



AUDITOR-GENERAL  
AUSTRALIAN CAPITAL TERRITORY



PA02/14

24 June 2003

The Speaker  
ACT Legislative Assembly  
South Building  
London Circuit  
CANBERRA ACT 2601

Dear Mr Speaker

In accordance with the Authority contained in the *Auditor-General Act 1996*, I transmit to the Legislative Assembly my Report titled "*Financial Incentive Package for Fujitsu Australia Ltd (FAL)*".

Yours sincerely

John A Parkinson

# FINANCIAL INCENTIVE PACKAGE FOR FUJITSU AUSTRALIA LTD (FAL)

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# **1. REPORT SUMMARY**

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## **INTRODUCTION**

1.1 This report presents a summary of the results of a performance audit that reviewed processes leading to the granting to Fujitsu Australia Limited (FAL) of a 'financial incentives package' as part of a legally binding agreement with the Australian Capital Territory.

1.2 In July 1997, an agreement titled 'Agreement for the Establishment of an Asia Pacific Desktop Service in the Australian Capital Territory' was signed between the Territory and Fujitsu Australia Limited (FAL). Under the legally-binding agreement, the Territory would provide a package of incentives to FAL, and FAL would establish a facility in Canberra to provide information technology related services including a Support Centre. The facility was to be FAL's pre-eminent Support Centre in the Asian Pacific Region. Significant economic benefits were expected to accrue to the Territory as a result of the agreement, largely through the increased employment opportunities the facility would create.

1.3 FAL's support centre has not been established as expected. Consequently, neither the expected employment opportunities nor the expected economic benefits have arisen. Under the terms of the agreement, FAL has been relieved of several significant obligations, including establishing the support centre, but the Territory has been required to continue to meet its obligations.

1.4 The Audit sought to clarify events leading to the agreement between the Territory and FAL, and ascertain, as far as practicable, whether the negotiations for the agreement (and its amending agreements) had been effectively managed from the Territory's perspective.

1.5 Rather than identifying individual officials the generic term 'government officials' has been used throughout the Report. It should be noted that the Audit's view is that the then Chief Executive of the Chief Minister's Department<sup>1</sup> and the Under Treasurer<sup>2</sup> controlled, directed or

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<sup>1</sup> John Walker who was Chief Executive till 28 March 1998.

<sup>2</sup> Mick Lilley who was Under Treasurer till 2 June 2000.

heavily influenced the activities undertaken by other government officials described in this Report.

### **AGREEMENT BETWEEN THE ACT AND FAL - JULY 1997**

1.6 The agreement between the Territory and FAL, executed in July 1997, acknowledged that ‘in recognition of the benefits of the Project to the Territory’ a financial incentives package would be offered to enable FAL to ‘establish in the ACT a Desk Top Service Centre to provide Australian and international customer call services’. The obligations on each party are discussed in the following sections.

#### **Obligations of the Territory - Financial Incentives Package for FAL**

1.7 The Territory’s obligations were in the form of ‘assistance’ to FAL. The assistance – a financial incentives package – included:

- exemption from paying payroll tax for ten years on wages paid to staff employed;
- the right to lease a floor in a Territory owned building for a period of ten years with no rent payable in the first two years and heavily subsidised rents for the third and fourth years;
- the right to lease other floors in the Territory owned building at any time within ten years at the same rates as the initially leased floor;
- the Territory to meet the costs of refurbishing the floors of the Territory owned building leased by FAL to a standard acceptable to both parties;
- a minimum of two weeks’ education and training in call centre and technical service for all full-time staff employed in the Centre, at no cost to FAL;
- up to \$75,000 to meet the cost of relocating staff to work at the Centre; and
- the Territory to enter into a strategic partnership with FAL whereby FAL would provide all Help Desk and Service Delivery functions for ACT agencies (at that time, these services were being provided by InTACT, an ACT Government agency).

1.8 A Submission to Cabinet in June 1997 recommending the financial incentives package estimated the cost of the package as \$9.0m.

**Obligations of FAL**

1.9 FAL's main obligation as identified in early negotiations and in the July 1997 agreement was that the company was to establish and maintain a facility to provide information technology related services including a Support Centre; that is, to establish an Asia Pacific Region Desktop Service in Canberra.

1.10 To the extent practicable, FAL was also required to 'use its reasonable endeavours to purchase plant, equipment, supplies, labour and services from companies located within the ACT region'.

1.11 The agreement also included FAL's targets for the employment of full-time staff in the Centre. The targets are shown in Table 1.1.

**Table 1.1: Employment Targets included in the Agreement between the Territory and FAL**

<b>Year</b>	<b>Year-end Target</b>
1997	191
1998	352
1999	709
2000	934

1.12 There was provision in the agreement that, if FAL did not achieve the targets, payroll tax would become payable according to a formula based on the proportion of the jobs target achieved.

**STRATEGIC PARTNERSHIP INCENTIVE**

1.13 The strategic partnership incentive – to provide Help Desk and Service Delivery functions for ACT agencies - was never delivered to FAL. Much of this Report addresses this incentive.

1.14 The strategic partnership incentive required all information technology help desk support and related services for ACT agencies to be outsourced to FAL. FAL was to provide the services under commercial terms and conditions consistent with industry practices. The services were to be paid for by the ACT agencies receiving the services.

1.15 At the time the strategic partnership incentive was offered, the services to be outsourced were being provided by Government employees

through the Government agency known as InTACT. The services are still provided by InTACT.

1.16 The incentive was intended to be a significant contribution to the establishment of FAL's Support Centre. In effect, the incentive would provide assured 'start up' business for the Centre. It was of critical importance to FAL (see Chapter 3 of this Report).

1.17 The delivery of this incentive was always likely to be difficult. This was because the Enterprise Bargaining Agreement (EBA) in place between the Territory and the relevant Union required that, amongst other things, consultations take place with the Union before any information technology outsourcing could occur. The terms of the EBA were such that serious industrial relations issues would have to be overcome before the intended outsourcing could be implemented.

1.18 No documentation was supplied during the Audit that indicated that known industrial relations issues were taken to account when the incentive was included in the legally binding agreement with FAL made in July 1997, or earlier when the outsourcing incentive was first offered to FAL.

## **AUDIT OBJECTIVE**

1.19 The objective of the Audit was to provide an independent opinion to the Legislative Assembly on whether:

- processes leading to the decisions on the financial incentives package to be granted to FAL for the establishment of its Asia Pacific Desktop Service in Canberra were effectively managed, from the Territory's perspective.

## **AUDIT OPINION**

1.20 The independent Audit opinion drawn on the audit objective is set out in the shaded box on the following page.

**AUDIT OPINION**

Processes leading to decisions on the financial incentives package to be granted to FAL for the establishment of its Asia Pacific Desktop Service in Canberra were **not** effectively managed from the Territory's perspective.

## **BASES OF AUDIT OPINION**

1.21 The Audit opinion that *processes leading to decisions on the financial incentives package to be granted to FAL for the establishment of its Asia Pacific Desktop Service in Canberra were not effectively managed from the Territory's perspective* is based on the following findings.

### **Early Proposals for a Financial Incentives Package (Chapters 2 and 3)**

#### ***Audit Findings***

- There is no documentation to show how the components of the financial incentives package initially offered to FAL in February 1997 were derived or valued.
- The financial incentives package was offered without adequate investigations, analysis, or research.
- There is no evidence of who approved the components of the initial financial incentives package.
- In April 1997, after FAL shortlisted the Territory as a candidate location for the Centre, the financial incentives package initially offered was significantly increased, without investigations, analyses, or research being undertaken.
- There is no evidence of who approved the increase in the incentives package.

#### ***Audit Comments***

1.22 Early in 1997, FAL approached several State and Territory governments with a proposal to establish an information technology Support Centre within the relevant State or Territory, and seeking submissions for related financial incentives. FAL would shortlist potential locations based on the submissions.

1.23 The Territory responded in February 1997 with an initial financial incentives package. There is no evidence of how the components or value of the incentives package offered were arrived at. There is no documentation of who approved the offering of the package. Based on the evidence available, the Audit considers the investigation, analysis,

and research undertaken prior to offering the incentives package were inadequate.

1.24 FAL shortlisted the Territory as a candidate location for the Centre late in March 1997, prompting further negotiations between FAL and Government officials. The negotiations resulted in a substantial increase to the payroll tax exemption component of the package, and also added two very significant components to the package. The first was the strategic partnership incentive to outsource information technology services to FAL. The second was an offer to lease the whole of the Moore Street Health Building to FAL at heavily subsidised rentals.

1.25 FAL advised government officials that Canberra had been selected as the site for location of the Service Support Centre in early May 1997.

1.26 As with the earlier stage of negotiations documentation reveals no evidence of investigation, analysis, or research taking place. Based on the evidence available, the Audit considers the processes leading to the substantial increase in the offered incentives package were inadequate.

### **Development of a Memorandum of Understanding and the July 1997 Agreement (Chapters 4 and 5)**

#### ***Audit Findings***

- In May 1997, within two weeks of FAL advising that the ACT had been selected, the Chair of the Territory's negotiating group recommended to the then Chief Executive of the Chief Minister's Department that the Territory should not proceed with the strategic partnership incentive; the Chair's recommendation was not accepted.
- In June 1997, as Government officials were drafting an agreement with FAL, a legal firm engaged by the Territory advised that significant difficulties would arise in implementing the strategic partnership incentive; the firm advised the incentive should not proceed.
- In June 1997, a non-binding Memorandum of Understanding was prepared, apparently because a legally binding agreement could not be completed by the intended date. The Memorandum of Understanding contained little more than had been in the Territory's bid to FAL, and excluded the strategic partnership incentive.

## FINANCIAL INCENTIVE PACKAGE FOR FUJITSU AUSTRALIA LTD (FAL)

- Difficulties with the strategic partnership incentive were raised by a second legal firm as well as the Government Solicitor's Office.
- The Memorandum of Understanding was signed three days before a submission was made to Cabinet seeking formal agreement to the Memorandum's terms.
- A legal firm engaged to review the proposed agreement with FAL recommended that several significant issues, including 'considerable industrial relations issues', be resolved before entering into the agreement. This advice was not acted on and a largely unchanged agreement was signed on 14 July 1997.

### *Audit Comments*

1.27 Government officials stepped up negotiations with FAL following the selection of Canberra as the preferred location for the Support Centre. As it became clear that a formal agreement could not be quickly finalised, officials turned their attention to the preparation of a Memorandum of Understanding. The Memorandum was to be a statement of intent outlining 'preliminary understandings as to how [the parties] will cooperate in relation to the Project'. The Memorandum of Understanding was not a legally binding instrument. It was signed in June 1997.

1.28 In July 1997, following further stages of negotiations, a legally binding agreement between the Territory and FAL was signed.

1.29 At several stages in this process, government officials received independent advice (including legal advice) regarding significant difficulties that could be expected in implementing the strategic partnership incentive. The strategic partnership incentive was a key component of the financial incentives package offered to FAL.

1.30 Government officials were fully aware of the issues they faced in trying to implement the proposed strategic partnership incentive. Up to this point, however, there is little evidence that officials actively sought to address the issues. The Audit considers that this aspect of the negotiation process was managed poorly from the Territory's perspective. In the event, the issues were never resolved and the strategic partnership incentive was not implemented.

## **Industrial Relations Issues (Chapter 6)**

### ***Audit Findings***

- The Community and Public Sector Union (CPSU) raised their concerns with Government officials immediately on becoming aware that negotiations with FAL might involve outsourcing of members' work (late June 1997).
- At separate meetings, members of the CPSU passed two resolutions setting out their resistance to any outsourcing of InTACT members' work; copies of the resolutions were provided to Government officials.

### ***Audit Comments***

1.31 Government officials were aware that the strategic partnership incentive raised industrial relations issues. In a series of meetings and exchanges of correspondence between Government officials and the CPSU, the Union clearly communicated its intention to resist vigorously any attempt by Government officials to outsource the work of members; i.e. to deliver the strategic partnership incentive to FAL. Nevertheless, officials persisted with negotiations with FAL in this matter.

## **Variations to the Financial Incentives Package – the October 1997 Agreements (Chapter 7)**

### ***Audit Findings***

- Recognising there were difficulties in delivering the strategic partnership incentive, FAL sought alternative (short-term) incentives.
- Government officials agreed to the alternative incentives proposed by FAL. However, there is no documentation that officials investigated, analysed, or researched the impact or cost of these incentives before agreeing to the proposal.
- The alternative incentives were incorporated into a 12-month agreement dated 14 October 1997.
- A second 14 October 1997 agreement postponed for 12 months the strategic partnership incentive.
- The second 14 October 1997 agreement also provided that if the strategic partnership incentive could not be delivered in 12

months FAL would be released from all its obligations. The obligations of the Territory, however, would remain in full force.

### *Audit Comments*

1.32 Government officials and FAL had belatedly recognised that, in the short term at least, the Territory could not deliver the strategic partnership incentive. FAL responded by requesting (and proposing) alternative incentives. The reaction from Government officials was to agree with the request. The alternative incentives were incorporated into a legally binding agreement on 14 October 1997. There is no documentation to suggest that the impact or costs of these short-term incentives were ever analysed by Government officials.

1.33 Importantly, a second legally binding agreement was signed on 14 October 1997. This agreement postponed implementation of the strategic partnership incentive, but required the incentive to be incorporated into a legally binding agreement to be made within a set period (approximately one year). This recognised that the Territory had offered the incentive and therefore had an obligation to deliver it. Not unreasonably, if the ACT did not deliver this important obligation, the 14 October 1997 agreement provided for FAL to be released from all its obligations. The Territory's obligations in regard to the incentives package would continue.

## **Decision to Abandon the Strategic Partnership Incentive (Chapter 8)**

### *Audit Findings*

- Government officials did not re-commence negotiations on implementation of the strategic partnership incentive until some seven months into the 12-month negotiation period.
- In late 1998, Government officials and FAL accepted that the Territory could not deliver the strategic partnership incentive.
- Alternative incentives were briefly considered. However, in December 1998, FAL exercised its right to withdraw from all its obligations; except for the strategic partnership incentive the Territory's obligation to deliver the major incentives continue.

*Audit Comments*

1.34 It was some seven months into the 12-month negotiation period prescribed by the 14 October 1997 agreement before Government officials re-commenced negotiations on implementation of the strategic partnership incentive. The negotiation period was extended by a further month, but there was growing recognition that the incentive could not be delivered.

1.35 After almost two years of discussion and negotiations, a decision was taken to abandon the strategic partnership incentive involving outsourcing. FAL, as they were legally entitled to, withdrew from all their obligations. The Territory, however, was legally obliged to deliver the major incentives other than the strategic partnership incentive.

**The Accommodation Incentives (Chapter 9)**

*Audit Findings*

- The Territory-owned Moore Street Health Building was offered as accommodation for FAL's Service Centre without consultation with the Territory agencies occupying the building.
- There was no consideration as to where agencies occupying the building could be relocated.
- Less than three months after FAL had exercised its right to occupy a floor of the Health Building, the major occupier (Community Care) was signalling concern about its future accommodation needs in the building.
- As FAL sought to exercise its right to occupy further accommodation within the Health Building, Government officials successfully negotiated to transfer FAL's new accommodation requirements to other premises (the Territory-owned Callam Offices in Woden).

*Audit Comments*

1.36 The accommodation incentives were introduced into the financial incentives package during early negotiations in March 1997 (after FAL had shortlisted Canberra as the candidate location, but before the final selection had been made).

1.37 The inclusion of rights over the whole of the Moore Street Health Building in the incentives package had the potential to cause significant logistical and financial problems for the Territory. Fortunately, this potential was not fully realised, as FAL exercised only part of their accommodation rights, and Government officials were able to successfully negotiate to transfer some of FAL's accommodation requirements to other premises.

## **OUTCOMES OF THE AGREEMENT BETWEEN THE TERRITORY AND FAL**

1.38 The agreement between the Territory and FAL was expected to be mutually beneficial for both parties. In return for a financial incentives package estimated by Government officials to be worth around \$9m, FAL would establish an information technology service centre in Canberra and in doing so create over 900 new high technology jobs'.

### **Number of Staff Employed by FAL in the Service Support Centre**

1.39 By the end of the year 2000, the Service Support Centre was expected to be employing 934 full-time equivalent staff. The Audit has estimated the number of full time equivalent staff who were working in the FAL Service Support Centre during 2001-02 as 90<sup>3</sup>.

### **Cost of Incentives Granted to FAL**

1.40 According to information supplied to the Audit the cost to the Territory of the incentives granted to FAL have been approximately \$2.6m made up as shown in Table 1.2:

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<sup>3</sup> The estimation is based on the amount of FAL's 2001-02 payroll as advised by FAL to the ACT Revenue Office. FAL supplied the advice for the purpose of claiming the payroll taxation exemption component of the incentives package. The Audit divided the payroll by an estimated \$40,000 average annual wage for an employee in the Centre.

**Table 1.2: Estimated Cost of Incentives Granted to FAL**

Incentive	\$m
Payroll tax exemptions	0.581
Rental subsidies	1.144
Building refurbishments <sup>1</sup>	0.827
Relocation of existing Government tenants	0.091
	\$2.643

<sup>1</sup> This relates to refurbishment of Callam Offices. A further \$2.143m was incurred in refurbishing Level 4 of the Health Building to accommodate the FAL Service Support Centre. Only a proportion of these costs are directly attributable to FAL's occupation of the premises, as they represent (in part) the upgrade of major building components that would have been required regardless of who occupied the building.

## CONCLUSION

1.41 The Audit has concluded that negotiations for the agreement between the Territory and FAL for the establishment of an information technology support centre in Canberra (and its amending agreements) were not effectively managed from the Territory's perspective. Documentation indicates that few decisions regarding the financial incentives package offered to FAL were made as a result of considered investigation, analysis or research. Accountability arrangements (i.e., who was responsible for managing the project and decision-making) are unclear. Early (and consistent) advice regarding the impracticality of aspects of the incentives package was disregarded.

1.42 The result of this haphazard approach was an unrealistic incentives package that left the Territory exposed. The package contained a critical component that was almost certainly undeliverable (that is, the strategic partnership incentive) and another component that if fully delivered had potential to cause the Territory significant logistical and financial problems (that is, the accommodation incentive).

1.43 Poor management of key processes led to a legally binding agreement the benefits of which were unlikely to be fully achieved by either party. The eventual failure of the Territory to deliver the strategic partnership incentive resulted in FAL being able to negotiate full release from its obligations. This outcome was reasonable for FAL given that the

Territory had failed to deliver on its obligations. It has, however, been at a cost to the Territory.

## **FUTURE ACTIONS**

1.44 The Audit considers that the processes leading to the negotiation of the agreements discussed in this Report raise issues of broader relevance than this instance. The following suggestions for future actions are made to address these broader issues.

### **Development of Guidelines**

1.45 The Audit is of the view that the agreement between the Territory and FAL, whereby FAL would establish an information technology support centre in Canberra in exchange for a package of financial incentives granted by the Territory, was essentially a procurement transaction. The Territory's intention was to purchase economic growth in the ACT through the new jobs created in the Service Centre. The purchase consideration for the economic growth/new jobs was the financial incentives package granted to FAL.

1.46 The Territory currently has legislation relating to procurement of goods, services and works by Territory entities. This legislation is the *Government Procurement Act 2001*. The Audit view is that the Procurement Act should cover arrangements such as those described in this Report.

***Suggestion for future action No. 1*** - Arrangements whereby incentives are granted to an organisation by the Territory or its agencies in exchange for the organisation establishing a facility or facilities in the ACT, and/or carrying out particular activities in the ACT, should be subject to the *Government Procurement Act 2001*. If necessary, the Act should be amended to ensure these types of arrangements are covered.

***Suggestion for future action No. 2*** - Consistent with the Procurement Act, the Procurement Board should develop and make guidelines on the policies, practices and procedures that must be followed in procurement arrangements that involve the granting of incentives by the Territory as part of the arrangements.

## **Public Reporting**

1.47 The contents of the various legally binding agreements made between the Territory and FAL were known only to a small number of Government officials. Anecdotally the Audit understands that an aura of secrecy existed over the agreements. There now is Territory legislation in place that requires the contents of all contracts to be made publicly available. The legislation is the *Public Access to Government Contracts Act 2000*. The Audit considers that agreements that involve the granting of incentives to an organisation should be subject to the disclosure requirements of the Act.

***Suggestion for future action No. 3*** - The Public Access to Government Contracts Act should apply to all arrangements that involve the granting of incentives to an organisation by the Territory. If necessary, the Act should be comprehensively amended to ensure these types of arrangements are covered.

1.48 The arrangements that were the subject of this Audit were not disclosed in any public report. Implementation of *Suggestion 3* will partly remedy this deficiency by ensuring that information on all arrangements involving incentives will be publicly available shortly after the agreements are entered into. However, the Audit is also of the view that the progress of arrangements that take some time to implement must also be publicly available. This could be done by including this requirement in the Chief Minister's Annual Reports Directions issued under the Annual Reports Act.

***Suggestion for future action No. 4*** - The progress of all arrangements that involve the granting of incentives to an organisation by the Territory should be reported in agencies' annual reports.

## **CHIEF EXECUTIVE'S RESPONSE**

1.49 In accordance with section 18 of the *Auditor-General Act 1996*, a final draft of this Report was provided to the Chief Executive of the Chief Minister's Department for consideration and comments. The response from the Chief Executive of the Chief Minister's Department follows.

*I welcome the conduct of this audit which provides a very useful critical analysis of some past practices in the consideration of a specific business assistance proposal. The procedures now in place for the consideration of business assistance packages are much more structured and transparent. However, the suggestions set out in this report will be carefully considered to see how the current processes can be further improved.*

## **2. PROPOSAL FOR A FINANCIAL INCENTIVES PACKAGE – FEBRUARY 1997**

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### **INTRODUCTION**

2.1 This Chapter examines the early stages of negotiations leading to the agreement between the Territory and Fujitsu Australia Ltd (FAL), under which FAL would establish information technology related services including a Support Centre in Canberra.

### **SIGNIFICANT FINDINGS**

- *There is no documentation to show how the components of the financial incentives package initially offered to FAL in February 1997 were derived or valued.*
- *The financial incentives package was offered without adequate investigations, analysis, or research.*
- *There is no evidence of who approved the components of the initial financial incentives package.*

### **BACKGROUND**

2.2 According to documents sighted by the Audit, the process for selection of the location for the Fujitsu Australia Ltd (FAL) Asia-Pacific Desktop Service Centre (hereafter called the Support Centre) commenced early in 1997. As a first step, FAL identified a small number of States or Territories as possible locations, and sought submissions from those interested in providing financial incentives to assist FAL to locate the Support Centre in the respective State or Territory. From these, a shortlist would be developed for more detailed examination. The ACT participated in the shortlisting process by attending various meetings with FAL representatives and by exchange of correspondence.

### **EARLY MEETINGS AND CORRESPONDENCE**

2.3 A meeting was held on 11 February 1997 to discuss the possibility of locating Fujitsu's new Support Centre in Canberra. The meeting was attended by FAL representatives, the then Chief Executive of the Department of Business, Arts, Sport and another government official.

2.4 The Fujitsu representatives advised that other States were well progressed in preparing bids.

2.5 Notes of the meeting include that there was a verbal commitment made by the officials that the ACT would submit a bid for the Desktop Service. There was urgency as the notes state that a 'substantial bid was required within two weeks'.

2.6 Subsequently, FAL wrote (letter dated 21 February 1997) to formally advise that its parent, Fujitsu Japan, had decided to establish an Asia Pacific Desktop Service Centre in Australia. The letter went on to advise that FAL would be seeking written submissions from five State and Territory Governments which had shown an interest in providing financial incentives to FAL to locate the Centre in their State or Territory. This included the ACT.

2.7 The letter included a timetable for the selection process. FAL expected to conclude the selection process, including completing an agreement with the selected government, by the end of May 1997.

### ***Audit Comment***

2.8 The Audit is unaware how, or by whom, the meeting of 11 February 1997 with FAL was initiated. Official files do not indicate that any significant discussion, investigation, or analysis by government officials occurred prior to this meeting. The commitment at the meeting to making a 'substantial bid' without any investigations or analyses would on the face of it seem to have been premature.

2.9 FAL's letter of 21 February 1997 was the first formal approach to the Territory for assistance.

### **THE TERRITORY'S DRAFT PROPOSAL**

2.10 The Territory's draft proposal, in response to FAL's request, was in the form of a document titled 'A Proposal to Fujitsu to Locate 'NEWCO' in Canberra' (NEWCO was the name FAL were using at the time for the Support Centre). It appears to have been conveyed to FAL informally on 21 February 1997, with the advice that 'it is only a rough draft copy, and is still being refined'.

## **FINANCIAL INCENTIVE PACKAGE FOR FUJITSU AUSTRALIA LTD (FAL)**

2.11 A financial incentives package was outlined in the draft proposal. The package was:

- a block of land at no cost;
- waiver of payroll tax for three years;
- training assistance through the Canberra Institute of Technology; and
- a financial grant towards location costs of core staff.

2.12 The draft bid document contained no information on the dollar value of the incentive package.

### ***Audit Comment***

2.13 The financial incentive package outlined in the draft bid was very modest compared to the incentive package finally offered to and accepted by FAL.

## **REVISIONS TO THE PROPOSED FINANCIAL INCENTIVES PACKAGE**

2.14 A government official wrote to FAL on 28 February 1997 responding to verbal requests by FAL's representatives for further information.

2.15 The official's letter included potential incentives as follows:

The ACT Government is prepared to negotiate a flexible package of financial assistance with Fujitsu to the value of \$1 million. This assistance can take the form of rent subsidy for a specified period, assistance with other relocation costs, for specific plant and equipment and for workforce development costs. This is of course in addition to payroll tax.

2.16 In relation to payroll tax, the letter stated:

The ACT Government would be willing to consider a waiver of payroll tax for a four year period which would achieve a saving to the Company of \$4.2 million in accordance with staffing levels below.

## FINANCIAL INCENTIVE PACKAGE FOR FUJITSU AUSTRALIA LTD (FAL)

Year 1	206 staff
Year 2	359 staff
Year 3	514 staff
Year 4	710 staff

2.17 The letter's summary stated:

The total package which can be offered by the ACT Government is in excess of \$6 million. As has been indicated there are other cost advantages which the ACT is able to offer in terms of labour costs and telecommunications as well as an ideal location between the major population centres in Australia.

The ACT Government has within time constraints, put together what we believe to be a substantial and attractive package. We look forward to discussing this package further in the next few days.

2.18 Following a meeting with an FAL representative, the government official again wrote to FAL on 11 March 1997, advising FAL of a further increase to the incentive package previously offered. The increase was that the payroll tax holiday was now to be for six years rather than the four years originally offered. The letter includes:

Our calculations would suggest the benefit to NEWCO would amount to more than \$7,600,000 over the period of six years and at the staffing levels you envisage.

### *Audit Comment*

2.19 Official files do not show how the incentives package offered to FAL was decided on. There are no analyses supporting the proposed financial incentives package. There is no documentation of who approved the incentives package. Similarly, there is nothing on file justifying the proposed increase in the payroll tax incentive offered, or showing who approved this increase in the financial incentives package.

## **SHORTLISTING THE TERRITORY FOR FURTHER CONSIDERATION**

2.20 FAL formally advised by letter dated 27 March 1997 that the Territory had been selected on a short list of three States and Territories. The others on the short list were Queensland and South Australia.

2.21 FAL requested a further submission by 18 April 1997 ‘firming up final offers’. To assist the development of the final offer, FAL would ‘share ... our detailed business plan and a check list of subjects on which we require your input’. FAL advised they intended to ‘conclude agreements with our final Government partner by 31 May 1997’.

***Audit Comment***

2.22 It would appear that the apparent strength of the financial incentives package offered to FAL was sufficient to persuade FAL to include the Territory on the shortlist.

**CONCLUSION**

2.23 The first documented indications that the ACT was considering bidding for FAL’s Asia Pacific Desktop Service Centre are notes of a meeting held on 11 February 1997. By 11 March 1997, only one month later, a bid had been made to FAL. The bid contained a payroll tax holiday of some \$7.6m, substantial rental assistance for seven years, and other forms of financial assistance.

2.24 There is little evidence of how Government officials arrived at components (or value) of the financial incentives package offered to FAL. This includes both the initial draft proposal and the subsequent substantial increase in the value of the payroll tax incentive. There is no documentation of who approved the offering of the package.

2.25 Based on the evidence available, the Audit considers the investigation, analysis, and research undertaken prior to offering the incentives package were inadequate.

### **3. PROPOSAL FOR A FINANCIAL INCENTIVES PACKAGE – APRIL 1997**

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#### **INTRODUCTION**

3.1 This Chapter examines the documented negotiations that took place, and the correspondence exchanged, leading to the selection of the ACT as the preferred location for FAL's Support Centre.

#### **SIGNIFICANT FINDINGS**

- *In April 1997, after FAL shortlisted the Territory as a candidate location for the Centre, Government officials significantly increased the financial incentives package initially offered, without undertaking documented investigations, analyses, or research.*
- *There is no evidence of who approved the increase in the incentives package.*
- *A copy of the formal bid by the Territory to FAL, including the financial incentives package, cannot be located on official files.*

#### **BACKGROUND**

3.2 The previous Chapter outlined the negotiations with FAL that led to the Territory being included in the short list of States and Territories to submit a bid for FAL's Support Centre to be located in their State or Territory. The Territory submitted a proposal substantially expanding on the previous financial incentives package. The Territory was eventually selected to be the candidate location.

#### **FAL BUSINESS PLAN FOR THE SUPPORT CENTRE**

3.3 In April 1997 FAL's business plan for their proposed Support Centre was provided to and explained to government officials by FAL representatives. The provision and explanation of the plan were made in order to assist the ACT to prepare its final offer.

3.4 Importantly the business plan included the anticipated full time equivalent staffing levels of the Support Centre over four years. The staffing levels anticipated in the business plan were as follows.

## **FINANCIAL INCENTIVE PACKAGE FOR FUJITSU AUSTRALIA LTD (FAL)**

1997-98	252
1998-99	345
1999-00	622
2000-01	950

3.5 The employment levels are important, as they are an indication of the economic benefit the Centre was expected to bring to the Territory. These employee numbers were eventually incorporated into the agreement signed between FAL and the Territory in July 1997.

### ***Audit Comment***

3.6 There is no evidence on file that achievability of FAL's business plan was subjected to any critical analyses by government officials. The plan, including the expected employment levels, was apparently accepted as being achievable without question.

## **INITIAL INVOLVEMENT OF THE UNDER TREASURER**

3.7 A meeting was held on 9 April 1997 attended by FAL representatives, the ACT Under Treasurer, another government official and a CanTrade representative.

3.8 The notes of the meeting do not indicate that any significant agreements were made at this meeting. It was, however, the first documented involvement of the Under Treasurer in the negotiation process.

### ***Audit Comment***

3.9 The Under Treasurer was to have a major role in the negotiations with FAL. His entry at this point is therefore significant.

## **EXPANSION OF THE FINANCIAL INCENTIVES PACKAGE**

### **Introduction of Accommodation Incentives**

3.10 The proposed financial incentive package offered to FAL included a suitable block of land 'at no cost ... in the form of a direct grant of land and waiver of stamp duty on transfer'. However, the nature of the

premises/accommodation incentive changed as the final offer to FAL was being developed. Government officials were considering the possibility of offering accommodation in Territory-owned premises as an alternative option.

3.11 A handwritten facsimile dated 14 April 1997 is the first indication that accommodation in Territory-owned premises – in this case, the Moore Street Health Building - was being considered as part of the FAL negotiations. The facsimile was written by an external consultant and sent to the Under Treasurer. The opening page of the facsimile states:

1. Herewith structuring of a deal – Moore Street building is a great opportunity provided we can be assured that DOH [Department of Health] can be accommodated elsewhere.
2. Our longterm strategy will be to progressively upgrade Moore Street (with ‘F’ [Fujitsu] as a tenant) and sell to revitalised market in say 2000.’

#### ***Audit Comment***

3.12 None of the prior documented negotiations or correspondence had included any mention of a Territory-owned building being provided to FAL for their Support Centre.

#### **Introduction of a Strategic Partnership Incentive**

3.13 At a meeting held on 16 April 1997 attended by FAL representatives advice was given by government officials that the incentives package would be significantly expanded from that previously offered. The expansion comprised:

- extension of the payroll tax holiday to ten years;
- location of the Support Centre in the Territory- owned Health Building; and
- introduction of the concept of a ‘strategic partnership agreement’ between the Territory and FAL, which would provide ‘start up’ business for the Support Centre.

3.14 It was indicated by the FAL representatives that a strategic partnership incentive consisting of ‘start up’ business for the Support Centre would possibly compensate for the up-front cash benefits being offered by the other jurisdictions competing for selection. The FAL

representatives said the offer of a strategic partnership incentive would potentially place the Territory in a very strong position.

3.15 At a subsequent meeting (18 April 1997), attended by FAL representatives and government officials, it was agreed that the bid to be submitted to FAL would include the strategic partnership incentive. The incentive would consist of FAL being contracted to provide help desk support services (and similar services) to all ACT Government agencies. The agencies would pay FAL for the services. This was to be the 'start up' business for the FAL Desktop Service Centre introduced to the negotiations by the Under Treasurer at the 16 April 1997 meeting.

***Audit Comment***

3.16 As with previous increases to the financial incentives package, there is no evidence of analysis of the impact, cost or risks to the Territory prior to the increased incentives being offered. In particular, there is no evidence of the risks involved in offering the Health Building (which at the time was largely occupied by ACT Community Care) and the help desk support services to FAL being recognised. Matters such as the relocation of the Government agencies occupying the Health Building, and the industrial relations issues related to the outsourcing to FAL of work currently being conducted by InTACT staff, were not addressed.

**THE TERRITORY BID FOR THE ESTABLISHMENT OF THE SUPPORT CENTRE IN CANBERRA**

3.17 The Territory's formal bid was submitted to FAL on 22 April 1997. A covering letter to the bid document is on file, however, a copy of the bid document is not.

3.18 The covering letter includes the following:

The strategic partnership, which is crucial to our bid, will give the business [i.e. the Support Centre] its best chance of success.

***Audit Comment***

3.19 The formal bid documents have not been located for the Audit. However, the covering letter clearly indicates the importance the strategic partnership incentive had now assumed in the incentives package.

## **SELECTION OF THE TERRITORY AS THE CANDIDATE LOCATION FOR THE FAL SUPPORT CENTRE**

3.20 FAL wrote to the Chief Executive of the Chief Minister's Department on 5 May 1997 advising that the Territory had been selected as the candidate location for the Support Centre. The importance of the strategic partnership incentive to FAL's decision was clearly expressed in the letter as follows:

An important part of your proposal to Fujitsu was the opportunity resulting from a partnership with the ACT Government in relation to InTACT and the associated offer to contract out to Fujitsu the ACT Government help desk and desktop service delivery functions. Such functions would result in the ACT Government being the first major customer of our new technology services venture. Your offer to contract out the ACT help desk and desktop service delivery service to Fujitsu will be a model that can be demonstrated to the Federal Government as a positive example of the outcome of their IT outsourcing initiatives.

Fujitsu's offer to the ACT Government is predicated upon ... the contractual agreement for contracting out the ACT Government's help desk and service delivery function commencing at or before November 1997 ...

### ***Audit Comment***

3.21 This response makes it clear that FAL understood that the incentives package included the ACT Government's help desk and desktop service delivery functions being outsourced under contract to FAL (i.e. this was the strategic partnership incentive). That is for the full incentives package to be delivered a major part of InTACT's functions needed to be outsourced to FAL. There is no evidence that the government officials driving the negotiations assessed the difficulties and risks of the Territory going down this path.

## **CONCLUSION**

3.22 FAL shortlisted the Territory as a candidate location for the Centre late in March 1997, prompting further negotiations between FAL and Government officials. The negotiations resulted in a substantial increase to the payroll tax holiday component of the incentives package, and added two very significant components to the package. The first was an offer to lease the whole of the Health Building to FAL at heavily

subsidised rentals. The building was proposed as the location of the Help Desk Centre. The second new component to the financial incentives package was the strategic partnership incentive to outsource information technology services to FAL.

3.23 As with the earlier stage of negotiations, documentation reveals no evidence of investigation, analysis, or research of the impact, cost, or risks to the Territory, particularly in relation to the strategic partnership incentive. Later Chapters of this Report show that delivering the strategic partnership incentive to FAL proved unachievable.

3.24 Based on the evidence available, the Audit considers the processes leading to the substantial increase in the offered incentives package were inadequate.

## 4. DEVELOPMENT OF A MEMORANDUM OF UNDERSTANDING

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### INTRODUCTION

4.1 This Chapter examines the documented negotiations that took place and the correspondence exchanged following the Territory's selection as the candidate location for FAL's Support Centre, and leading to the signing of a Memorandum of Understanding between FAL and the Territory.

4.2 Immediately following the signing of the Memorandum of Understanding a submission was made to Cabinet on the Support Centre. This submission and its related Cabinet decision are also referred to in this Chapter.

### SIGNIFICANT FINDINGS

- *In May 1997, within two weeks of FAL advising that the Territory had been selected as the candidate location for the Support Centre, the Chair of the Territory's negotiating group recommended the Territory not proceed with the strategic partnership incentive; the Chair's recommendation was not accepted.*
- *In June 1997, as Government officials were drafting an agreement with FAL, a legal firm engaged by the Territory advised that significant difficulties would arise in implementing the strategic partnership incentive; the firm advised the incentive should not proceed.*
- *Difficulties with the strategic partnership incentive were raised by a second legal firm, as well as the Government Solicitor's Office.*
- *In June 1997, a non-binding Memorandum of Understanding was prepared, which contained little more than the Territory's bid to FAL, and excluded the strategic partnership incentive.*
- *The Memorandum of Understanding was signed three days before a submission was made to Cabinet seeking formal agreement to its terms.*

## **BACKGROUND**

4.3 As outlined in the previous Chapters the ACT had firstly been short listed for the FAL Support Centre and then selected from the short list as the candidate location. FAL sought to formalise the arrangements, through legally-binding contracts, by the end of May 1997.

## **FORMATION OF A TERRITORY NEGOTIATING COMMITTEE**

4.4 The first step taken in further negotiating the proposed arrangements between the Territory and FAL was the appointment of a negotiating group by the Chief Executive of the Chief Minister's Department. The group's Chair was the Chairman of the Board of the InTACT Group. The other group members were the Under Treasurer and two other government officials.

4.5 FAL were advised on 5 May 1997 that this negotiating group would 'conclude contractual negotiations ... by 30 May 1997'.

### *Audit Comment*

4.6 The appointment of a negotiating group was a sound step. However, establishment of the group at this stage was too late. The decisions about the content of the incentives package had already been taken.

## **THE NEGOTIATING GROUP'S RECOMMENDATION TO WITHDRAW FROM THE PROPOSALS**

4.7 Notes dated 19 May 1997 are on file of a meeting held to discuss issues related to the arrangements to be put in place between the ACT and FAL. The notes are not clear, however, they do indicate that difficulties were being encountered in resolving issues. This is evidenced by the concluding note of the meeting which states:

'Disagreement **fundamental** on control management/staff etc.'

4.8 The Chairman of the negotiating group wrote to the Chief Executive of the Chief Minister's Department on 24 May 1997 concerning the status of negotiations with FAL. The Chairman said:

I am afraid that the negotiations with Fujitsu Australia Limited (FAL) have reached a position from which I cannot see a way forward which would both be sensible for the ACT Government

Departments to meet their IT needs or defensible both in terms of probity and in achieving value for money for the Territory.

The crux of the problem is that FAL are seeking a guarantee now (May 1997), that we will, in November 1997, enter into an exclusive five year service contract with them. They want that guarantee even before we have established service levels and before they can tell us what charges will apply. Further, they want us to agree now, that in November 1998, they will be able to renegotiate that service contract with new service levels and new prices.

...

I do not have any conviction that continuing negotiations would result in a shifting of FAL's position.

In these circumstances, I recommend we withdraw from the proposals, which commenced the arrangement with FAL.

### ***Audit Comment***

4.9 The meeting on 19 May 1997 was held only two weeks after FAL had advised that the Territory was the selected candidate location. The difficulties encountered arose from the strategic partnership incentive. The difficulty in gaining agreement was very significant as the strategic partnership incentive was crucial to the Territory's bid.

4.10 The correspondence of 24 May 1997 from the Chairman of the negotiating group to the Chief Executive of the Chief Minister's Department also relates to the strategic partnership incentive. At this point, it should have been obvious that this component of the financial incentives package was going to be very difficult to deliver.

### **NEGOTIATIONS WITH FAL CONTINUE**

4.11 Notwithstanding the recommendation from the Chairman of the negotiating group, the Chief Executive of the Chief Minister's Department wrote to FAL on 28 May 1997, confirming the Government's desire to rapidly conclude negotiations. The letter alluded to a 'shaky start' to negotiations and noted that although 'there are some industrial relations difficulties in fully enabling [the strategic partnership incentive] I am convinced we can mutually find satisfactory solutions'.

4.12 Documentation available to the Audit does not identify who made the decision to proceed with negotiations.

4.13 On 4 June 1997, the Chief Executive of the Chief Minister's Department wrote to FAL stating that the range of incentives offered in the proposal provided to FAL in April 1997 remained valid (as previously stated the proposal document is not on file and has not been seen by the Audit).

4.14 The letter goes on to identify the obligations the Territory expected FAL to meet. In summary these were:

- a commitment by FAL in terms of job numbers to be created at the Support Centre with some repayment of money expended by the Government if job numbers are not met; and
- that management and other services to be provided by FAL under the proposed strategic agreement would be charged for at commercial terms and conditions acceptable to both parties, including provisional margins consistent with industry practices.

4.15 An attachment to the Chief Executive's letter set out the steps involved in implementing the strategic agreement. A timetable for the completion of each step was incorporated in the attachment.

4.16 At the request of the Under Treasurer, the Government Solicitor's Office prepared a draft legal agreement to be entered into between the Territory and FAL. A draft agreement was delivered to the Under Treasurer on 6 June 1997. The covering letter to the draft agreement stated clearly that several important points had to be settled before a suitable legal agreement could be finalised.

### ***Audit Comment***

4.17 Negotiations with FAL continued contrary to the recommendation of the Chairman of the negotiating group. Who made this decision, and why, is unclear. The Audit notes that from this time, the Under Treasurer led the Territory's negotiations with FAL.

4.18 The Chief Executive's 4 June 1997 letter appears to be an attempt by the Chief Executive to get negotiations on track. However, the letter offered no solution to overcoming the difficulties with the strategic partnership incentive.

4.19 The draft agreement prepared by the Government Solicitor's Office was far from useable at this stage. The Government Solicitor's Office considered further negotiations remained to be completed before the envisaged strategic partnership agreement incentive could be incorporated into a useable agreement.

### **RECOGNITION OF INDUSTRIAL RELATIONS DIFFICULTIES ARISING FROM ENTERPRISE BARGAINING AGREEMENTS**

4.20 On the 11 June 1997, a legal firm engaged by the Territory provided advice to a Chief Minister's Department official with industrial relations responsibilities. The advice included the following:

The proposal in its current form involves the privatisation/outsourcing of InTACT and/or its functions.

The proposal, if it goes ahead, will almost certainly involve an industrial dispute and/or industrial action.

The proposal cuts across a number of clauses in the Enterprise Agreement. In particular, there has been no in-house staff bid as required by clause 4.4D(vi) and clause 4.5E. Indeed the process seems to have short-circuited the agreed procedures for readying staff for an in-house bid.

The proposal also appears to cut across clause 4.5 of the CPSU Schedule. In the Government's favour, there is an argument that Government must only consult on the process, not the decision and that, therefore, staff need only be consulted once an agreement has been signed with Fujitsu. However, it is clear that all staff (and indeed management) in InTACT have been proceeding on the basis that they were being prepared for an in-house bid and that privatisation/outsourcing would only occur after this preparation was complete. In this context, the concept of giving the whole of InTACT's business to a successful tenderer is a new proposal which has not been discussed with staff. I therefore consider that clauses 4.5A and B of the Agreement will be breached if the proposal proceeds.

Finally, there are a range of factors which, while not strictly legal, would make it difficult to fight this case in both the press and the [Industrial Relations] Commission.

- There are letters on the file challenging the business efficacy of the decision. In particular there is a letter from [the Chairman of the negotiating group] to [Chief

Executive, Chief Minister's Department] recommending that negotiations with Fujitsu be terminated.

- The second placed tenderer should Fujitsu fall over is local, Canberra based consortium.
- While Fujitsu is promising jobs, there appears to be a ready argument that it is simply repacking existing jobs both in the Federal and ACT Governments, not creating new ones and that those jobs would be likely to be taken up by companies already based in Canberra.

4.21 The legal firm made several recommendations, the first of which was that the proposed strategic partnership incentive should not proceed.

***Audit Comment***

4.22 The legal firm's advice is the first piece of documentation that refers specifically to the enterprise bargaining agreement (EBA), which contained significant industrial relations matters relevant to the agreement with FAL. The EBA's included provisions specifically setting out how the Government was to act in regard to any information technology service outsourcing proposal it was contemplating. The legal advice, in effect, was that the EBA's provisions precluded outsourcing as envisaged in the strategic partnership incentive.

**CLAW-BACK PROVISIONS**

4.23 A proposal was put to FAL which sought to 'claw-back' the financial incentives provided to FAL if FAL did not meet its obligations under the proposed agreement. Specifically, the Territory would seek to recover payroll tax foregone if FAL did not reach the employment targets to be specified in the Agreement. The targets identified were:

1997-98	191
1998-99	352
1999-00	709
2000-01	934

4.24 This proposal was clarified in a later letter to FAL dated 18 June 1997.

*Audit Comment*

4.25 This was late recognition that the incentives package was intended to purchase something from FAL; that is, the creation of a large number of jobs leading to an expansion in the ACT economy. The payroll tax penalty was an attempt to have embedded in the legal agreement a method to claim back some of the value of the incentives package if FAL was unable to deliver the jobs creation it had foreshadowed.

**THE MEMORANDUM OF UNDERSTANDING**

**Legal Advice During Development of the MOU**

4.26 A legal firm was engaged to draft a Memorandum of Understanding (MOU). The MOU was to serve as a statement of intent outlining 'preliminary understandings as to how [the parties] will cooperate in relation to the Project'. A draft of the MOU was provided to a government official on 18 June 1997. In their covering letter, the legal firm said:

We have prepared a brief outline of the key understandings as instructed by you. We note that there are a significant number of issues which will need to be addressed in more formal legal documentation. In particular we note that detailed consideration will need to be given to legal issues surrounding the strategic partnership arrangements (including industrial relations issues).

4.27 An updated version of the MOU was provided on 19 June 1997. The legal firm noted in their covering letter:

... there are significant legal and industrial relations issues associated with the principles set out in the MOU which need to be carefully addressed. We confirm that you have requested us not to provide any legal advice in relation to the industrial relations issues surrounding the MOU. We recommend that such advice be obtained prior to providing this draft to Fujitsu Australia Pty Ltd.

4.28 A Memorandum of Understanding between the Territory and FAL was signed on 20 June 1997 by the Under Treasurer and a representative of FAL.

***Audit Comment***

4.29 As it became clear that a formal agreement could not be quickly finalised, officials turned their attention to the preparation of a Memorandum of Understanding. The MOU was a non-binding statement of intent, and seems mainly to have been symbolic. It appears to have contained little more than had been in the Territory's bid to FAL. Advice from the legal firm engaged to draft the MOU identified the strong likelihood of significant difficulties in implementing the strategic partnership incentive, as had earlier advice from another legal firm. Nevertheless, the MOU was signed.

**Advice from the Government Solicitor's Office**

4.30 The Government Solicitor's Office provided advice on 20 June 1997. The advice arose from the Government Solicitor's Office's review of the draft Memorandum dated 18 June 1997. The Solicitor's advice identified serious concerns under the headings of:

- transfer of staff;
- terms and conditions of strategic partnerships; and
- form of documentation and other issues.

***Audit Comment***

4.31 The Solicitor's advice was further confirmation of the difficulties to be resolved with the strategic partnership incentive.

**CABINET SUBMISSION AND DECISION**

4.32 A Cabinet submission signed by the Chief Minister and the Minister for Urban Services was presented to Cabinet on 23 June 1997. The submission recommended Cabinet agree to the terms of the MOU. The submission was favourably biased towards proceeding with the proposed arrangements with FAL. No mention of the major difficulties which had been identified by various parties was mentioned in the submission.

***Audit Comment***

4.33 The Cabinet decision was made on 23 June 1997 and appears to have been no more than a rubber stamp. In the decision Cabinet agreed to

the terms in the Memorandum of Understanding. The Memorandum, however, had already been signed on 20 June 1997. Accordingly, whether or not Cabinet agreed with the terms in the Memorandum was irrelevant. The Memorandum was already signed.

## **CONCLUSION**

4.34 Government officials stepped up negotiations with FAL following the selection of Canberra as the preferred location for the Support Centre. As it became clear that a formal agreement could not be quickly finalised, officials turned their attention to the preparation of a Memorandum of Understanding, as a statement of intent outlining ‘preliminary understandings as to how [the parties] will cooperate in relation to the Project’. The MOU was not a legally binding instrument. It was signed in June 1997, three days before Cabinet endorsed its terms.

4.35 At several stages in the process of developing the MOU, government officials received independent advice (including legal advice) regarding significant difficulties that could be expected in implementing the strategic partnership incentive.

4.36 Government officials were fully aware of the issues they faced in trying to implement the proposed strategic partnership incentive. Up to this point, however, there is little evidence that the officials leading the negotiations actively sought to address the issues. The Audit considers that this aspect of the negotiation process was managed very poorly from the Territory’s perspective. As it turned out, the issues were unresolved and the strategic partnership incentive was never implemented.

## **5. INITIAL AGREEMENT WITH FAL – 14 JULY 1997**

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### **INTRODUCTION**

5.1 This Chapter outlines the documented negotiations and correspondence leading to the signing of the first legally binding agreement between FAL and the Territory.

### **SIGNIFICANT FINDINGS**

- *A legal firm engaged to review the proposed agreement with FAL recommended that several significant issues, including ‘considerable industrial relations issues’, be resolved before entering into the agreement.*
- *The legal advice was not acted on and a largely unchanged agreement was signed on 14 July 1997.*

### **BACKGROUND**

5.2 Previous Chapters have described the documented negotiations leading to the signing of a Memorandum of Understanding by FAL and the Territory. The next step was to be the negotiation and signing of a legal agreement to support the implementation of the actions agreed in the memorandum between the parties.

### **DRAFT AGREEMENT WITH FAL**

#### **Draft Proposed by FAL**

5.3 A first draft of an ‘Assistance Agreement’ to put into place the terms and conditions outlined in the Memorandum of Understanding was sighted by the Audit. The draft was prepared by FAL and provided to a government official on 4 July 1997.

5.4 The draft agreement generally reflected the content of the Memorandum of Understanding (MOU).

5.5 A major difference was that the MOU included a proposal that a strategic partnership would be created. The MOU included:

## **FINANCIAL INCENTIVE PACKAGE FOR FUJITSU AUSTRALIA LTD (FAL)**

It is proposed that the parties enter into a 'Strategic Partnership' under which it is proposed that among other things as of 1 November 1997:

- 1) existing Help Desk and Service Delivery staff be managed jointly by InTACT Group management and a Partnership Management Committee (comprising representatives of the Territory and FAL);
- 2) InTACT Help Desk and Service Delivery staff to be co-located with FAL staff in relation to provision of the Help Desk and Service Delivery services to the Territory at dates to be agreed;
- 3) FAL to provide FAL personnel to fill any vacancies in relation to the provision of the new services as determined by FAL in order to continue to meet the agreed service levels;
- 4) FAL to provide Help Desk and Service Delivery services to the Territory on terms and conditions to be agreed; and
- 5) FAL will assist InTACT in relation to its business operations and transitional matters on terms to be agreed.'

5.6 On the other hand, the draft agreement proposed by FAL recognised that the strategic partnership arrangements could not be settled prior to the date on which the parties had set for the signing of the binding agreement.

5.7 The draft agreement required that the terms of strategic partnership were to be agreed by 1 November 1997. Failing to reach agreement on the partnership by 1 November 1997 would be grounds for both parties being released from all obligations. In this regard the draft agreement included:

The parties have entered into this Agreement on the understanding that they will enter into an agreement for the provision by the Company of Help Desk and Support Services on the following basis:

The agreement to be negotiated will be a strategic partnership whereby the Company manages the Help Desk and Service Delivery functions which are presently conducted by the InTACT Group in the Territory (the 'Strategic Partnership Agreement'). These services are to be provided by the Company under commercial terms and conditions acceptable to both parties,

including prices and margins which are consistent with industry practices. The agreement shall be subject to open book accounting procedures to be agreed between the parties. Other principles which are to apply to the Strategic Partnership Agreement are specified in Appendix 2 to this agreement.

If, the parties are unable to execute a Strategic Partnership Agreement on or before 1 September 1997, then, unless otherwise agreed, either party may terminate this Assistance Agreement forthwith by giving notice to terminate to the other party.

### ***Audit Comment***

5.8 Unlike the Memorandum of Understanding, the draft agreement recognised there were difficulties arising with the strategic partnership incentive, and there were chances the incentive could not be delivered. In this regard, the draft provided that if agreement on the partnership incentive could not be reached by 1 November 1997 the whole arrangement for the location of FAL's Support Centre in Canberra could be abandoned at the option of either party. By including the abandonment option in the draft agreement FAL clearly indicated the importance to FAL of the strategic partnership incentive.

### **Review of Draft Agreement by Legal Firm**

5.9 A legal firm – the same firm that had drafted the MOU – was engaged to review the draft agreement proposed by FAL. The legal firm provided written advice on 9 July 1997. The advice contained several points. Of major significance was advice on termination of the agreement (clause 10) and on the conditional nature of the agreement (clause 20). The advice stated:

#### ***Clause 10 - Termination***

This clause requires significant re-drafting. The clause is expressed to be exhaustive in terms of the circumstances in which a party may be entitled to terminate the Agreement.

Clause 10.1(b) is not acceptable. As drafted, it would mean that the only reason for which the Territory could terminate the Agreement other than for an insolvency event is if FAL failed to establish a facility in the Territory. There are other circumstances in which the Territory should have the right to terminate the Agreement (for example, fundamental breach by FAL or failure to

achieve an employment milestone). This clause should be deleted.

A specific clause may also be included to provide that if the Employment Milestones are not met, then the Territory may terminate the Agreement.

Given the long-term nature of the Agreement (ten years) consideration may be given to the Territory being able to terminate the Agreement for other circumstances, including at its convenience.

Clause 10.2. This clause is not acceptable. Termination of the Agreement is without prejudice to the rights or remedies of either party. It should be deleted.

### ***Clause 20 – Conditional Agreement***

Pursuant to clause 20, it is proposed that the parties enter an agreement for the provision by FAL of Help Desk and Support Services.

The precise terms of the agreement are to be determined between the parties.

Careful consideration needs to be given to human resources issues surrounding the proposal.

If the parties are unable to enter a Strategic Partnership Agreement prior to 1 September 1997, then either party may terminate the Agreement. This may give rise to issues to the Territory if it has already expended monies on refurbishment of the Health Building or provided a grant to FAL for relocation expenses. The provisions of the Lease Agreement need to be reviewed against this agreement.

Clause 20(4) requires the Territory to pay the company for the relocation of staff, upgrading of premises and training of staff. These costs could be significant. The clause needs to be reviewed.

Appendix 2, which sets out the principles for a Strategic Partnership Agreement between the parties, also needs to be reviewed. Although expressed to be principles, they may be capable of constituting an agreement between the parties which may be capable of enforcement by FAL. In particular, the standard Fujitsu Services Terms and Conditions need to be reviewed.

The management arrangements between FAL and InTACT also need to be reviewed.

Considerable industrial relations issues need to be addressed in relation to the proposal. This should be obtained prior to entering the Agreement.

***Audit Comment***

5.10 The advice from the legal firm was relevant and valuable. Nevertheless it seems it was not acted upon.

**FORMAL AGREEMENT WITH FAL**

5.11 The 'Agreement for the Establishment of an Asia Pacific Desktop Service Centre in the Australian Capital Territory' was signed on 14 July 1997 by the Chief Executive of the Chief Minister's Department whose signature was witnessed by the Chief Minister.

5.12 A public announcement was made by the Chief Minister when the Agreement was signed. The announcement was made at Parliament House at a signing ceremony. The ceremony had been arranged sometime before.

5.13 The suggested speaking notes for the Chief Minister are on file. The notes include the statement that 'the Fujitsu support and service centre is expected to generate more than 900 jobs in Canberra over the next four years'. The announcement was reported in the Canberra Times on 15 July 1997. The incentives package was not mentioned.

5.14 The signed agreement was unchanged in any significant way from the draft agreement provided by FAL on 4 July 1997. Few of the recommendations made by the legal firm were incorporated into the final agreement. In particular, a comparison of the signed agreement with the draft agreement shows that clauses 10 and 20 of the draft and of the signed agreement are virtually identical.

***Audit Comment***

5.15 The 14 July 1997 agreement was signed without the problems identified by the legal firm being addressed or advised to FAL. Arrangements had been made for the Chief Minister to publicly sign the

agreement on 14 July 1997. The signing date was only three working days after the legal firm's advice was received.

## **COST-BENEFIT ANALYSIS**

5.16 A cost-benefit analysis was prepared by the Economic Management Group in the Chief Minister's Department on or around 8 August 1997. The analysis used the FAL Business Plan (see paragraph 3.3) and a draft of the Memorandum of Understanding as its main data sources (see Chapter 4). The official preparing the analysis was not provided with a copy of the 14 July 1997 agreement.

5.17 The completed analysis was based on FAL's projections in its business plan being fully achieved. Consequently, as would be expected, the analysis results were significantly positive for the Territory.

### ***Audit Comments***

5.18 It was sensible that a cost-benefit analysis should be conducted. The analysis however was conducted after the incentives package had been offered and accepted. It was also after the 14 July 1997 agreement had been signed.

5.19 As the analysis accepted that the FAL business case would be fully achieved its usefulness as a decision making tool was very limited. The analysis did not critically examine whether the business case was achievable.

5.20 The Audit view is that the analysis provided little, if any, information useful for negotiating with FAL. It was conducted too late and was based on untested data.

## **CONCLUSION**

5.21 A draft agreement was provided by FAL to government officials on 4 July 1997 and the final agreement was signed on 14 July 1997. In the period between receipt of the draft agreement and signing of the final agreement, a legal firm was engaged to review the draft agreement. The firm provided their advice but largely it was not acted upon.

5.22 There is no documented evidence that government officials carefully examined the advice. It seems that the scheduled time of the

## **FINANCIAL INCENTIVE PACKAGE FOR FUJITSU AUSTRALIA LTD (FAL)**

Chief Minister's announcement that FAL was establishing its Support Centre in Canberra, and creating 900 jobs, controlled when the agreement had to be signed. This could explain why a complete review of the content of the draft agreement and negotiations was not conducted prior to the agreement being signed. Perhaps officials simply did not have the time.

## **6. INDUSTRIAL RELATIONS ISSUES**

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### **INTRODUCTION**

6.1 This Chapter examines the documented meetings and correspondence exchanges between the Community and Public Sector Union (CPSU) and government officials regarding potential industrial relations issues that could be encountered by the Territory in delivering the strategic partnership incentive.

### **SIGNIFICANT FINDINGS**

- *The Community and Public Sector Union (CPSU) raised their concerns with Government officials immediately on becoming aware that negotiations with FAL might involve outsourcing of members' work (late June 1997).*
- *At separate meetings, members of the CPSU passed two resolutions setting out their resistance to any outsourcing of InTACT members work; copies of the resolutions were provided to Government officials.*

### **CONCERNS RAISED BY THE UNION**

6.2 On 27 June 1997 the InTACT CPSU workplace delegate sent an e-mail requesting that detail be provided to the CPSU on what was being proposed with FAL and how it would affect all InTACT staff. The e-mail asked for a response by 2 July 1997.

6.3 As the CPSU considered it had not received a satisfactory response by the requested date the Union workplace delegate called a meeting of members for 3 July 1997. That meeting passed a resolution as follows:

This meeting of CPSU members within InTACT demands that the ACT Government abides by our EBA and enters into consultation with the CPSU regarding the Fujitsu proposal and provides full details of what the proposal constitutes and any possible further developments that have been under consideration.

This meeting of members reaffirms its commitment to the InTACT model which was agreed to by the ACT Government. We deplore and condemn the apparent continued attempts by some senior bureaucrats within Chief Minister's Department

BASAT and the Office of Financial Management to destroy the model, which we feel will deliver significant benefits to not only the ACT Government and its employees but also the wider ACT community.

We therefore ask that the Chief Minister reaffirms her commitment to the InTACT strategic partnership model as outlined in the [Request For Offer] and Business Plan and directs her senior bureaucrats to do the same.

We support the Government in its endeavours to create further jobs in Canberra however this must not be achieved at the expense of the Government's own employees.

### ***Audit Comment***

6.4 The CPSU resolution highlights the Union's and its members' serious concerns. It also shows that the Union and its members would strongly resist implementation of the strategic partnership incentive.

6.5 That the issues were being raised should have come as no surprise to government officials. Officials had been advised on several occasions, and from separate (legal) sources, that implementation of the strategic partnership incentive would generate serious industrial relations issues.

### **NEGOTIATIONS WITH THE UNION**

6.6 Further e-mails and letters were exchanged between government officials and the CPSU during the period leading to 7 July 1997. The officials were apparently able to convince the Union that outsourcing was off the agenda. Included in an e-mail to members by the workplace delegate dated 7 July 1997 was the following:

I would like to think that the outsourcing issue is now dead. Unfortunately the actions of the ACT Government's senior bureaucrats over the past 18 months leads me to believe this may not be so and I would ask you all to remain vigilant. If any member hears or suspects that the issue is being raised again please contact me as a matter of urgency.

6.7 The CPSU raised further matters later in July 1997.

6.8 The Minister for Urban Services on 18 July 1997 issued a media release on the awarding to FAL of a strategic partnership with the ACT

for 'electronic data storage management' products. This partnership was different and separate from the strategic partnership incentive discussed in this Report. However, the wording of the release referred to 'services' being provided by the selected strategic partners as well as 'products'. This reference to 'services' alarmed the Union, as it believed this could mean outsourcing to FAL of the services presently being provided by InTACT staff (i.e. implementation of the strategic partnership incentive).

6.9 The Union wrote on the 21 July 1997 to the Chief Executive of the Chief Minister's Department seeking a meeting to discuss the matter. Apparently as a result of the letter, a meeting was held between a government official and Union representatives. The Union representatives, however, were not satisfied with the meeting's outcome. The CPSU wrote to the Chief Executive of the Chief Minister's Department on 25 July 1997. The letter included:

You will notice this message is being copied to a number of parties. The CPSU believes that, unless ACT Government meets with a representative from CPSU as a matter of urgency, and that unless ACT Government send to that meeting a representative empowered to discuss fully the status of discussions with Fujitsu and enter into agreements with the CPSU; the CPSU is left with no recourse than to notify a dispute in the Australian Industrial Relations Commission.

### **Meeting on 5 August 1997**

6.10 A CPSU representative met with the Chief Executive of the Chief Minister's Department on the 5 August 1997. The outcome of that meeting included significant agreements as follows:

CPSU will receive today (6/7/97) a letter from the Acting Chief Executive of the Department of Urban Services (DUS) about the principles with regard to staffing issues in relation to the Fujitsu MOU.

DUS will immediately initiate discussions with staff and the CPSU about the implementation of those principles, and Fujitsu will also join those discussions where appropriate.

CPSU has agreed to consult with the Chief Executive DUS with regard to CPSU representation on the InTACT Board of Management and any management/project committees formed with strategic partners. The CPSU indicated that as the staff of InTACT are the largest group of stakeholders the issue of their

representation on these committees is non-negotiable any they would expect agreement to this.

CPSU have agreed to further consultation with the Chief Executive DUS. However if this avenue of consultation cannot provide answers to legitimate questions with regard to InTACT staff the CPSU reserves the right to seek clarification from the Chief Executive CMD.

### ***Audit Comment***

6.11 The Union was clearly concerned about possible outsourcing issues arising from the agreement with FAL.

6.12 The meeting described above with CPSU representatives is the first documented indication that government officials were recognising that it was essential to involve the Union and its members in developing how the strategic partnership incentive could be delivered to FAL. The Union, however, had not agreed to any outsourcing occurring.

### **UNION MEMBER'S RESOLUTION**

6.13 A meeting of Union members was held on 15 September 1997. That meeting resolved:

This meeting of CPSU Members is committed to the continued existence of the InTACT Group as the provider of IT infrastructure services to the ACT Government.

This meeting reconfirms its commitment to the concept of strategic partnerships which contain no element of either direct or indirect outsourcing of Public Sector functions.

This meeting requires that prior to any agreement being signed with Fujitsu there will be timely consultation in order for members to adequately consider and provide input to the agreement.

This meeting of CPSU Members endorses the approach to co-location with Fujitsu as detailed today, noting that there is no element of outsourcing contained in the proposal.'

*Audit Comment*

6.14 This resolution further confirmed the continuing opposition of the Union and its members to the type of outsourcing embodied in the strategic incentive partnership. It should have been a clear indication to government officials that serious reconsideration of how the incentive could be delivered was necessary.

**CONCLUSION**

6.15 Government officials were aware that the strategic partnership incentive raised industrial relations issues. In a series of meetings and exchanges of correspondence between government officials and the CPSU, the Union clearly communicated its intention to resist vigorously any attempt by government officials to outsource the work of members; i.e. to deliver the strategic partnership incentive to FAL. Nevertheless, officials persisted with negotiations with FAL on this matter.

## **7. VARIATIONS TO THE FINANCIAL INCENTIVES PACKAGE – THE OCTOBER 1997 AGREEMENTS**

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### **INTRODUCTION**

7.1 This Chapter examines steps leading to the postponement of attempts to implement the outsourcing arrangements in the strategic partnership incentive and a proposal from FAL to introduce alternative, short-term, incentives.

### **SIGNIFICANT FINDINGS**

- *Recognising there were difficulties in delivering the strategic partnership incentive, FAL sought alternative (short-term) incentives.*
- *Government officials agreed to the alternative incentives proposed by FAL. However, there is no documentation that officials investigated, analysed, or researched the impact or cost of these incentives before agreeing to the proposal.*
- *The alternative incentives were incorporated into a 12-month agreement dated 14 October 1997.*
- *A second 14 October 1997 agreement postponed for 12 months the strategic partnership incentive.*
- *The second 14 October 1997 agreement also provided that if the strategic partnership incentive could not be delivered in 12 months FAL would be released from all its obligations. The obligations of the Territory, however, would remain in full force.*

### **BACKGROUND**

7.2 Postponement of the implementation of the outsourcing arrangements in the strategic partnership incentive was included in a legally binding agreement dated 14 October 1997. A second agreement also dated 14 October 1997 included alternative, short-term, incentives for FAL for the next twelve months as a replacement for the postponed strategic partnership incentive.

## **POSTPONEMENT OF IMPLEMENTATION OF THE STRATEGIC PARTNERSHIP INCENTIVE**

7.3 The agreement finalised on 14 July 1997 (discussed in Chapter 5) required that a strategic agreement should be finalised between the Territory and FAL on or before the 1 September 1997. The parties, however, recognised that this date could not be achieved. The implementation deadline was extended to 1 October 1997 in an agreement dated 3 September 1997.

7.4 The 1 October 1997 date also proved to be unachievable and a further agreement dated 29 September 1997 was made. This agreement extended the date for completing the agreement until 15 October 1997.

7.5 Eventually the parties agreed that it was not feasible to conclude a Strategic Agreement by the revised date of 15 October 1997.

7.6 However, both parties wished to continue the relationship between the Territory and FAL and sought means to do so. The parties signed an agreement on 14 October 1997 ('the first October agreement') that was effectively a device to allow the 14 July 1997 (as amended by the 3 September and 29 September 1997 agreements) to be suspended for a year.

7.7 The parties apparently wished to continue negotiations. In this regard a requirement was inserted into the first October agreement for negotiations on the strategic partnership incentive to recommence no later than six months after the agreement's commencement. The parties were to complete negotiations and conclude an agreement between them covering the company's provision of helpdesk and desktop service delivery services to ACT agencies for five years commencing 1 November 1998.

7.8 Importantly the agreement also included the following:

- (c) if the parties have not executed the 5 Year Agreement by 31 October 1998, then the Company shall be relieved from all of its obligations under the [Assistance Agreement] but the obligations of the Territory under the [Assistance Agreement] shall remain in full force (except that the Territory shall be relieved of its obligations under subclause 3.1(iv) and (v) of the [Assistance Agreement]).

*Audit Comment*

7.9 The clause referred to in the preceding paragraph is particularly notable. There is no explanation in any documentation sighted by the Audit showing why it was included in the agreement.

7.10 When FAL advised government officials that Canberra had been selected as the candidate location for FAL's Support Centre, FAL stressed that the strategic partnership incentive was an important factor in the Territory's selection (see paragraph 3.20). This was well known to officials (see paragraph 3.18).

7.11 On this basis, a reasonable assumption is that the reason the clause allowing for the release of FAL from its obligations was included in the first October agreement was recognition by both parties that if the ACT did not deliver the strategic partnership incentive, it had failed to deliver one of the most significant incentives in its offered incentive package.

**ALTERNATIVE, SHORT-TERM, INCENTIVES**

7.12 FAL wrote to the Chief Executive of the Chief Minister's Department on 16 September 1997 requesting consideration of alternative, short-term, incentives.

7.13 The letter stated that the FAL decision to locate its Regional Headquarters for Desktop Services was made on the basis of financial and other commercial terms and conditions offered by ACT officials. The letter states that the commercial value to FAL of the various offers was quite considerable. It also included the following:

The purpose of this letter is to formally request consideration from the ACT Government of alternative business arrangements for Fujitsu to replace some of anticipated business we had expected in the first twelve months which is not able to be delivered. This is because an Enterprise Bargaining Agreement exists between the CPSU and the ACT Government which currently specifically excludes the possibility of that anticipated business.

7.14 As a result of this approach from FAL, a further agreement was signed between the Territory and FAL on 14 October 1997 ('the second October agreement'). The period of the agreement was 1 November 1997

to 31 October 1998, but provided that the term could be extended by mutual agreement of the parties.

7.15 The agreement incorporated all the services requested by FAL in its letter of 16 September 1997 to the Chief Executive of the Chief Minister's Department.

7.16 The relevant clause in the agreement includes:

6.1 Where InTACT or any ACT Government department through InTACT requires services of the type specified in Appendix 2, FAL will be the only supplier to InTACT, provided that the terms offered to InTACT by FAL are commercially competitive and agreed by the parties.

7.17 The professional services specified in Appendix 2 of the agreement were:

- assistance in development of a packaged billing system;
- scoping, analysis and solution design of Business Applications and Information Management planning;
- requirements analysis and solution design to cater for on-line transactions and information management for HR and FMIS application software with a view to systems replacement by FAL and InTACT with timing and price to be agreed by the parties;
- assistance with Oracle financial software across all ACT Government departments;
- scoping, analysis and solution design of other government wide corporate applications such as but not limited to Whole of government, Electronic Commerce, Document and Image Management and Workflow capability and information technology planning;
- assistance with requirements analysis and coordination of solutions for Year 2000 compliance. This will include replacements or enhancements for individual agency business applications;
- advice and guidance in respect of tools and methodologies used by InTACT as required;
- recommendations for improvements to services and service levels provided by InTACT to the ACT;

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- ad-hoc assistance to InTACT to provide extraordinary staff cover;
- provision of disaster recovery and hot site services for the InTACT Group; and
- advice and guidance on InTACT's data centre operations.

### *Audit Comment*

7.18 FAL sought, and were granted, further incentives as compensation for agreeing that the Territory could postpone delivery of the strategic partnership incentive. The second October agreement effectively delivered FAL valuable new incentives replacing for twelve months the postponed strategic partnership incentive.

7.19 There is no documentation to suggest the Government officials analysed the impact or cost of these short-term incentives.

## CONCLUSION

7.20 Government officials and FAL had belatedly recognised that, in the short term at least, the Territory could not deliver the strategic partnership incentive. Consequently two new agreements were signed on 14 October 1997.

7.21 The first October agreement postponed implementation of the strategic partnership incentive, but required the incentive to be incorporated into a legally binding agreement within a future set period (approximately one year). This recognised that the Territory had offered the incentive and therefore had an obligation to deliver it. Not unreasonably, if the ACT did not meet this important obligation, the 14 October 1997 agreement provided for FAL to be released from all its obligations. The Territory's obligations in regard to the incentives package would continue.

7.22 The second October agreement was in response to a request from FAL for alternative incentives. The alternative incentives proposed by FAL were accepted and incorporated into a legally binding agreement. There is no documentation to suggest government officials analysed the impact or cost of these short-term incentives.

## **8. DECISION TO ABANDON THE STRATEGIC PARTNERSHIP INCENTIVE**

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### **INTRODUCTION**

8.1 Eventually attempts to deliver the strategic partnership incentive to FAL were abandoned. This Chapter outlines the activities leading to the decision as evidenced by documentation on files.

### **SIGNIFICANT FINDINGS**

- *Government officials did not re-commence negotiations on implementation of the strategic partnership incentive until some seven months into the 12-month negotiation period.*
- *In late 1998, Government officials and FAL accepted that the Territory could not deliver the strategic partnership incentive.*
- *Alternative incentives were briefly considered. However, in December 1998, FAL exercised its right to withdraw from all its obligations.*
- *The Territory's obligation to deliver the major incentives other than the strategic partnership incentive continued.*

### **BACKGROUND**

8.2 The difficulties involved in successfully implementing the strategic partnership incentive, and the concomitant outsourcing of help desk and desktop service delivery have been described in previous Chapters of this Report.

### **REACTIVATION OF NEGOTIATIONS REGARDING THE STRATEGIC PARTNERSHIP**

8.3 Documentation on official files shows there was little action regarding the strategic partnership incentives for some time after the amending agreements were signed in October 1997. The first indication on file is a minute to the Chief Minister from the Under Treasurer dated 27 May 1998. This minute provided a brief overview on the agreement with FAL and FAL's progress with the Support Centre. The minute was to provide the Chief Minister with information in preparation for a planned meeting with the Managing Director of FAL.

8.4 The meeting was apparently a first step in the reactivation of negotiations for FAL to provide desktop service delivery services to ACT agencies. The minute pointed out that negotiations needed to commence promptly and cover the provision of helpdesk and desktop service delivery services to ACT agencies for a five-year period commencing 1 November 1998.

### **Communication from FAL**

8.5 On 31 July 1998, FAL wrote to the Chief Executive of the Chief Minister's Department stating that FAL wished to expedite the execution of the five-year agreement. To progress the issue FAL requested a meeting for 8 August 1998.

8.6 A meeting was held on 17 August 1998. Following from that meeting, FAL prepared a proposal of how their provision of helpdesk and desktop services to Government agencies could operate. The FAL proposal recognised that existing enterprise bargaining agreements could generate obstacles to their proposal. In this regard, the FAL proposal included:

Last year we were aware that the Enterprise Bargaining Agreement in place with the ACT Government presented an issue, as it put the prospect of outsourcing the services in jeopardy. It is anticipated that a number of InTACT employees would wish to transfer to Fujitsu at the appropriate time and it is our intention to recruit and hire suitable people from InTACT to become part of the EMC team. We are not appraised of any developments in this area and will need to assess the likely reaction of the Unions involved and seek assurances from the ACT Government that this will not be an impediment to progress. A strategy will have to be developed that produces a "win-win" outcome for the ACT Government and for Fujitsu before any contracts are concluded.'

8.7 The negotiations did not progress and further extensions of the implementation deadline were considered. Consequently, the Chief Executive of the Chief Minister's Department wrote to FAL confirming his agreement that the time for concluding the five-year agreement would be extended from 31 October 1998 to 30 November 1998.

8.8 On 24 November 1998, the Chief Executive of the Chief Minister's Department wrote again to FAL, this time setting out a proposal for FAL to provide an extensive range of services for a five-year period. This

proposal was to form the basis of a revised five-year strategic partnership incentive. The new proposal did not involve any outsourcing to FAL.

***Audit Comment***

8.9 The Audit notes that negotiations regarding implementation of the strategic partnership incentive did not recommence until some seven months after the October 1997 agreement, which set a twelve month deadline, was signed. A meeting with FAL was held, but a further two months elapsed without negotiations.

8.10 It seems the government officials had lost enthusiasm for delivering the strategic partnership incentive and were now acknowledging that the strategic partnership incentive was unlikely to be delivered. Indeed, the Chief Executive's letter of 24 November 1998 effectively abandoned the outsourcing arrangements in the strategic partnership incentive proposing alternative incentives in its place.

**FAL WITHDRAWAL FROM THE ASSISTANCE AGREEMENT**

8.11 The Chief Executive's letter of 24 November 1998 had asked FAL to provide considerable detail on how the services identified in the Chief Executive's letter would be delivered by FAL.

8.12 FAL's initial response (dated 30 November 1998) was supportive and confirmed that generally FAL was in agreement with the Chief Executive's proposals. However, because of time constraints FAL were not in a position to provide the requested detail in the short term. FAL's view was that the detail should form the basis of a contract and that contract negotiations should commence immediately.

8.13 There was apparently a change in thinking within FAL between 30 November 1998 and 24 December 1998. On 24 December, FAL wrote to the Chief Executive of the Chief Minister's Department. The letter included the following statements:

On 14 July 1997, the Australian Capital Territory and Fujitsu Australia Limited entered into an agreement for the establishment of an Asia Pacific Desktop Service Centre in the Australian Capital Territory. This agreement (which was amended on 3 September 1997, 29 September 1997, 14 October 1997 and 30 October 1998) (the "Amended Assistance Agreement" also referred to as the "AAA") was conditional upon the parties

executing an agreement by 30 November 1998 for the provision of help desk and desktop service delivery services for a 5-year period. Despite numerous meetings and discussions between the parties, such agreement was not executed by that deadline.

The purpose of this letter is to confirm that in the above circumstance the provisions of clause 1(c) of the agreement dated 14 October 1997 (the “Amending Agreement”) apply, so that Fujitsu is “relieved from all of its obligations under the AAA but the obligations of the Territory under the AAA shall remain in full force (except that the Territory shall be relieved of its obligations under sub-clauses 3.1(iv) and (v) of the AAA)”.’

8.14 The letter from FAL effectively concluded the negotiations that had commenced some two years previously.

8.15 Government officials sought legal advice on whether FAL was correct in stating that FAL was relieved of its obligations but that the Territory’s obligations remained in place. The advice (18 January 1999) was that FAL was correct, and in particular FAL were relieved of the obligations of:

- establishing and maintaining the Support Centre;
- meeting employment milestones in relation to the Support Centre; and
- purchasing plant equipment, supplies labour and services from companies located within the ACT.

8.16 The legal advice also confirmed that the Territory’s obligations under the Assistance Agreement would continue, including:

- providing the payroll tax exemption in accordance with the Assistance Agreement;
- continuation of the leases of Government-owned accommodation to FAL in accordance with the terms of the leases.

8.17 Although further letters were exchanged between FAL and meetings were held, the failure by the parties to reach any agreement on the outsourcing to FAL of help desk and desktop service delivery services to ACT agencies ended FAL’s obligations.

*Audit Comment*

8.18 FAL's withdrawal from the assistance agreement was the culmination of a drawn-out, and ultimately unsuccessful, negotiation process. The Territory failed to deliver a critical component of the financial assistance package offered to FAL. The legal advice confirmed that FAL was legally entitled to walk away from all its obligations under the various agreements signed. The Territory's significant obligations however remained in place.

**CONCLUSION**

8.19 It was some seven months into the 12-month negotiation period prescribed by the 14 October 1997 agreement before government officials re-commenced negotiations on implementation of the strategic partnership incentive. The negotiation period was extended by a further month, but there was growing recognition that the incentive could not be delivered.

8.20 After almost two years of discussion and negotiations, a decision was eventually taken to abandon the strategic partnership incentive involving outsourcing. FAL, as they were legally entitled to, withdrew from all their obligations. The Territory, however, remained legally obliged to deliver the major incentives as agreed except for the strategic partnership incentive.

## **9. THE ACCOMMODATION INCENTIVES**

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### **INTRODUCTION**

9.1 This Chapter examines the inclusion of accommodation incentives in the incentives package offered to FAL. The Chapter also includes an outline of the extent of the incentive taken up by FAL and an estimate of the cost to the ACT of the accommodation incentive.

### **SIGNIFICANT FINDINGS**

- *The Territory-owned Moore Street Health Building was offered as accommodation for FAL's Service Centre without consultation with the Territory agencies occupying the building.*
- *There was no consideration by government officials as to where agencies occupying the building could be relocated.*
- *Less than three months after FAL had exercised its right to occupy a floor of the Health Building, the major occupier (Community Care) was signalling concern about its future accommodation needs in the building.*
- *As FAL sought to exercise its right to occupy further accommodation within the Health Building, government officials successfully negotiated to transfer FAL's new accommodation requirements to other premises (the Territory-owned Callam Offices in Woden).*

### **BACKGROUND**

9.2 The accommodation incentives were introduced into the financial incentives package during early negotiations in March 1997 (after FAL had shortlisted Canberra as the candidate location, but before the final selection had been made). This issue is discussed briefly in Chapter 3 of this Report.

### **INTRODUCTION OF ACCOMMODATION INCENTIVES**

9.3 The proposed financial incentive package initially offered to FAL included a grant of a suitable block of land but made no mention of the provision of accommodation in Territory-owned premises. Nevertheless, as outlined in Chapter 3, accommodation in Territory-owned premises –

in this case, the Moore Street Health Building - was offered in April 1997 to FAL representatives as premises for the Support Centre. According to the notes of the meeting, other than that there would be an initial rent free period, specific rental charges were not discussed.

***Audit Comment***

9.4 There is no documentation evidencing that there had been any consideration before the offer was made of where Government agencies then occupying the Health Building would be located if FAL accepted the offer. The building was mainly occupied by ACT Community Care who occupied the ground level and levels 1, 2 and 3. Miscellaneous Government related tenants occupied levels 4 and 5.

9.5 The Audit considers it was inappropriate for government officials negotiating the agreement with FAL not to consult with the major tenants of the building before making the offer. The impact of the accommodation offer should have been carefully analysed.

**Inclusion of the Accommodation Incentives in the Memorandum of Understanding**

9.6 There are no further decisions or agreements related to the Health Building on the files sighted by the Audit until drafts of the Memorandum of Understanding were being prepared (see Chapter 4). The signed Memorandum sets out the accommodation incentive as:

- (a) exclusive occupation of the current "Health Building" located at Moore Street, Canberra City under a lease arrangement to be agreed.
- (b) the rent payable under the lease arrangement is proposed to be as follows:
  - (i) 1997-98: rent free;
  - (ii) 1998-99: rent free;
  - (iii) 1999-00: \$60 per square metre;
  - (iv) 2000-01: \$150 per square metre; and
  - (v) subsequent years as agreed between the parties as set out in the final agreement.
- (c) The Territory also proposes to fitout and refurbish the premises to an agreed standard acceptable to both parties

at a cost to be established with the assistance of a facilities management company acceptable to both parties.

9.7 The Memorandum clarified the understanding between FAL and government officials regarding the premises on offer, including the rental to be charged.

### **Formalisation of Accommodation Incentive**

9.8 The accommodation incentive was formalised through reference in the 14 July 1997 agreement (see Chapter 5) and in detail in a lease made between the Territory and FAL for level 4 of the Health Building.

9.9 In the 14 July 1997 agreement under the heading of 'Assistance' the Territory agreed to lease the premises to FAL for ten years in accordance with a Deed of Agreement for Lease of the Moore Street made between the parties.

9.10 The Deed of Agreement for the lease was for Level 4 of Moore Street. However, the deed also included an option for additional floors. The option allowed FAL to take up additional floors at levels 3 and 5 at any time during the ten-year term of the lease. The deed also required the Territory to use its best endeavours to make available space at level 1, 2 and ground if FAL requested the space during the lease term.

9.11 The deed set the rental payable by FAL as follows:

Year 1	Rent free
Year 2	Rent free
Year 3	\$50 per m <sup>2</sup> per annum gross
Year 4	\$150 per m <sup>2</sup> per annum gross
Year 5	\$270 per m <sup>2</sup> per annum gross
Year 6	\$270 per m <sup>2</sup> per annum gross
Year 7	Year 6 rent adjusted by CPI
Year 8	Year 7 rent
Year 9	Year 8 rent adjusted by CPI

### ***Audit Comment***

9.12 The Territory's commitment to providing the building to FAL for ten years became legally binding through the 14 July 1997 agreement and the deed of agreement for the lease of level 4 of the building. There is no evidence, prior to the agreement and the deed being signed, that any

consideration or consultation had taken place regarding the relocation of existing ACT agencies in the building.

### **Early Recognition of Accommodation Difficulties for Existing Tenants**

9.13 A minute prepared on 18 February 1998 identified that the parts of the Building occupied by ACT Community Care required significant refurbishment works to meet immediate and future workplace, staffing and strategic requirements. The minute indicates that the need for the refurbishment work was being discussed in late 1997. The minute includes the following:

Given a level of uncertainty in the future of their accommodation tenure at Moore Street, and the need to undertake certain refurbishment/relocation works, ACT Community Care are anxious to confirm their tenure or alternatively undertake the necessary steps to find a long term solution to their requirements.

### ***Audit Comments***

9.14 Less than three months after FAL had occupied level 4 of the Health Building, the major tenant of the building was signalling accommodation difficulties. This was formal recognition of the difficulties created for existing tenants of the Health Building by the commitment of the premises to FAL.

### **Renegotiations of FAL Accommodation Requirements**

9.15 A minute dated 22 April 1998 refers to FAL representatives discussing with government officials the transfer of FAL's option over level 5 of the Health Building to another building. According to the minute, FAL had concerns over some functional difficulties with their tenancy in the building. These consisted of security issues for staff working after hours and some corporate image problems arising from sharing the building with ACT Community Care and their clients. The minute also stated that FAL advised that office space available in the Government owned Callam Offices in Woden would meet their requirements for a second 'data recovery' site. In this regard an option was suggested that FAL be given additional space at Callam or transferring their existing rights over the Health Building to the Callam Offices.

9.16 FAL wrote on 21 May 1998 formally notifying that FAL desired to exercise its option over level 5 of the Health Building. This letter, and subsequent discussions with FAL representatives over transferring FAL's further Health Building rights to the Callam Offices, apparently led to the Territory making a formal offer to FAL. The offer was to transfer FAL's rights in the Health Building (other than to level 4) to the Callam Offices. FAL accepted the offer in principle on 11 June 1998. The new arrangements were later formalised through the completion of new lease agreements. In due course FAL occupied part of the Callam Offices.

***Audit Comment***

9.17 The transfer of FAL's further rights to Moore Street space to the Callam Offices saved the ACT from potentially serious and costly problems arising from the need to relocate ACT Community Care if FAL chose to exercise all its rights over the Moore Street Building.

**CURRENT POSITION**

9.18 At the time of writing this Report FAL continue to occupy level 4 of the Moore Street Health Building. FAL, however, are presently not occupying the Callam Offices as the Department of Urban Services has leased the space from FAL. This is a no cost arrangement, as FAL were released from paying rental charges and the Department of Urban Services is not required to pay FAL. The arrangement is due to conclude on 30 June 2003.

9.19 It is understood that discussions were in progress at the time this Report was being written for FAL to relinquish its rights to level 4 of the Health Building and also in the Callam Offices.

***Audit Comment***

9.20 FAL did not achieve the expansion it anticipated in 1997 when the financial incentives package was being negotiated and agreed. As a result FAL has exercised only part of the accommodation rights granted to it in the incentives package. On current indications, the unclaimed rights are not likely to be claimed in the future.

## **ESTIMATED COST OF THE ACCOMMODATION INCENTIVE TO THE TERRITORY**

### **Rental Subsidies**

9.21 The financial benefits of the rental subsidies to FAL under the financial incentives package have been calculated to 31 December 2002 by the Department of Urban Services as shown in Table 9.1.

<b>Table 9.1: Cost of Rental Subsidies to FAL</b>	
<b>Premises</b>	<b>Cost \$</b>
Moore Street Health Building	832,902
Callam Offices	310,824
<b>Total</b>	<b>\$1,143,726</b>

### **Refurbishment and Relocation Costs**

9.22 The Department of Urban Services has also advised in relation to refurbishment costs as follows:

*Moore Street* – the decision to provide accommodation to Fujitsu in the Moore Street building precipitated a major building refurbishment. Major heating and cooling components including boilers, cooling towers and chillers were past their useful life and were replaced as part of this exercise. This would be a normal building owner responsibility and it is common that an agreement to upgrade building services can form part of a lease agreement. Total cost for the refurbishment of level 4 Moore Street was \$2.143m.

*Callam Offices* – to accommodate Fujitsu the Territory agreed to a refurbishment package for Callam Offices which comprised some building services works and fitout for A3. Total project cost was \$827,155. As well, additional funding of approximately \$91,413 was required to relocate existing tenants within Callam Offices.

### **Total Cost of Accommodation Incentive**

9.23 The total cost to the Territory of the accommodation incentives component was therefore at least \$2.063m comprising the rental subsidies of the Health Building and Callam Offices and the costs associated with FAL locating in Callam Offices. Some proportion of the Moore Street

refurbishment costs would also be attributable to the FAL's occupation of level 4, however, this cost has not been calculated.

## **CONCLUSION**

9.24 The inclusion of rights over the whole of the Moore Street Health Building in the financial incentives package had the potential to cause significant logistical and financial problems for the Territory. Fortunately, this potential was not fully realised as FAL exercised only part of its accommodation rights and some of its requirements were accommodated in other government owned premises.

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<sup>4</sup> 46 Reports were issued prior to 1996. Details can be obtained from the ACT Auditor-General's Office or the ACT Auditor-General's homepage: <http://www.audit.act.gov.au>.

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13. Annual Management Report for the Year Ended 30 June 2000

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- 3 Annual Management Report for Year Ended 30 June 1999
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- 4 Annual Management Report for Year Ended 30 June 1998

- 5 Management of Housing Assistance
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