



Tasmanian
Audit Office



**Report of the Auditor-General
No. 1 of 2012-13**

Sale of TOTE Tasmania

July 2012

The Role of the Auditor-General

The Auditor-General's roles and responsibilities, and therefore of the Tasmanian Audit Office, are set out in the *Audit Act 2008* (Audit Act).

Our primary responsibility is to conduct financial or 'attest' audits of the annual financial reports of State entities. State entities are defined in the Interpretation section of the Audit Act. We also audit those elements of the Treasurer's Annual Financial Report reporting on financial transactions in the Public Account, the General Government Sector and the Total State Sector.

Audits of financial reports are designed to add credibility to assertions made by accountable authorities in preparing their financial reports, enhancing their value to end users.

Following financial audits, we issue a variety of reports to State entities and we report periodically to the Parliament.

We also conduct performance audits and compliance audits. Performance audits examine whether a State entity is carrying out its activities effectively and doing so economically and efficiently. Audits may cover all or part of a State entity's operations, or consider particular issues across a number of State entities.

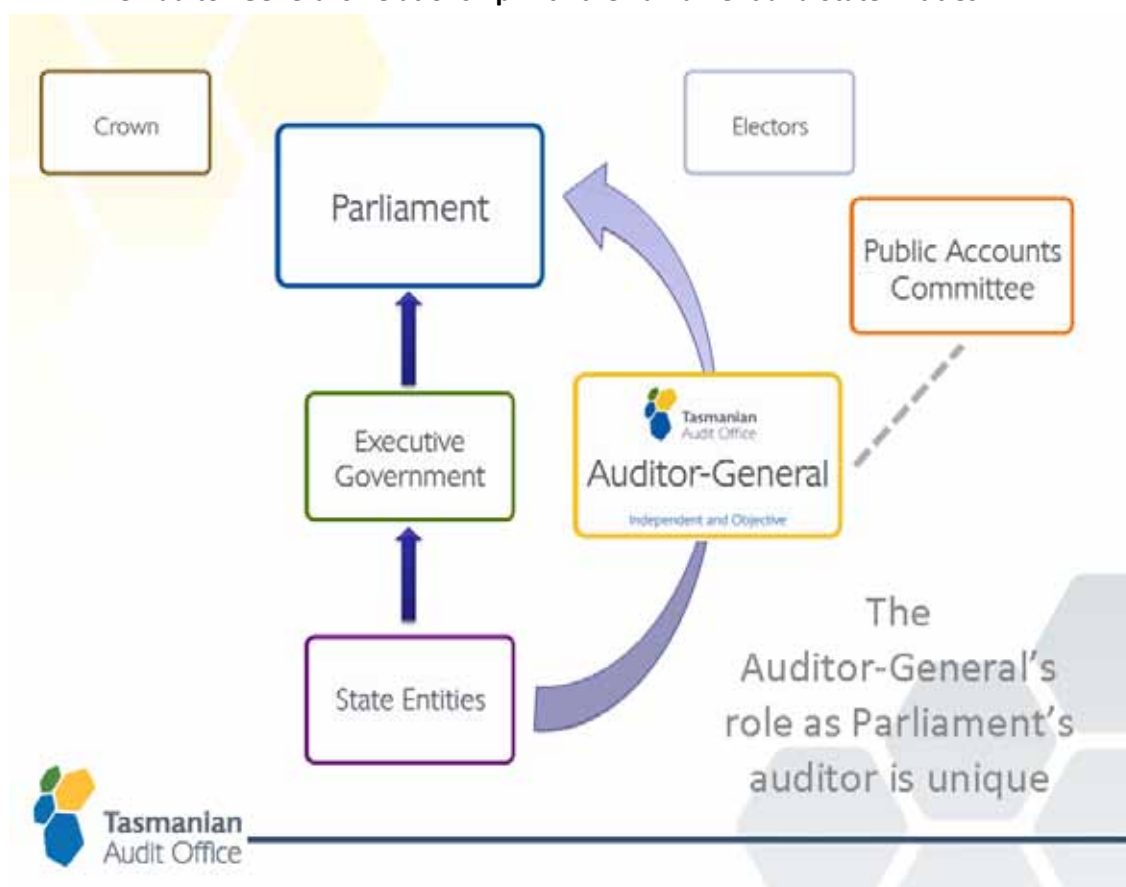
Compliance audits are aimed at ensuring compliance by State entities with directives, regulations and appropriate internal control procedures. Audits focus on selected systems (including information technology systems), account balances or projects.

We can also carry out investigations but only relating to public money or to public property.

Performance and compliance audits are reported separately and at different times of the year, whereas outcomes from financial statement audits are included in one of the regular volumes of the Auditor-General's reports to the Parliament normally tabled in May and November each year.

Where relevant, the Treasurer, a Minister or Ministers, other interested parties and accountable authorities are provided with opportunity to comment on any matters reported. Where they choose to do so, their responses, or summaries thereof, are detailed within the reports.

The Auditor-General's Relationship with the Parliament and State Entities





2012

PARLIAMENT OF TASMANIA

**REPORT OF THE
AUDITOR-GENERAL
No. 1 of 2012–13**

Sale of TOTE Tasmania

July 2012

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24 July 2012

President
Legislative Council
HOBART

Speaker
House of Assembly
HOBART

Dear Madam President

Dear Mr Speaker

REPORT OF THE AUDITOR-GENERAL

No. 1 of 2012–13

Sale of TOTE Tasmania

This report has been prepared in conformity with section 24 of the *TOTE Sale Act 2009* and the work was performed consistent with section 23 of the *Audit Act 2008*. The objective of the review was to determine whether the Treasurer has achieved a fair and reasonable price for the sale of TOTE.

Yours sincerely

H M Blake

AUDITOR-GENERAL

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Foreword

Decisions by governments to buy or sell assets arise from their policy considerations with Auditors-General appropriately precluded from commenting on policy. The authority to sell TOTE Tasmania Pty Ltd was granted to the Treasurer when the Tasmanian Parliament passed the *TOTE Tasmania (Sale) Act 2009*. This Act details the Treasurer's responsibilities and requires me to review the sale as I consider appropriate and to lay a report of my findings before each House of Parliament within 120 days.

This requirement is satisfied by completion of this Report. It details matters that I consider needed to be reviewed in order for me to satisfy my review objective which was to determine whether the Treasurer achieved a fair and reasonable price for the sale of TOTE Tasmania Pty Ltd.

H M Blake

Auditor-General

24 July 2012

List of acronyms and abbreviations

Agility	Agility Interactive Pty Ltd
BWUT	Bet Worldwide Unit Trust
GST	Goods and Services Tax
Sports Alive	Sports Alive Pty Ltd
Tasracing	Tasracing Pty Ltd
Tatts	Tatts Group Limited
Tasradio	Tasradio Pty Ltd
The 2009 Sale Act	<i>TOTE Tasmania (Sale) Act 2009</i>
TOTE	TOTE Tasmania Pty Ltd
Treasury	Department of Treasury and Finance

Executive summary

Executive summary

Background

TOTE Tasmania Pty Ltd (TOTE) was a State-owned company with its shares held in trust, for the Crown, by the Treasurer and Minister for Racing. It has an exclusive right to conduct wagering in Tasmania. TOTE conducts its business via a variety of channels, including telephone, internet and on-course as well as hotel and retail outlets.

In early January 2009, the Treasurer announced the intention to sell TOTE. The Treasurer said the sale of TOTE would give the Tasmanian community a better return on its investment than retaining it. At the time, it was speculated that TOTE was worth anything from \$250m to \$400m.

To facilitate the sale, Parliament passed the *TOTE Tasmania (Sale) Act 2009* (the 2009 Sale Act), which gave the Treasurer the power to sell or transfer shares in TOTE as he or she considers appropriate, but the Treasurer was required to have regard to achieving a fair and reasonable price¹. The 2009 Sale Act also required the Auditor-General to conduct a review² of any sale made within 120 days of sale day³ and table conclusions before each House of Parliament⁴.

Whilst interest was received from potential buyers in 2009, the Treasurer did not receive any final binding offers that were acceptable and the sale process was abandoned.

In October 2011, the Treasurer indicated that if the market was right, the Government would again consider selling TOTE if the return to the taxpayer was sufficient. Consultants were engaged to advise Treasury on whether a fair and reasonable price for TOTE was offered.

On 1 December 2011, the Treasurer announced that TOTE would be sold to Tatts Group Limited (Tatts) for \$103m subject to

¹ Section 5 of the *TOTE Tasmania (Sale) Act 2009*.

² Note that we performed a review; not an audit. ASAE 3000 uses the terms 'reasonable assurance engagement' and 'limited assurance engagement' to distinguish between the two types of assurance engagements that an assurance practitioner may perform. A review provides a lower level of assurance than an audit.

³ Under Section 3 of the *TOTE Tasmania (Sale) Act 2009*, Sale Day means the day on which TOTE's shares are acquired by a purchaser or the day on which the business vests in the purchaser. This was 26 March 2012.

⁴ Section 24 (1) *TOTE Tasmania (Sale) Act 2009*.

regulatory approval. The sale was completed on 26 March 2012. After that date, control of TOTE passed to Tatts.

The objective of this review was to determine whether the Treasurer achieved a fair and reasonable price for TOTE.

Detailed review conclusions

The overall conclusion is that a fair and reasonable price for TOTE was achieved. That conclusion is based on conclusions regarding the following separate review criteria.

Was the sale process appropriate?

We conclude that the sale process was appropriate, because:

- The approach to the sale was reasonable and consistent with past asset sales.
- Selection of a narrow and confidential sale process was a reasonable course of action.
- The identification of buyers was thorough and consistent with the decision to run a narrow and confidential sale process.
- The parties involved in the sale process had appropriate authority, skills and knowledge and were free from conflicts of interest.

Was the agreed price fair and reasonable?

The sale price considerably exceeded the retention value and there was no reason to expect a higher sale price would be achieved in the future. The agreed price appeared to be fair and reasonable.

Were other sale objectives achieved?

The following sale objectives were achieved:

- a continued terrestrial wagering presence in Tasmania
- the continuation of wagering on Tasmanian racing product in Tasmania
- a timely sale
- the successful party demonstrated experience and capacity to operate a wagering business in Tasmania
- the treatment of TOTE employees was considered as part of the sale process.

List of recommendations

The following Table reproduces the recommendation made in Section 2.3 of this Report.

Rec	Section	We recommend that ...
1	2.3	... Treasury fully document the analysis performed to enable it to rely on expert reports.

Audit Act 2008 section 30 — Submissions and comments received

Audit Act 2008 section 30 — Submissions and comments received

Introduction

In accordance with section 30(2) of the *Audit Act 2008*, a copy of this Report was provided to the Department of Treasury and Finance. A summary of findings was also provided to the Treasurer with a request for comment or submissions.

The comments and submissions provided are not subject to the audit nor the evidentiary standards required in reaching a review conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with those who provided a response or comment.

Submissions and comments received

Department of Treasury and Finance

Treasury agrees with the conclusions of your report and notes the recommendation.

Martin Wallace

Secretary

Introduction

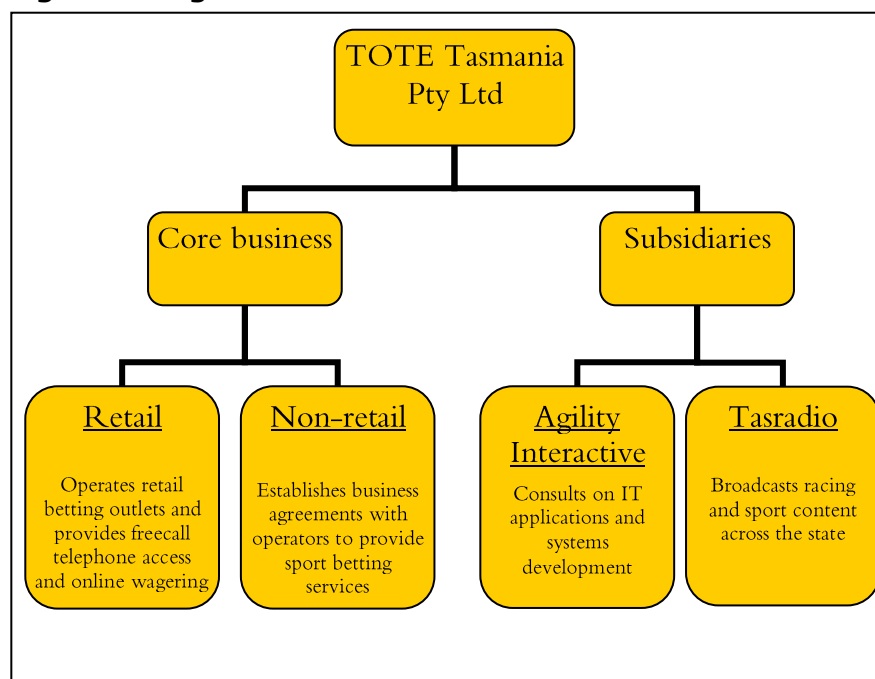
Introduction

Background

TOTE Tasmania Pty Ltd (TOTE) was a State-owned company with its shares held in trust, for the Crown, by the Treasurer and Minister for Racing. It had an exclusive right to conduct pari-mutuel wagering in Tasmania⁵. TOTE acted as a totalisator for thoroughbred, harness and greyhound racing, as well as sport and other fixed odds products⁶. It conducted its business via a variety of channels, including the telephone, internet, on-course and through a network of almost 120 hotel and retail outlets throughout Tasmania.

TOTE had two wholly owned subsidiaries, Tasradio Pty Ltd (Tasradio), which broadcast racing and sport content across the State, and Agility Interactive Pty Ltd (Agility), which provided consulting and other professional services focusing on IT applications and systems development. The organisational structure of TOTE, as at December 2011, is shown in Figure 1.

Figure 1: Organisational structure of TOTE



Source: Tasmanian Audit Office

⁵ All bets are deposited into a pool and the payout to winners is made from that pool once the operator's commission and tax is deducted. The final payout to winners is not determined until the pool is closed.

⁶ Calculates and displays the bets already made via current odds.

In early January 2009, the Treasurer announced the intention to sell TOTE. The Treasurer said the sale of TOTE would give the Tasmanian community a better return on its investment than retaining it. At the time, it was speculated that TOTE was worth anything from \$250m to \$400m.

To facilitate the sale, Parliament passed the *TOTE Tasmania (Sale) Act 2009* (the 2009 Sale Act). The 2009 Sale Act gave the Treasurer the power to sell or transfer shares in TOTE as he or she considers appropriate, but the Treasurer must have regard to achieving a fair and reasonable price⁷. However, it also requires the Auditor-General to conduct a review⁸ of any sale made within 120 days of sale day⁹ and table conclusions before each House of Parliament¹⁰.

The Department of Treasury and Finance (Treasury) engaged a consultant to assist with determining a fair and reasonable price for the business. Whilst interest was received from potential buyers, the Treasurer did not receive any final binding offers that were acceptable. Therefore, in December 2009 the government abandoned the sale process and determined that it no longer intended to sell TOTE, but the 2009 Sale Act was never repealed.

Between 2009 and 2011, TOTE experienced a substantial reduction in profitability mainly resulting from increased industry competition^{11,12}.

In mid-2011, the Board of TOTE engaged a number of companies to advise on the future of TOTE. Draft reports from the consulting firms were provided to Treasury in August 2011.

By October 2011, the Government had confirmed that it was again considering whether to sell TOTE. The Treasurer reiterated that if the market was right, the Government would consider selling any

⁷ Section 5 of the *TOTE Tasmania (Sale) Act 2009*.

⁸ Note that we performed a review; not an audit. ASAE 3000 uses the terms ‘reasonable assurance engagement’ and ‘limited assurance engagement’ to distinguish between the two types of assurance engagements that an assurance practitioner may perform. A review provides a lower level of assurance than an audit.

⁹ Under section 3 of the *TOTE Tasmania (Sale) Act 2009*, Sale Day means the day on which TOTE’s shares are acquired by a purchaser or the day on which the business vests in the purchaser. This was 26 March 2012.

¹⁰ Section 24 (1) *TOTE Tasmania (Sale) Act 2009*.

¹¹ Select Committee on the Role and Future Viability of TOTE Tasmania, Transcript: 17 October 2011.

¹² Note that we have limited our evaluation to financial information available relating to periods prior to July 2011. The reason for exclusion of later information is that it was not available to the decision makers.

non-core assets if the return to the taxpayer was sufficient. Following this announcement, the Treasurer confirmed that the government was open to offers for TOTE. Treasury again engaged consultants to advise it on whether a fair and reasonable price for TOTE was proposed by any potential buyers.

On 1 December 2011, the Treasurer announced that the Government had reached an agreement to sell TOTE to the Tatts Group Limited (Tatts) for \$103m. The sale, which was subject to regulatory approval, was completed on 26 March 2012. After that date, control of TOTE passed from the Government to Tatts.

As the 2009 Sale Act was never repealed, the Auditor-General was still required to conduct a review of any sale made within 120 days of the sale day and table his conclusions before each House of Parliament.

We have also included, as an Appendix to this Report, our analysis of the financial performance of TOTE following a review of the *Special Purpose Financial Report* covering the period July 2011 to March 2012.

Review objective

The objective of the review was to determine whether the Treasurer achieved a fair and reasonable price for TOTE.

Review scope

The review scope encompassed:

- Matters for review: matters related to the valuation and sale of TOTE
- Entities under review: TOTE and Treasury
- Period of review: the time leading up to and during the sale.

Review criteria

The criteria that we developed to support the review's objective in examining the sale of TOTE were:

1. Was the sale process appropriate?
2. Was the agreed price fair and reasonable?
3. Were other sale objectives achieved?

Conduct of review

To conduct the review, we:

- evaluated compliance with the 2009 Sale Act
- verified the sale methodology
- checked compliance with the sale process and evaluation plan for the sale of TOTE
- examined relevant documents from both TOTE and Treasury.

We also interviewed the Treasurer.

Timing

Planning for this review began in March 2012. Fieldwork was completed in May 2012 and the report was finalised in July 2012.

Resources

The total cost of the review excluding production costs was \$46 390. This was within our budget of \$114 620.

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1 Was the sale process appropriate?

1 Was the sale process appropriate?

1.1 Background

The process used to sell TOTE had the capacity to impact on the eventual price received and related terms and conditions. In addition, the perceived ‘fairness’ of the process is important for the reputation of the State and its Government.

To determine whether the process was appropriate, we considered:

- overall methodology (the various steps followed)
- identification of potential buyers
- consistency of approach with other asset sales
- appropriateness of parties involved in the sale.

1.2 Was the methodology appropriate?

There are a number of approaches that can be implemented in the sale of Government assets, as listed in Table 1.

Table 1: Possible sale processes and their features

Process	Definition	Features
Initial public offering	First sale of stock to the public	<ul style="list-style-type: none"> - Relies on good market conditions to obtain a high price - Requires capital investment prior to listing
Broad auction process	A large number of potential buyers are contacted in a public sale process	<ul style="list-style-type: none"> - Can be a drain on resources - Hard to control dissemination of competitive information - May take a long time to complete - More complete testing of market
Narrow sale process	A limited number of buyers are contacted in a confidential sale process	<ul style="list-style-type: none"> - More difficult to achieve the highest price - Requires selection of the ‘right’ group of buyers - Allows for more streamlined process - Allows for confidential negotiations

We found that the above limitations of each sale process were considered by the financial adviser when providing advice to Treasury. The financial adviser indicated that:

- Market conditions were not supportive of an initial public offering outside of the resources sector.
- A broad auction process had been previously attempted and discontinued in 2009. That process was seen to have compromised some confidentiality and the State's capacity to maximise value.
- The previous sale process had already tested the level of interest in relation to TOTE.
- The field of potential buyers was likely to be narrow.
- A narrow process would reduce the time taken for the sale and also the risk of the sale impacting on financial performance.

Based on these statements, the financial adviser concluded that a narrow and confidential sale process would be the most appropriate means of sale. This recommendation was ultimately accepted by the Treasurer in August 2011.

We evaluated documentation including advice received and accounts of the previous unsuccessful process. We also interviewed the key figures including the Secretary of Treasury and the Treasurer¹³. We accepted the arguments made by the financial advisor and considered the narrow sale process appropriate in the circumstances.

1.3 *Was the identification of potential buyers thorough?*

Having determined that a narrow sale process was appropriate, it was important that the identification of potential buyers was thorough and that the right potential buyers were approached.

We found that potential buyers were first discussed in a consultant's report to TOTE in of August 2011¹⁴. Although the value of TOTE to specific potential buyers was raised in this report, it was not the basis for selecting which parties would be engaged.

Selection of the parties to engage in the sale process was recommended in a subsequent written recommendation from the financial adviser to Treasury on 12 September 2011¹⁵. The recommendations were based on the following criteria:

¹³ The Treasurer was also the Premier. Our interview was concerned with her role as Treasurer.

¹⁴ The consultant eventually became the financial adviser to Treasury.

¹⁵ Note at this stage no decision had been made to sell.

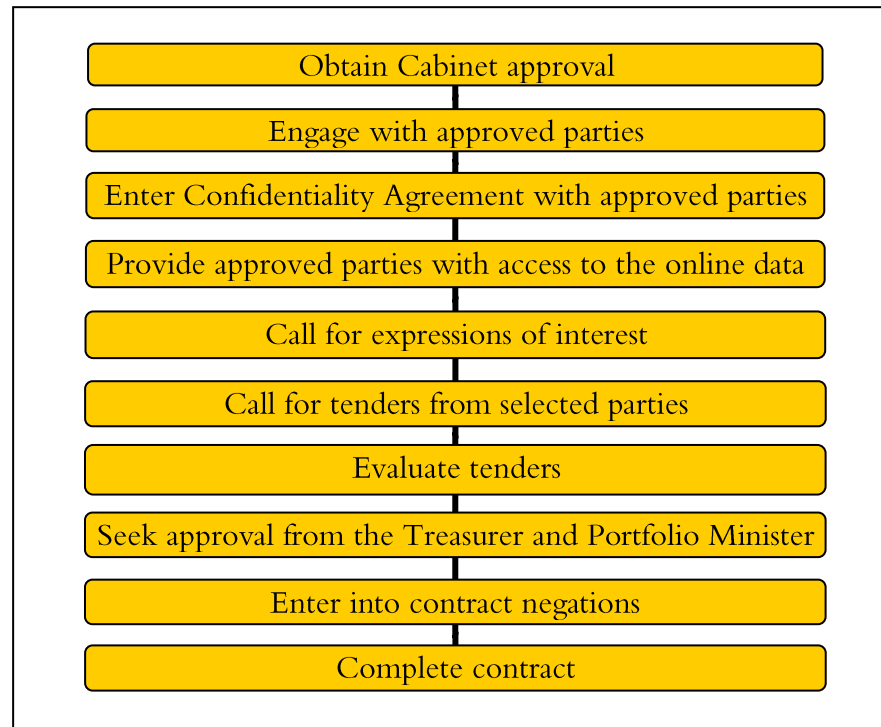
- relevant and demonstrated operating capability in the wagering sector
- ability to combine operations in the event of a potential acquisition
- financial capacity to complete the transaction in a timely manner
- ability to pool with Supertab, UNiTAB or alternate pooling arrangements
- demonstrated interest in TOTE Tasmania
- compliance with Tasmanian Gaming Commission requirements
- probity, confidentiality and timing considerations.

Treasury formally approved the parties to be engaged by the financial adviser. Initial discussions with the approved parties established that there was sufficient interest to justify running a formal sale process.

We believe that Treasury obtained reliable and expert advice. We also considered that the criteria used were stringent and appropriate and that, given this, potential buyers were readily determined.

1.4 *Was the sale consistent with other recent asset sales?*

We considered that comprehensive evaluation of the steps involved in the sale of TOTE could be achieved by making a comparison with past asset sales. As a result, we used the sale of the Hobart International Airport Pty Ltd and the Printing Authority of Tasmania to measure performance against this question. Those sales included the steps identified in Figure 2.

Figure 2: Standard Government asset sale process

Source: Tasmanian Audit Office

Our review of sale documentation confirmed that similar steps occurred during the sale of TOTE.

In summary, we consider the sale process was consistent with recent asset sales.

1.5 *Were the parties involved in the sale process appropriate?*

A number of parties were involved in the sale of TOTE. In this Section we considered whether:

- The level of involvement of TOTE was appropriate?
- The Treasurer had the authority to approve the sale and whether Cabinet was kept informed?
- Advisers, including Treasury, were skilled and knowledgeable?
- All parties were free from conflicts of interest?

The TOTE Board had a role in initiating the process by requesting a strategic review, but had no involvement in the sale thereafter. We noted that TOTE initiated the review process which ultimately led to the sale by commissioning two consultants regarding the valuation of TOTE. We also noted from discussions with Board members, Treasury and the Treasurer that the possibility of selling TOTE was discussed at regular meetings. In any event, we consider that limited

involvement of the Board was consistent with normal business practice since the shareholder retains control over the ownership decision.

The Treasurer had delegated authority under the 2009 Sale Act to sell TOTE. Although, no papers were submitted to Cabinet, the Treasurer advised that there was no need to keep Cabinet informed but that she had done so by regular verbal updates.

Advisers included Treasury, a legal adviser, financial adviser and a probity adviser. Our view, based on reputation of the advisers, documentation and documented communications, is that these parties were skilled and knowledgeable in their respective areas of expertise and that, collectively, they provided all necessary advice and accountabilities. In particular, both the legal and financial advisers' teams included members with extensive knowledge of the wagering industry.

We noted that all parties involved completed a declaration that they had no conflicts of interest and would advise Treasury of any that might arise during the sale process. We also noted that the probity adviser considered these matters and made no adverse findings.

As a result, we concluded that the parties involved, and their level of involvement, was appropriate.

1.6 Conclusion

We conclude that the sale process was appropriate, because:

- The approach to the sale was reasonable and consistent with past asset sales.
- Selection of a narrow and confidential sale process was a reasonable course of action.
- The identification of buyers was thorough and consistent with the decision to run a narrow and confidential sale process.
- The parties involved in the sale process had appropriate authority, skills and knowledge and were free from conflicts of interest.

2 Was the agreed price fair and reasonable?

2 Was the agreed price fair and reasonable?

2.1 Background

A number of value-related concepts must be considered during an asset sale process. These include the retention value (defined in Section 2.3), sale price and expected value to potential buyers. All values will be calculated using different future cash flows and based on differing assumptions. As a result, one asset could receive a number of different valuations.

In assessing whether the agreed price was fair and reasonable, we sought to:

- determine the effective sale price
- confirm that the sale price exceeded the retention value
- find out if the agreed price was the highest bid
- establish whether there was a possibility of receiving a higher bid.

The following sections address specific questions regarding the valuation of TOTE.

2.2 What was the effective sale price?

In a sale, the effective price includes the Binding Offer as well as any components of the offer that add to the overall price achieved. The actual sale price was \$103m. We considered possibly relevant adjustment factors including existing levels of debt and benefits earned but not yet received.

We concluded that no adjustment was required for debt since that was just one component of the net assets of TOTE that were purchased. We also noted that \$43.6m of GST credits have been transferred to TOTE under Tatts' ownership. As part of the Share Purchase Agreement, the Government will receive the value of these credits. As a result, the GST credits do not impact on the effective sale price as the amount would have been received by the State whether or not the sale had proceeded.

Similarly, the Share Purchase Agreement provided for the State to receive \$15.4m in overpaid GST recovered after the Share Purchase Agreement was signed. Again, this has no impact on the effective sale price since that amount would have been received by the State whether or not the sale had proceeded.

In summary, we believe the effective sale price is equal to the actual sale price of \$103m.

2.3 *Was the agreed price higher than the retention value?*

Retention value is the value of a business if the owners were to retain possession. This is commonly based on the net present value of any expected future cash flows, and acts as a ‘reserve price’ in an asset sale¹⁶. In this case, the retention value reflects the expected performance of TOTE under Government ownership, taking into account the impact of Government ownership on the growth strategy, capital structure and performance.

Retention value can be very different from the best price offered by potential buyers because of many factors including:

- risk tolerance
- cost advantages available to industry participants through economies of scale
- availability of capital to finance necessary infrastructure development
- potential for increased market share to generate greater revenue across a buyer’s full range of products.

Treasury sought a retention value from the financial adviser in November 2011. At that time, the maximum retention value was estimated to be \$43m, considerably less than the sale price of \$103m.

Methodology

The retention valuation methodology included the following key elements:

- valuations for five separate scenarios, based on possible future events and strategies¹⁷
- valuations based on projected future costs and income under each of the scenarios
- cost and income discounted using different rates reflecting different risk profiles of the retail and non-retail segments
- derivation of a weighted average of valuations for the five scenarios based on estimates of the likelihood of those scenarios eventuating.

¹⁶ Net present value is a method of valuing expected cash inflow and outflows over time at an appropriate discount rate.

¹⁷ The scenarios were developed through a consultative process between TOTE, Treasury and the financial adviser.

Assumptions

The key assumptions made by the financial adviser were theoretically sound, with some examples including:

- cash flow streams from retail and non-retail segments discounted at various rates due to differing risk profiles
- equal weightings for the five scenarios¹⁸
- margins and turnover based on the 2012–15 TOTE Corporate Plan and industry trends
- projected operating costs below those of the 2010–11 Financial Statements¹⁹.

Analysis

Our expectation was that we would be largely reviewing Treasury's analysis including documentation regarding²⁰:

- evaluation of the expert's professional competence and objectivity
- consideration of data used by the expert
- understanding and support for the assumptions and methods used.

However, the level of documentation provided by Treasury fell short of our expectations. On enquiry, Treasury was able to demonstrate it had performed the analysis. In particular, it had good reasons for its choice of advisers, the financial adviser's projections were based on the 2012–15 TOTE Corporate Plan and Treasury had a good understanding of that Plan. While noting that previous Corporate Plans appeared optimistic in the light of subsequent results, we were satisfied that the 2012–15 TOTE Corporate Plan was more realistic and provided a conservative basis for calculating a retention value.

We also found little documentation from Treasury in support of the financial adviser's valuation methodology. We were satisfied that Treasury had considered the broad methodology framework but not that it had reviewed or considered its application by the financial

¹⁸ The report shows different weightings were used initially which produced a lower valuation than \$43m. Subsequently, the financial adviser settled on equal weightings in order to provide a more conservative (higher) retention value.

¹⁹ Projecting costs below actual also provided a more conservative (higher) retention value.

²⁰ That expectation was based, in part, on our own professional requirements under auditing standards when relying on the advice of an expert.

adviser. For example, we could find no discussion of weightings used for different scenarios or confirmation that valuation models had been correctly applied.

To obtain greater confidence, we:

- reviewed the financial adviser's methodology, including the five scenarios, use of net present value and calculation of weighted average
- reviewed the assumptions for reasonableness
- recalculated the net present value of the base case using the financial adviser's data
- considered projections in the light of recent financial data and industry trends.

Our analyses had some unavoidable limitations, including lack of information relating to other scenarios and lack of projection data in the financial adviser's report beyond the next four years.

Nonetheless, we are confident that our analyses provided reasonable support for the financial advisor's retention value.

Recommendation 1

We recommend that Treasury fully document the analysis performed to enable it to rely on expert reports.

Advice from another consultant

Prior to the assessment process, another retention value was commissioned by TOTE and provided to Treasury that was significantly higher than that in the financial adviser's report. Treasury rejected this valuation in August 2011. This decision was subsequently supported by advice from its financial adviser that the valuation suffered from key deficiencies including:

- Forecast assumptions were considerably more ambitious and aggressive than those included in the 2011-15 TOTE Corporate Plan.
- Assumptions did not reflect industry trends.
- Uncertainty surrounding the pooling arrangements was not adequately considered.
- Significant capital investment was not considered.
- Discount rates did not reflect the greater risk associated with the non-retail segment compared to the retail segment.

We are not aware of separate Treasury analysis, but in any event, we found the points persuasive for a number of reasons, including recent financial information and decreasing margins in the industry. We also noted TOTE's subsequent 2012–15 Corporate Plan was even less supportive of the consultant's projections than TOTE's 2011–15 Corporate Plan. In particular, the 2010–11 Financial Statements were more consistent with TOTE's 2012–15 Corporate Plan than with the consultant's projections. A further concern we had with the higher valuation was that it calculated cost savings to a potential buyer, but did not reintroduce those costs when determining the value to Government.

Summary

We consider that the financial adviser's maximum retention value of \$43m was reasonable. Therefore, the successful bid was considerably better than the retention value.

2.4 Was the agreed price the highest bid?

Two binding offers were submitted to Treasury on 23 November 2011. Once received, Treasury favoured the Tatts offer and sought to improve the terms and conditions.

We were satisfied that Tatts' final binding offer was the highest bid.

2.5 Was there any possibility of receiving a higher bid later on?

The following section discusses whether a better offer might have been obtained given more time or a different process. In considering this question, it is important to note that many factors drive the price paid for a business including business performance, economic conditions and industry trends.

In Section 1.3, we concluded that the identification of potential buyers was a sufficiently thorough process to obtain the best price at that time. In this Section, we considered the following additional questions:

- Did TOTE's risk profile make delaying the sale undesirable?
- Did recent financial trends suggest the value may increase in the future?
- Could buyer incentives to pay greater than retention value disappear?
- Did advice from the financial advisor suggest a higher bid was possible?

- Did valuations from independent investment companies and other commentators suggest a higher bid was possible?

2.5.1 *Did TOTE's risk profile make delaying the sale undesirable?*

On 18 November 2011, Treasury addressed Parliament's Select Committee on the Role and Future Viability of TOTE. Treasury covered TOTE's financial performance and position as well as its key pressures and risks. The combination of these factors impacted on the timing of the sale.

Some of the key risks that TOTE was facing prior to the sale included:

- high level of risk associated with operating a wagering business in a rapidly changing and intensely competitive global market
- downgrading of net wagering revenue forecasts
- migration of customers towards the fixed odds online arena
- customer retention in the non-retail business segment.

Treasury saw this situation as representing an increased level of risk for Government. Essentially, TOTE needed to pursue growth in high-risk markets, yet the Treasurer as TOTE's shareholder was risk averse. For these reasons, it made sense to accept a reasonable sale price now rather than taking the chance of a higher price in the future.

2.5.2 *Did recent financial trends suggest the value may increase in the future?*

The effect of the increasing risk exposure was also compounded by declining financial performance and position. In its address to the Select Committee, Treasury drew the following information from TOTE's 2010–11 Annual Report:

- Turnover increased by \$205m while net wagering revenue fell by \$2m.
- Operating expenses increased by \$6m.
- Net assets decreased.
- Capital expenditure exceeded net cash inflows.

These statements were supported by the Auditor-General who noted significant uncertainty relating to TOTE's operations in the *Report of the Auditor-General No. 5 of 2011–12*. Treasury also projected declining earnings and return on assets. These conditions resulted in

significant capital constraints due to a large upcoming capital expenditure program and increasing pressure on TOTE's borrowing levels.

Again, we concluded that it made sense to accept a reasonable sale price now rather than taking the chance of a higher price in the future.

2.5.3 Could buyer incentives to pay greater than retention value disappear?

Treasury identified the following reasons that potential buyers might place additional value on TOTE above its retention value:

- cost savings from access to large pari-mutuel pools
- economies of scale and capacity to buyer's infrastructure rather than upgrade TOTE's infrastructure
- ability to manage risk.

The financial adviser was concerned that any delay in the sale may result in degradation of value regarding the above reasons and specifically commented on the potential impact of:

- an unfavourable outcome in pooling fee negotiations
- sunk expenditure on the new wagering system and other infrastructure.

Once more, we concluded that it was better to accept a reasonable sale price now rather than taking the chance of a higher price in the future.

2.5.4 Did advice from the financial advisor suggest a higher bid was possible?

The financial adviser provided a range of valuations for potential buyers, with a maximum potential sale price of \$130m. That valuation represented an enterprise multiple of between 7.5 and 8.5 times, meaning that the TOTE was worth between 7.5 and 8.5 times its historical earnings²¹. This valuation is slightly lower than the industry average multiple of 8.6²² reflecting TOTE's scale, risk factors, lack of access to capital and dependency on pooling arrangements.

²¹ That is, earnings before interest, tax, depreciation and amortisation (known as EBITDA).

²² The figure of 8.6 is calculated as the average sale price of gaming businesses divided by average earnings, over the period 1994–2011.

We considered the close proximity of the industry multiple to TOTE's calculated multiple as providing reasonable evidence in support of the maximum value of \$130m.

That maximum valuation suggests that it was unlikely that a higher bid, than the effective sale price of \$103m, would be achievable in the foreseeable future.

2.5.5 Did valuations from independent investment companies and other commentators suggest a higher bid was possible?

In the following sub-sections, we consider advice to investors provided by investment companies that were independent of the TOTE sale. This advice comes in the form of a direct opinion on the value achieved by TOTE or indirect opinion in the form of advice.

Where a direct opinion has been issued, it typically involves an analysis of the assumptions made by Tatts in arriving at the sale price including estimated revenue for 2012–13 and any savings expected to be achieved through rationalisation of processes and systems. However, in the context of the indirect opinion, the advice to investors analyses the impact on both Tatts' and Tabcorp's (Tatts' major competitor) share price.

Macquarie Bank

One of the amounts made public during the sale process was \$150m. This forecast price was issued by Macquarie Bank's Equities Research Division in November 2011 and was based on potential earnings.

The report went on to say that, should the Government be successful in selling TOTE for approximately \$150m, it would represent an attractive exit multiple of 19 times the 2010–11 earnings. As discussed in Section 2.5.4, this multiple would be more than double the industry average.

Given the risks facing TOTE and the high multiple implicit in Macquarie's proposed sale price, we are not persuaded that Macquarie's proposed price represents strong evidence that the achieved sale price could have been significantly bettered.

Summary of advice from other independent investment companies and commentators

Four investment companies provided direct or indirect advice that an enterprise multiple of 7.9 times based on 2012–13 earnings was either reasonable or high. Accordingly, their advice supported the actual sale price achieved.

We also sighted feedback from independent commentators indicating that a fair price had been achieved.

2.6 *Conclusion*

The sale price considerably exceeded the retention value and there was no reason to expect a higher sale price would be achieved in the future. The agreed price appeared to be fair and reasonable.

3 Were other sale objectives achieved?

3 Were other sale objectives achieved?

3.1 Background

The Treasurer's key objective in pursuing the sale of TOTE was to achieve a fair and reasonable price for the business in accordance with the 2009 Sale Act. Other objectives were developed by Treasury to support the achievement of the sale objectives.

The following sections review the extent to which the objectives were met. The sale objectives included:

- ensuring the Tasmanian racing industry would not be negatively impacted and that there would be:
 - a continued terrestrial wagering presence in Tasmania
 - a continuation of wagering on Tasmanian racing product in Tasmania
- achieving a timely sale
- ensuring the successful party had experience and capacity to operate a wagering business
- ensuring employee welfare was considered.

3.2 *Will the Tasmanian racing industry be negatively impacted?*

In the first instance, an outcome of the 2009 sale process was the introduction of measures to better secure the future of the racing industry. These included the establishment of Tasracing Pty Ltd (Tasracing) as a state-owned company. As part of Tasracing's establishment, a funding deed was drawn up which required:

- annual government funding of \$27m increasing at a rate of half of CPI for 20 years commencing from 1 July 2009
- access to a loan facility of \$40m.

We also noted that, a Wagering Services Deed introduced in addition to the Share Purchase Agreement, commits Tatts to continued terrestrial wagering and wagering on Tasmanian racing product indefinitely. In addition, under the *Gaming Control Act 1993*, Tatts will continue paying a licence fee to the State.

Based on the protection mechanisms put in place, it appears that negative impacts of the TOTE sale on the Tasmanian racing industry will be minimal.

3.3 *Was an expeditious sale achieved?*

In the corporate sphere, business sales can take at minimum three to six months to finalise, with some taking longer than 12 months²³. Furthermore, the average time to sell a business increases as access to finance becomes more difficult²⁴. Based on this corporate evidence, a sale of between six and 12 months would represent a success in terms of timeliness.

Consideration of a possible TOTE sale was approved by the Treasurer in August 2011 and completed in March 2012, a period of seven months²⁵. This is comparable with recent Government asset sales and within a benchmark based on corporate business sales.

We therefore concluded that the sale of TOTE was timely.

3.4 *Did the successful party have demonstrated experience or capacity to operate a wagering business?*

Treasury noted that Tatts has significant wagering experience in Australia. Treasury was also of the view that the risk of Tatts not meeting the requirements of the Tasmanian Gaming Commission was low. The basis of this opinion is that Tatts is independently regulated in Queensland, South Australia and the Northern Territory. In addition, Tatts already holds a number of licences or approvals issued by the Tasmanian Gaming Commission.

3.5 *Was employee welfare considered in the sale process?*

We examined available documentation and made inquiries with Treasury to determine whether the sale process had considered:

- minimisation of job losses
- remuneration of continuing staff
- a plan for any employees made redundant.

With respect to job losses, Tatts was already in the wagering business. So, we accepted that there would be some duplication of roles

²³ Various sources including: Jamiesons business brokers, www.jamiesons.com.au and AssetXcel, www.assetxcel.com.au.

²⁴ Smart Company, www.smartcompany.com.au.

²⁵ Although no decision to sell was made until 1 December 2011.

following the sale, which would result in positions being made redundant.

In relation to redundancy planning, we noted that employee welfare including long service leave and superannuation entitlements was considered as part of the 2009 Sale Act.

Beyond the time of sale, the longer-term impact is more difficult to predict. Under the Wagering Service Deed, Tatts is indefinitely committed to retain the existing retail network, radio station and call centre. As a result, Treasury concluded that there would be minimal impact on TOTE's operational staff. Conversely, there was expected to be a significant impact on TOTE's corporate staff as well as any specialist staff (such as those working for Agility), although that was not explicitly stated in Treasury documentation. Employees made redundant were entitled to a redundancy payment as per their contracts of employment.

We found that employee welfare was adequately considered in the sale process.

3.6 *Conclusion*

The following sale objectives were achieved:

- a continued terrestrial wagering presence in Tasmania
- the continuation of wagering on Tasmanian racing product in Tasmania
- a timely sale
- the successful party demonstrated experience and capacity to operate a wagering business in Tasmania
- the welfare of employees was considered as part of the sale process.

Independent reviewer's conclusion

Independent reviewer's conclusion

This independent conclusion is addressed to the President of the Legislative Council and to the Speaker of the House of Assembly. Section 24 of the *TOTE Tasmania (Sale) Act 2009* requires the Auditor-General to review all sales under section 5 of that Act as he or she considers appropriate and lay a report of his or her findings. As a result, I have conducted a review. A review is substantially more limited in scope than an audit conducted in accordance with Australian Audit Standards and consequently does not enable me to obtain assurance that I would become aware of all significant matters that might be identified in an audit. Accordingly, I do not express an audit opinion. However, and as indicated under the heading Review Scope below, I was provided with all of the information that I requested and there was no effort by any party to the review to limit the scope of my work.

Review objective

The objective of the review was to determine whether the Treasurer achieved a fair and reasonable price for the sale of TOTE.

Review scope

The review scope encompassed:

- Matters for review: matters related to the valuation and sale of TOTE
- Entities under review: TOTE and Treasury
- Period of review: the time leading up to and during the sale.

In developing the scope for this review and completing my work, the Treasurer and Treasury provided me with all of the information that I requested. There was no effort by any party to the review to limit the scope of my work. This Report is a public document and its use is not restricted in any way by me or by any other person or party.

Responsibility of the Treasurer

Section 5 of the *TOTE Tasmania (Sale) Act 2009* provides the Treasurer with the authority to sell TOTE Tasmania Pty Ltd and, in doing so, the Treasurer is to have regard to the achievement of a fair and reasonable price.

Auditor-General's responsibility

In the context of this review, my responsibility was to review all sales under section 5 of *TOTE Tasmania (Sale) Act 2009* as I consider appropriate and lay a report of my findings by no later than 24 July 2012.

I conducted my review in accordance with Australian Auditing Standard ASAE 3100 *Compliance engagements*, which required me to comply with relevant ethical requirements relating to review engagements. I planned and performed the review in order to state whether, on the basis of criteria outlined below, anything has come to my attention that causes me to believe the price received for the sale of TOTE Tasmania Pty Ltd was not fair and reasonable.

The criteria that I developed to support my review objective in examining the sale of TOTE were:

- Was the sale process appropriate?
- Was the agreed price fair and reasonable?
- Were other sale objectives achieved?

To conduct the review, I:

- evaluated compliance with the 2009 Sale Act
- verified the sale methodology
- checked compliance with the sale process and evaluation plan for the sale of TOTE
- examined relevant documents from both TOTE and Treasury.

I believe that the evidence I have obtained was sufficient and appropriate to provide a basis for my conclusion.

Auditor-General's conclusion

Based on the review, which is not an audit, nothing has come to my attention that causes me to believe that the Treasurer did not achieve a fair and reasonable price for the sale of TOTE Tasmania Pty Ltd.

H M Blake

Auditor-General

24 July 2012

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Recent reports

Recent reports

Tabled	Special Report No.	Title
May 2011		Volume 5: Other State Entities 30 June 2010 and 31 December 2010, including University of Tasmania
Jun 2011	98	Premier's Sundry Grants Program and Urban Renewal and Heritage Fund
Jun 2011	99	Bushfire management
Jun 2011		Volume 4 Part 1: Local Government Authorities and Business Units 2009–10
Jun 2011		Volume 4 Part 2: Local Government Authorities and Business Units 2009–10
Jul 2011	100	Financial and economic performance of Forestry Tasmania
Sep	No. 1 of 2011–12	Tourism Tasmania: is it effective?
Sep	No. 2 of 2011–12	Children in out of home care
Nov	No. 3 of 2011–12	Financial Statements of State entities: Volume 1 — Analysis of the Treasurer's Annual Financial Report 2010–11
Nov	No. 4 of 2011–12	Financial Statements of State entities: Volume 2 — Executive and Legislature, Government Departments and other General Government Sector entities 2010–11
Nov	No. 5 of 2011–12	Financial Statements of State entities: Volume 3 — Government Business Enterprises, State Owned Companies, Water Corporations and Superannuation Funds 2010–11
Nov	No. 6 of 2011–12	Financial Statements of State entities: Volume 4 Part I — Local Government Authorities 2010–11
Dec	No. 7 of 2011–12	Financial Statements of State entities: Volume 5 — Other State entities 30 June 2011 and 31 December 2010
Mar	No. 8 of 2011–12	The assessment of land-use planning applications
Jun	No. 9 of 2011–12	Financial Statements of State Entities: Volume 6 — Other State Entities 30 June 2011 and 31 December 2011
Jun	No. 10 of 2011–12	Public Trustee: Management of minor trusts
Jun	No. 11 of 2011–12	Updating the Motor Registry System
Jun	No. 12 of 2011–12	Follow-up of Special Reports 75–81

Current Projects

Current projects

Performance and compliance audits that the Auditor-General is currently conducting:

Title	Subject
TasPorts amalgamation	Assesses whether the promised benefits of amalgamation have been achieved.
Managing hospital bed demand	Assesses the effectiveness of the Department of Health and Human Services' efforts to manage the demand for hospital beds through alternatives to hospital treatment.
National Partnership Agreement on Homelessness	Examines whether the state is effectively and efficiently meeting its obligations under the National Partnership Agreement on Homelessness. The audit will be done concurrently with other jurisdictions with oversight by the Australian Council of Auditors-General.
Fraud control in local government	Assesses whether local government Councils' fraud management strategies are effective to prevent, detect and respond to fraud.
Tasmanian Adult Literacy Action Plan	Ascertains whether the Department of Education has implemented the Tasmanian Adult Literacy Action Plan.
Royal Derwent Hospital sale	Assesses the sale of the Royal Derwent Hospital site in terms of the tender process, value and sale agreement compliance.

Appendix

Appendix

TOTE Tasmania Pty Ltd

Introduction

On 1 December 2011, the Treasurer entered into an agreement to sell 100 per cent of the shares in TOTE Tasmania Pty Ltd (TOTE or the Company) to TattsBet Limited, part of the consolidated Tatts Group Limited (Tatts). The sale agreement was executed in accordance with the *TOTE Tasmania (Sale) Act 2009* with the sale completed on 26 March 2012.

The Auditor-General was engaged by the Department of Treasury and Finance (Treasury) to review a special purpose financial report (the financial report) of TOTE prepared for the period 1 July 2011 to 26 March 2012. The financial report represented the final period of TOTE's activities whilst under State ownership. This review was conducted in accordance with Auditing Standard on Review Engagements *ASRE 2405 Review of Historical Financial Information Other than a Financial Report* issued by the Auditing and Assurance Standards Board.

Review of the Special Purpose Financial Report

Review completion

The financial report was certified by the nominated delegate (the delegate) on 21 May 2012, received by us on 25 May 2012 and a qualified review report was issued on the same day.

The review report was qualified on the basis that deferred tax assets recognised in the Statement of Financial Position did not include a deferred tax asset of \$0.305m arising from certain business capital expenditure. It was our view that this deferred tax asset should have been recognised as an asset.

Our review report also contained an emphasis of matter paragraph drawing attention to the fact that the carrying amount of the deferred tax asset did not include the effect of the total write-off of TOTE's investment in Sports Alive.

Both of these matters are discussed later in this Chapter.

Basis of preparation

The financial report comprised a Statement of Financial Position as at 26 March 2012, and the related statements of Comprehensive Income, Cash Flow and Changes in Equity for the period ended on that date, and a summary of significant accounting policies, other explanatory notes and a

Completion Balance Sheet prepared in accordance with the Share purchase agreement.

To ensure impacts of the sale and new ownership did not influence financial reporting, the financial report was prepared using accounting policies consistent with those applied by TOTE in its financial report as at and for the year ended 30 June 2011. This was an important assumption because it ensured that, despite the sale, there would be comparability between the financial results at 26 March 2012 and prior years. However, one change in accounting policy was made although its financial impact was not significant. This related to a change in the entitlement of employees to long service leave from 15 years of continuous employment to 10 years and a corresponding reassessment of probabilities, which contributed to an increase in the provision for employee benefits.

Sports Alive

In December 2009, TOTE acquired a 25 per cent share in Bet Worldwide Unit Trust (BWUT) for \$5m. BWUT owned 100 per cent of online bookmaker Sports Alive Pty Ltd (Sports Alive) which was placed into voluntary liquidation on 26 August 2011 with its licence cancelled on the same day. The carrying amount of TOTE's investment in BWUT in its financial statements at 30 June 2011 amounted to \$3.880m. As a result of Sports Alive being placed into liquidation, the value of this investment was written down to nil at 26 March 2012. This write-down had no impact on the final sale price. The remaining balance of the initial investment of \$5m had been written down in previous years, \$0.150m in 2009–10 and \$0.970m in 2010–11.

At the time of preparing this Chapter, the former Chairman and Chief Executive Officer were involved in examinations being held under the *Corporations Act 2011* by the liquidators of Sports Alive. Allegations and demands for compensation are being defended.

Deferred income tax matters

Impact of the write-off of the investment in Sports Alive

In the preparation of the financial report, the probability of a deferred tax asset arising from the write-down of the investment in Sports Alive to nil, and the capacity to offset this capital loss against future capital gains, was deemed by the delegate to be remote. This assessment took into account existing accounting policies. We concurred with this assessment. As a result, no deferred tax asset was recognised.

Business capital expenditure incurred by TOTE

TOTE incurred business capital expenditure in relation to strategic business reviews, legal fees in relation to Sports Alive matters and the sale process. For income tax purposes such costs may be treated as 'black-hole'

expenditure under Section 40-880 of the *Income Tax Assessment Act 1997* and be deducted in equal proportions over a period of five income years and recognised as a deferred tax asset. The potential 'black-hole' related deferred tax asset totalled \$0.305m at 26 March 2012.

A deferred tax asset was not recognised for this 'black-hole' expenditure because the delegate argued that Tatts could not claim the deferred tax asset. While this may be so, not accounting for this asset represented a departure from the principle of preparing the financial report in accordance with existing accounting policies. This resulted in the deferred tax asset being understated by \$0.305m, an amount we regarded as material resulting in our review report being qualified.

Goods and Services Tax

In the 2010–11 financial report, TOTE disclosed a contingent asset relating to a review of the basis upon which Goods and Services Tax (GST) applies to its wagering margin. The Company received a favourable ruling from the Australian Taxation Office, which resulted in a GST refund of \$15.397m. This amount was received prior to 26 March 2012 and is discussed further in the Comprehensive Income Statement section of this Chapter. In addition, TOTE's GST losses carried forward totalled \$41.268m at the time of the sale. The timing of the recovery of this benefit by the State remains unclear at this stage and is subject to a private binding ruling by the Australian Taxation Office. In the event that Tatts recovers any of this benefit, the Share purchase agreement requires this to be paid to the State.

Intangibles write-off

Prior to the announcement of the sale, TOTE commenced a project, referred to as *TOTE 2020*, to replace its wagering computer system and entered into a contract with a software supplier. Following the announcement of the sale, TOTE stopped the project and agreed with the supplier to terminate the contract. Capitalised project costs, which totalled \$4.938m by 26 March 2012, were written down to nil. This write-down had no impact on the final sale price.

Repayment of Debt

The Company's borrowings totalled \$14m at 30 June 2011. This debt was fully extinguished using the proceeds from the GST refund. Prior to finalisation of the sale, TOTE borrowings had increased to \$4m to meet its short term obligations and operating requirements. This balance remained outstanding at 26 March 2012, was paid by Tatts and deducted from the sale price.

Financial results

For the purposes of this Section, it should be noted that the comparative information used in this analysis is for a twelve-month period.

Comprehensive Income Statement

	Period to 26 March 2012	12-Month period 2010–11	12-Month period 2009–10
	\$'000s	\$'000s	\$'000s
Investments from customers (wagering)	886 892	961 027	756 423
Settlements from other TABs	70 094	69 139	54 760
Dividends, commissions, rebates and taxes	(884 347)	(949 064)	(734 941)
Gross wagering income	72 639	81 103	76 242
Wagering and pooling fees	(15 971)	(17 079)	(13 942)
Race fields fees	(11 257)	(12 843)	(9 068)
Net wagering income	45 411	51 181	53 232
Other income from operating activities	3 606	3 619	3 713
Total Income	49 017	54 800	56 945
Employee benefits	(15 471)	(17 468)	(12 628)
Depreciation and amortisation	(3 235)	(5 404)	(3 268)
Licence fee	(4 847)	(6 392)	(6 255)
Other expenses	(19 180)	(23 030)	(19 153)
Total Expenses	(42 733)	(52 294)	(41 304)
Net operating profit before finance cost and tax	6 284	2 506	15 641
Finance costs	(517)	(960)	(447)
Net operating profit before tax	5 767	1 546	15 194
GST recovery	15 397	0	0
Write down of investment	(3 880)	(970)	(150)
Net gain/(loss) on disposal of assets	(121)	3 872	0
TOTE 2020 write-off	(4 938)	0	0
Distributions to Tasracing	0	0	(5 126)
Net profit before tax	12 225	4 448	9 918
Income tax expense	(5 673)	(1 307)	(2 928)
Net profit after tax	6 552	3 141	6 990
Other Comprehensive Income	0	0	0
Total Comprehensive Profit	6 552	3 141	6 990

Comment

For the period ended 26 March 2012, TOTE reported a Net operating profit before tax of \$5.767m, compared to \$1.546m reported for the full twelve-month period ended 30 June 2011. Net wagering income amounted to \$45.411m for the first three quarters of 2011-12 and represented 88.7 per cent of Net wagering income for the previous 12 months of \$51.181m. The favourable result reflected good trading conditions up until the announcement of the sale and the fact that TOTE's turnover is seasonal and peaks around the spring and autumn racing carnivals.

Total Expenses were \$42.733m for the period and represented 81.7 per cent of Total Expenses for the previous full year of \$52.294m. Costs are less seasonal in nature. Following the sale announcement, TOTE curtailed a number of operating expenses. However, it incurred costs in connection with the sale, adjustments to long service leave and back pay of superannuation on overtime. These transactions, and the seasonal nature of TOTE's revenues, make judgements about the likely full year results compared to 2010-11 difficult.

Overall, TOTE reported a Net profit after tax of \$6.552m compared to \$3.141m for the previous period. Significant non-operating items impacting on this result were:

- GST recovery, inclusive of interest, of \$15.397m
- write down of the Sports Alive investment of \$3.880m
- write down of the development costs for *TOTE 2020* of \$4.938m.

All three items were discussed earlier in this Chapter.

The net gain on disposal of assets of \$3.872m in 2010-11 arose from the sale in that year of the FM licence owned by Tasradio, a TOTE subsidiary.

The distribution to Tasracing in 2009-10 of \$5.126m was a one-off payment made as part of the transition from the previous structural arrangements.

Statement of Financial Position

	2012	2011	2010
	\$'000s	\$'000s	\$'000s
Current Assets			
Cash and cash equivalents	11 360	11 633	10 300
Receivables	7 053	6 819	2 664
Other current assets	2 122	915	628
Total Current Assets	20 535	19 367	13 592
Current Liabilities			
Payables	8 290	10 771	8 709
Borrowings	4 000	14 000	10 000
Telephone betting deposits	8 251	10 093	7 709
Bonds on deposit	313	306	285
Employee benefits	1 654	1 130	955
Income tax payable	4 870	1 555	2 382
Total Current Liabilities	27 377	37 854	30 040
Working Capital	(6 843)	(18 487)	(16 448)
Non-Current Assets			
Property, plant and equipment	4 803	5 126	6 022
Intangibles	16 122	17 171	14 358
Investments	100	3 980	4 950
Deferred tax assets	1 228	1 172	340
Total Non-Current Assets	22 254	27 449	25 670
Non-Current Liabilities			
Employee benefits	309	398	307
Other liabilities	15	24	21
Total Non-Current Liabilities	324	422	328
Net Assets	15 087	8 540	8 894
Equity			
Retained earnings	14 782	8 235	8 590
Asset revaluation reserve	305	305	304
Total Equity	15 087	8 540	8 894

Comment

At 26 March 2012, TOTE's Equity totalled \$15.087m, an increase of \$6.547m on 2011. The increase primarily reflected the Net Profit, \$6.552m, as no dividends were paid during the period.

The corresponding growth in Net Assets related to:

- higher Other current assets, \$1.207m, mainly due to prepaid licensing fees which are paid in advance at the beginning of financial year
- lower Payables, \$2.481m, as TOTE paid creditors prior to the completion of the sale
- decreased Borrowings, \$10m, discussed previously
- lower Telephone betting deposits, \$1.842m, due to the loss of some clients following the announcement of the sale
- increased Employee benefits, \$0.435m, primarily reflecting the decrease in the qualifying period for long service leave from 15 years to ten years and the reassessment of probability factors
- higher Income tax payable, \$3.315m, which correlated with the increased profit for the period
- lower Intangibles, \$1.049m, being the net effect of write-offs of discontinued projects and amortisation expense, partly offset by capitalised cost incurred during the period on capital projects
- lower Investments, \$3.880m, following the write-down of TOTE's investment in Sports Alive to nil.

Statement of Cash Flows

	Period to	12-Month period	12-Month period
	26 March 2012	2010–11	2009–10
	\$'000s	\$'000s	\$'000s
Receipts from customers and other TABs	281 404	385 311	336 035
Payments to customers	(191 680)	(282 625)	(239 829)
Payments to suppliers and employees	(87 113)	(101 977)	(86 291)
GST receipt	0	5 041	5 472
Income tax paid	(2 414)	(2 967)	(3 522)
Borrowing costs	(498)	(951)	(453)
Interest received	555	632	404
Other receipts	1 467	1 974	4 304
GST refund	15 397	0	0
Cash from operations	17 119	4 438	16 120
Payments for assets	(7 393)	(8 367)	(5 664)
Proceeds from sale of assets	1	4 756	0
Investment in associate	0	0	(5 100)
Cash (used in) investing activities	(7 391)	(3 611)	(10 764)
Proceeds from (payments for) borrowing	(10 000)	4 000	10 000
Payments to Tasracing	0	0	(5 126)
Dividends paid	0	(3 495)	(3 000)
Cash from (used in) financing activities	(10 000)	505	1 874
Net increase (decrease) in cash	(273)	1 332	7 230
Cash at the beginning of the period	11 633	10 300	3 071
Cash at end of the period	11 360	11 633	10 300

Comment

During the period ended 26 March 2012 Cash decreased marginally by \$0.273m to \$11.360m. The cash flow in the current period was significantly affected by the GST refund of \$15.397m and the subsequent repayment of the Company's loan. Other movements in individual line items reflected comments made in other sections of this Chapter.

Financial analysis

		Period to	12-Month	12-Month
	Bench	26 March 2012	2010–11	2009–10
	Mark			
Financial Performance				
Net Profit (Loss) (\$'000s)		6 552	3 141	6 990
EBIT (\$'000s)		6 284	2 506	15 641
EBITDA (\$'000s)		9 519	7 909	18 909
Operating margin	>1.0	1.01	1.00	1.02
Return on assets		14.0%	5.8%	47.3%
Return on equity		55.5%	36.0%	78.6%
Returns to Government				
Dividends paid (\$'000s)		0	3 495	3 000
Income tax paid (\$'000s)		2 414	2 967	3 523
Total return to the State (\$'000s)		2 414	6 462	6 523
Dividends paid or payable (\$'000s)		0	0	6 495
Dividend payout ratio	50%	0%	0%	93%
Dividend to equity ratio	6%	0%	0%	73%

Comment

Financial Performance measures showed a decline in operating results in 2010–11 as indicated by weakening Net Profit after tax, Earnings before interest and tax (EBIT) and Earnings before interest, tax, depreciation and amortisation (EBITDA) and Return on assets. This decline was caused by a number of factors including:

- increased competition, which led to profit margins being eroded with payments of rebates and commission to attract or retain lucrative customers
- relatively higher increases in both Wagering and pooling fees and Racefield fees
- increases in salary related costs and more aggressive asset amortisation policies.

TOTE's Financial Performance measures improved in the period under review. However, one-off transactions, such as the GST refund, changes to long service leave or costs incurred in relation to the sale, and the seasonal nature of TOTE's revenues, make comparisons of financial performance to previous years difficult.

Overall, TOTE returned \$18.077m (as per the above table plus income tax of \$2.678m in 2008–09) to the State in the form of dividends and income tax equivalents since the separation of the racing and wagering components of the business on 1 January 2009. During the same period, the Company paid \$5.126m to Tasracing Pty Ltd and \$18.802m in 2008–09 to the former Tasmanian Racing Board.

Audit Mandate and Standards Applied

MANDATE

Section 23 of the *Audit Act 2008* states that the Auditor-General may at any time carry out an examination or investigation for one or more of the following purposes:

- "(a) Examine the accounting and financial management information systems of the Treasurer, a statement or subsidiary of a State entity to determine their effectiveness in achieving or monitoring program results;
- (b) Investigating any matter to the account of the Treasurer, a State entity or a subsidiary of a State entity;
- (c) Investigating any matter relating to public money or other money, or to public property or other property;
- (d) Examining the compliance of a State entity or a subsidiary of a State entity with written laws or its own internal policies;"

The conduct of such audits is often referred to as compliance auditing.

- "(e) Examining the efficiency, effectiveness and economy with which a related entity of a State entity performs functions -
 - i) on behalf of the State entity;
 - ii) partnership or jointly with the State entity; or
 - iii) as the delegate or agent of the State entity."

The conduct of such audits is often referred to as performance auditing.

STANDARDS APPLIED

This audit was performed in accordance with Standard on Assurance Engagements ASAE 3500, 'Performance Engagements', which states that:

'The objective of a performance engagement is to enable the assurance practitioner to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party by reporting on assertions, or information obtained directly, concerning the economy, efficiency or effectiveness of an activity against identified criteria.'

The audit included such tests and other procedures considered necessary in the circumstances.



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