, but was unable to conclude the transaction due to an unexpected decision of the Australian Treasurer. It is not evident that a relaunched competitive process was not possible. The Premier and Treasurer had announced the immediate relaunch of a competitive process via the 19 August media release.
(Unsolicited) proposals are by definition outside the normal planning and procurement processes of Government.	The government's policy was for the proceeds of the partial lease to be spent on other infrastructure. It therefore planned to lease Ausgrid and first initiated the sale process in November 2015.
The NSW Government is continually seeking to capture value, and unique and innovative ideas from industry that provide real and tangible benefits to the people of New South Wales. In order to achieve this it procures projects, goods and services.	A lease is not procurement of a project, good or service.

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Source: Guide for Submission and Assessment of Unsolicited Proposals, DPC, 2014 and Audit Office analysis.



## Appendix four – Ausgrid unsolicited proposal process



Source: Guide for Submission and Assessment of Unsolicited Proposals, DPC, 2014 and Audit Office analysis.



## Appendix five – About the audit

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### Audit objective

This audit examined whether the transaction for the unsolicited proposal for a partial long-term lease of Ausgrid was effectively conducted and in compliance with the government's Unsolicited Proposals: Guide for Submission and Assessment.

### Audit criteria

We addressed the audit objective by assessing whether:

1. the decision to proceed with the transaction as an unsolicited proposal was justified
2. the proposal was rigorously assessed and demonstrates value for money was achieved for the people of NSW
3. probity arrangements were in place and assured the integrity of the transaction
4. roles and responsibilities were clear and implemented effectively.

### Audit Exclusions

The audit did not seek to:

- disclose details of the previous tender bids.

### Audit approach

Our procedures included:

5. Interviewing:
  - staff from DPC and (where relevant) NSW Treasury involved in the Ausgrid unsolicited proposal process and previous tender process.
6. Examining:
  - a) the NSW Government's Unsolicited Proposals: Guide for Submission and Assessment
  - b) documentation relating to the unsolicited proposal, including the Initial Submission by IFM Investors and AustralianSuper, Assessment Reports, Participation Agreements, probity report, meeting minutes and agendas
  - c) previous tender documentation, including submitted bids, evaluations and related advice to government.

The audit approach was complemented by quality assurance processes within the Audit Office to ensure compliance with professional standards.

### Audit methodology

Our performance audit methodology is designed to satisfy Australian Audit Standard ASAE 3500 Performance Engagements and other professional standards. The standards require the audit team to comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance and draw a conclusion on the audit objective. Our processes have also been designed to comply with requirements specified in the *Public Finance and Audit Act 1983* and the *Local Government Act 1993*.

### Acknowledgements

We gratefully acknowledge the co-operation and assistance provided by staff at the Department of Premier and Cabinet and NSW Treasury.

### Audit cost

The estimated cost of the audit is \$358,000.



## Appendix six – Performance auditing

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### What are performance audits?

Performance audits determine whether state or local government entities carry out their activities effectively, and do so economically and efficiently and in compliance with all relevant laws.

The activities examined by a performance audit may include a government program, all or part of an audited entity, or more than one entity. They can also consider particular issues which affect the whole public sector and/or the whole local government sector. They cannot question the merits of government policy objectives.

The Auditor-General's mandate to undertake performance audits is set out in section 38B of the *Public Finance and Audit Act 1983* for state government entities, and in section 421D of the *Local Government Act 1993* for local government entities.

### Why do we conduct performance audits?

Performance audits provide independent assurance to the NSW Parliament and the public.

Through their recommendations, performance audits seek to improve the value for money the community receives from government services.

Performance audits are selected at the discretion of the Auditor-General who seeks input from parliamentarians, state and local government entities, other interested stakeholders and Audit Office research.

### How are performance audits selected?

When selecting and scoping topics, we aim to choose topics that reflect the interests of parliament in holding the government to account. Performance audits are selected at the discretion of the Auditor-General based on our own research, suggestions from the public, and consultation with parliamentarians, agency heads and key government stakeholders. Our three year performance audit program is published on the website and is reviewed annually to ensure it continues to address significant issues of interest to parliament, aligns with government priorities, and reflects contemporary thinking on public sector management. Our program is sufficiently flexible to allow us to respond readily to any emerging issues.

### What happens during the phases of a performance audit?

Performance audits have three key phases: planning, fieldwork and report writing.

During the planning phase, the audit team develops an understanding of the audit topic and responsible entities and defines the objective and scope of the audit.

The planning phase also identifies the audit criteria. These are standards of performance against which the audited entity, program or activities are assessed. Criteria may be based on relevant legislation, internal policies and procedures, industry standards, best practice, government targets, benchmarks or published guidelines.

At the completion of fieldwork, the audit team meets with management representatives to discuss all significant matters arising out of the audit. Following this, a draft performance audit report is prepared.

The audit team then meets with management representatives to check that facts presented in the draft report are accurate and to seek input in developing practical recommendations on areas of improvement.

A final report is then provided to the head of the audited entity who is invited to formally respond to the report. The report presented to the NSW Parliament includes any response from the head of the audited entity. The relevant minister and the Treasurer are also provided with a copy of the final

report. In performance audits that involve multiple entities, there may be responses from more than one audited entity or from a nominated coordinating entity.

## **Who checks to see if recommendations have been implemented?**

After the report is presented to the NSW Parliament, it is usual for the entity's audit committee to monitor progress with the implementation of recommendations.

In addition, it is the practice of Parliament's Public Accounts Committee to conduct reviews or hold inquiries into matters raised in performance audit reports. The reviews and inquiries are usually held 12 months after the report received by the NSW Parliament. These reports are available on the NSW Parliament website.

## **Who audits the auditors?**

Our performance audits are subject to internal and external quality reviews against relevant Australian and international standards.

The Public Accounts Committee appoints an independent reviewer to report on compliance with auditing practices and standards every four years. The reviewer's report is presented to the NSW Parliament and available on its website.

Periodic peer reviews by other Audit Offices test our activities against relevant standards and better practice.

Each audit is subject to internal review prior to its release.

## **Who pays for performance audits?**

No fee is charged for performance audits. Our performance audit services are funded by the NSW Parliament.

## **Further information and copies of reports**

For further information, including copies of performance audit reports and a list of audits currently in-progress, please see our website [www.audit.nsw.gov.au](http://www.audit.nsw.gov.au) or contact us on 9275 7100.



## OUR VISION

Our insights inform and challenge government to improve outcomes for citizens.

## OUR PURPOSE

To help parliament hold government accountable for its use of public resources.

## OUR VALUES

**Purpose** – we have an impact, are accountable, and work as a team.

**People** – we trust and respect others and have a balanced approach to work.

**Professionalism** – we are recognised for our independence and integrity and the value we deliver.

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