



**Department of the
Premier and Cabinet
Internal Audit**

Advance Queensland Business
Development Fund Process
Internal Audit Regarding
Fortress Capstone Pty Ltd

August 2019

Private and confidential

30 August 2019

Dave Stewart
Director-General
Department of the Premier and Cabinet

Advance Queensland Business Development Fund Process Internal Audit Regarding Fortress Capstone Pty Ltd

Dear Dave

We are pleased to advise you that we have completed our internal audit of the Advance Queensland Business Development Fund process regarding Fortress Capstone Pty Ltd for the Department of the Premier and Cabinet (DPC).

The internal audit was performed in accordance with the Terms of Reference of 1 August 2019 and our procedures were limited to those described therein. General terms are covered by our engagement letter.

Our attached report provides:

- ▶ An overview of the objective, scope and approach of the engagement.
- ▶ A summary of results for each scope area.

We would like to acknowledge and thank the DPC, the Office of the Premier, and Queensland Investment Corporation (QIC) staff and management for their cooperation during this engagement.

Yours sincerely



Ernst & Young

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Inherent limitations

Due to the inherent limitations of any internal control structure, it is possible that fraud, error or non-compliance with laws and regulations may occur and not be detected. Further, the internal control structure, within which the control procedures that have been subject to internal audit operate, has not been reviewed in its entirety and, therefore, no opinion or view is expressed as to its effectiveness of the greater internal control structure. An internal audit is not designed to detect all weaknesses in control procedures as it is not performed continuously throughout the period and the tests performed on the control procedures are on a sample basis. Any projection of the evaluation of control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.

We believe that the statements made in this report are accurate, but no warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by Queensland Investment Corporation, the Office of the Premier and the Department of the Premier and Cabinet (DPC) management and personnel. We have indicated within this report the sources of the information provided. We have not sought to independently verify those sources unless otherwise noted with the report. We are under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form unless specifically agreed with DPC.

The internal audit findings expressed in this report have been formed on the above basis.

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Ernst & Young was engaged on the instructions of the Department of the Premier and Cabinet ("DPC") to examine the process surrounding the awarding of funding under the Advance Queensland Business Development Fund to Fortress Capstone Pty Ltd, a company associated with the Premier's Chief of Staff, Mr Barbagallo AM.

The results of Ernst & Young's work, including the assumptions and qualifications made in preparing the report, are set out in Ernst & Young's report dated 30 August 2019 ("**Report**"). The Report should be read in its entirety including any disclaimers and attachments, the applicable scope of the work and any limitations. A reference to the Report includes any part of the Report. No further work has been undertaken by Ernst & Young since the date of the Report to update it.

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Section 1

Executive Summary



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Executive Summary

1.1 Background

During the Premier's portfolio Estimates Hearing on 23 July 2019, the Premier committed that an audit would be undertaken to examine the process surrounding the awarding of funding under the Advance Queensland Business Development Fund (the "Fund" or "BDF") to Fortress Capstone Pty Ltd (Fortress Capstone), a company associated with the Premier's Chief of Staff, Mr David Barbagallo AM (Chief of Staff).

On 25 July 2019, the Premier wrote to the Acting Director-General, Department of the Premier and Cabinet, to formally request the audit. Accordingly, the Acting Director-General commissioned the Department's internal auditor, Ernst and Young, to undertake this engagement.

1.2 Scope

The scope of this engagement was an independent review of:

1. The chronology and decision-making process for the investment made by the Business Development Fund in relation to Fortress Capstone Pty Ltd, including:
 - The assessment and approval of funding in line with documented processes (including but not limited to):
 - Receipt of funding application by the fund
 - Assessment of the application in line with prescribed criteria
 - Approval process for awarding the funds.
 - Management of potential conflicts of interest throughout the application process.
2. Compliance with *the Ministerial and Other Office Holder Staff Act 2010* (Act) and Ministerial Handbook in relation to the declaration of interests and disclosure of conflicts of interest processes specifically in relation to Fortress Capstone Pty Ltd.

This internal audit considered the period from the appointment of the Chief of Staff on 15 May 2017 to the Premier's portfolio Estimates hearing on 23 July 2019.

1.3 Limitations of Scope

The following was not included in the scope of this engagement:

- Any other applications or funds awarded by the Fund, other than that awarded to Fortress Capstone Pty Ltd on 11 August 2017, as outlined in the scope.
- The merits of the investment decision made by the Fund in relation to the application by Fortress Capstone Pty Ltd.
- Disclosures of conflicts of interest other than those related to Fortress Capstone Pty Ltd.

The work we performed did not constitute an external audit or review in accordance with standards which apply to external auditing and accordingly does not express any form of assurance under those standards. Our work was performed in line with EY standards of internal audit which comply with International Standards for the Professional Practice of Internal Audit.

Additionally, the scope of our work did not constitute an investigation, nor a legal review and we do not provide a legal opinion on any matter, including the interpretation of Act requirements.



Executive Summary

1.3 Summary of observations

Please refer to section 2 for detailed results.

The Advance Queensland Business Development Fund investment process is administered by the Queensland Investment Corporation (QIC) on behalf of the Queensland Government. It is defined by the Advance Queensland Business Development Governance Framework ("Framework"). We observed evidence to support the application of the framework in key areas, including:

- The Investment Panel approved the shortlisting of the application.
- High-level due diligence checks were performed on Fortress Capstone Directors.
- Minutes of the Investment Panel pitch presentation recorded that:
 - a presentation was made by representatives of the Fortress Capstone application (and did not include the Chief of Staff)
 - the Investment Panel advised that they did not have any conflict of interests
 - the Investment Panel approved the investment in Fortress Capstone

Evidence was not available however to support application of all elements of the framework or disclosure of conflict of interest, such as:

- Assessment of the application's eligibility for shortlisting against the criteria was not formally documented. QIC advised that the Fortress Capstone application was reviewed to confirm that it met the key criteria prior to circulation to the Panel seeking approval for shortlisting.
- Actual or potential conflict of interest (or absence of conflicts) were not documented or disclosed:
 - by the applicant as part of the application process (not a requirement of the framework)
 - by the QIC team members analysing the eligibility of the application for shortlisting (not a requirement of the framework)
 - by Investment Panel members in the approval of the application shortlisting stage, as they did not declare they were explicitly free from conflicts of interest.

The Act, Ministerial Handbook and Directive 2014/01 are applicable to all Ministerial Staff Members. In respect of conflicts of interest disclosures by the Chief of Staff under the Act, Handbook and related Directives, we observed evidence to support:

- Declaration of interests by the Chief of Staff, within required timeframes, on commencement and annually thereafter.
- The Chief of Staff did not participate in the application to the Fund according to the meeting minutes for the pitch presentation and a Statutory Declaration signed by the Chief Executive Office (CEO) of Fortress Capstone.

We did not obtain evidence to support application of all elements of the Act, Handbook and Directives:

- Whilst we were advised that the declaration of interest forms were received and filed securely in the Premier's Office, a formal record of lodgement of the forms was not evidenced, nor the Premier's sign-off of the declaration forms.
- There was no evidence of formal declaration by the Chief of Staff of:
 - A change in interest in his investment in Fortress Capstone in July 2017 (an additional investment of \$99,975, which equates to approximately 0.6% change in proportion of shareholding individually and jointly through a trust). "Significant" changes require disclosure, however what constitutes a significant change is not defined. The Chief of Staff advised that this was the sixth round of capital raising for Fortress Capstone, and that he had committed to the additional investment prior to joining the Premier's Office.
 - The application and award of the Fund to Fortress Capstone. The Chief of Staff did send a letter to the Integrity Commissioner on 28 February 2018 (the date the Shareholder's Agreement was executed with the Fund) seeking advice about the potential conflict.

We recommend that greater formality is applied:

- To the documentation of key processes, including conflict processes, in the Fund; and
- To the lodgement, sign-off and communication of interests, and changes in interests, including clarification of what constitutes a significant change.



2. Detailed Results

Scope Area 1. The chronology and decision-making process for the investment made by the Business Development Fund in relation to Fortress Capstone Pty Ltd

Background

The Queensland Government appointed the QIC to administer the Advance Queensland Business Development Fund on its behalf. QIC's role is to provide administrative and secretariat support. In addition to this, an Investment Panel ("Panel"), responsible for assessing investment applications submitted to the Fund, and for making investment decisions for execution by QIC, was appointed by the Queensland Government. The Advance Queensland Business Development Fund invests alongside a co-investor from the private sector. The Advance Queensland Business Development Fund investment process is defined by the Advance Queensland Business Development Governance Framework ("Framework").

In the case of Fortress Capstone Pty Ltd, the co-investor was a syndicate. The lead investor of the syndicate was ACAC Innovation Pty Ltd, represented by its Director. Other Fortress Capstone Pty Ltd shareholders, including the Chief of Staff, were listed as additional investors on the co-investment application submitted to the Fund on 20 July 2017. The purpose of the application to the Fund was to obtain investment to assist in the enhancement and growth of the Cruise Traka smartphone-based solution (owned by Fortress Capstone). The Cruise Traka is used by passengers to share their cruise experience with family and friends.

Refer to Appendix A for a summary of the investment process. Appendix B summarises the chronology of the investment process.

Observations

Application of the Framework was demonstrated through:

- All sections of the application form were completed, including the list of investors and supporting financial and capital structure documentation.
- Evidence of background checks (Australian Criminal History, Bankruptcy and Global Media Checks) on the Fortress Capstone Directors, was observed. Additionally, an ASIC search was performed on Fortress Capstone as part of the due diligence process.
- The application was sent to the Investment Panel seeking approval to shortlist and any conflict declarations, via circular resolution. A majority (seven of eight) of panel members approved the shortlisting to evaluation stage. No conflicts of interest were disclosed as part of the responses.
- The shortlisting was communicated to the syndicate and Investment Panel meeting minutes record that the lead co-investor and Chief Executive Officer (CEO) of Fortress Capstone presented to the Panel. Minutes also record that no conflicts of interest were declared.
- The investment of \$267,500 in Fortress Capstone Pty Ltd was approved by the Panel, noting that this was half of the amount requested, subject to the review of the Term Sheet and adjustment to incorporate mandatory terms and the completion of due diligence and background checks.
- The Term Sheet was signed and transaction documents (Subscription and Shareholders agreements) were executed by the relevant parties (Fortress Capstone Pty Ltd, Advance Queensland Business Development Fund, Co-Investor, and Founder of Fortress Capstone Pty Ltd).
- The Authority to Invest document to the value of \$267,890, signed by three QIC signatories was observed. This represents approval for payment of funds only. The \$390 difference from the approved value was explained.
- QIC notified Queensland Treasury of the execution of the investment.



2. Detailed Results

Scope Area 1. The chronology and decision-making process for the investment made by the Business Development Fund in relation to Fortress Capstone Pty Ltd (cont.)

Observations continued

Evidence was not available to support application of all elements of the framework or disclosure of conflicts of interest, specifically:

- The application was not submitted via the on-line process, rather emailed to 'BusinessDevFundApplications@qic.com' on 20 July 2017. It was explained that email submission in this form is accepted by the Fund and is a common format for submission.
- The application listed the Chief of Staff as a co-investor, but did not explicitly disclose his role in Queensland Government or any potential conflict. This was not a specific requirement of the framework. The role of the Chief of Staff was disclosed in the presentation at the pitch meeting, on 11 August 2017. Furthermore, the Chief of Staff advised QIC of his role on 3 October 2017 during the due diligence process.
- Documented evidence of assessment of the application against the eligibility criteria was not observed. Enquiry with QIC representatives noted there were no standard forms/documentation for recording the review of applications at the time of the Fortress Capstone application. QIC advised that the Fortress Capstone application was reviewed to confirm that it met the key criteria prior to circulation to the Panel seeking approval for shortlisting. QIC also advised that a Business Development Fund Investment Checklist has since been developed.
- While all QIC staff are subject to a Code of Conduct which includes conflicts of interest, the framework does not require a specific conflict declaration for each applicant to the Fund by the staff who perform the assessment of eligibility for shortlisting. QIC explained that employees are required to lodge a Conflict of Interest Notice (COIN) internally when making investments generally. QIC advised that no COINs were lodged in connection with the Fortress Capstone pre or post the Fund investment as no employees hold interest in the entity.
- Whilst the email communication as part of the shortlisting requested Panel Members to declare any conflict of interests, responses of the seven Panel Members who approved the application to progress to the evaluation stage did not specifically declare they were free from conflicts. Seven panellist participated in the pitch presentation and approval meeting. Minutes record that no conflicts of interest were declared for the Panel in the presentation and approval meeting.



2. Detailed Results

Scope Area 1. The chronology and decision-making process for the investment made by the Business Development Fund in relation to Fortress Capstone Pty Ltd (cont.)

Recommendations

We appreciate that these recommendations pertain to QIC and cannot be actioned directly by DPC. We have included them in this report, such that DPC may consider sharing these with QIC. We recommend:

1. Clarifying the declaration, documentation requirements and mechanism for managing actual or potential conflicts of interest throughout the application and selection process for the Fund, including:
 - ▶ Requirement for applicants to explicitly declare and document actual or potential conflicts
 - ▶ Requirement for QIC staff involved in the process to declare and document actual or potential conflicts (or that they are free from conflicts)
 - ▶ Requirement for Investment Panel members to explicitly declare that they are free from conflicts (where applicable) in the shortlisting process
 - ▶ Establishing a mechanism for conflict management if an actual or perceived risk is identified from any declarations made as part of the process
2. Determine and confirm the documentation requirements for the assessment of application eligibility against key criteria such that evidence is retained to support the process undertaken.
3. Where deviations from the Governance Framework occur, for example, receipt of an application via email rather than on-line, determine the process for assessing and documenting the acceptance (or otherwise) of this deviation.



2. Detailed Results

Scope Area 2. Compliance with the *Ministerial and Other Office Holder Staff Act 2010 (Act)* and Ministerial Handbook in relation to the declaration of interests and disclosure of conflicts of interest processes specifically in relation to Fortress Capstone Pty Ltd.

Background

The Act, Ministerial Handbook and Directive 2014/01 are applicable to all Ministerial Staff Members. Section 24 of the Act and Section 3.4 of the Ministerial Handbook outline requirements for declaring interests, while section 25 of the Act outlines requirements for dealing with conflicts of interest. Directive 2014/01 provides further guidance, including details of the information to be declared and how to identify a conflict of interest.

In addition to this, the Ministerial Handbook has standard forms for use by staff when declaring interests, specifically:

- Declaration of Interest form (F2F1): To be submitted by a staff member within one month of commencing employment as a Ministerial Staff Member, within one month of a change in of the Minister, and whenever there is a change to the Ministerial Staff Member's interests.
- Variation of Declaration of Interest form: To be submitted whenever there is a change to the staff member's interests that is of a type prescribed under Directive 2014/01.
- Annual Review of Declaration of Interests (F2F2) - No Variation form: To be submitted if the annual review of a staff member's Declaration of Interests indicates that no change to the information previously supplied is required.

Appendix B summaries the chronology of the investment process, and shows when forms were submitted by the Premier's Chief of Staff.

Observations

Application of the Act, Ministerial Handbook and Directive was demonstrated through:

- A Declaration of Interest form (F2F1), signed by the Chief of Staff dated 26 May 2017 (within 1 month of starting employment) was sighted. This noted a shareholding in Fortress Capstone Pty Ltd under the "Shareholding in public and private companies" section of the form.
- A Declaration of Interest form annually thereafter signed by the Chief of Staff was sighted (F2F1 on 19 June 2018, and an Annual Review of Declaration of Interest - No Variation form F2F2 on 30 May 2019).
- The Chief of Staff advised that he informed the Fortress Capstone Board that he could not partake in the application process to the Fund for co-funding investment due to possible perception of conflict of interest. A Statutory Declaration, signed by the Chief Executive Officer, Director and Company Secretary of Fortress Capstone (dated 13 August 2019), was provided which notes the Chief of Staff advised at a Board Meeting for Fortress Capstone on 18 July 2017 that he could not participate in the application process for the Fund.
- A copy of a calendar invite between the Chief of Staff and Integrity Commissioner for 20 July 2017 was observed (the Fortress Capstone application was submitted via email on 20 July 2017).
- A letter from the Chief of Staff was sent to the Integrity Commissioner on 28 February 2018 to seek advice about whether a conflict of interest existed in respect of the award of the Advance Queensland Business Development Fund to Fortress Capstone.



2. Detailed Results

Scope Area 2. Compliance with the *Ministerial and Other Office Holder Staff Act 2010 (Act)* and Ministerial Handbook in relation to the declaration of interests and disclosure of conflicts of interest processes specifically in relation to Fortress Capstone Pty Ltd (cont.).

Observations continued

Evidence was not available to support application of all elements of the Act, Ministerial Handbook and Directive, specifically:

- The F2F1 form and F2F2 form (version 3 implemented in April 2014) state it “must be/is to be lodged with your Minister”. While there is no specific method for lodgement specified, a formal record of lodgement (e.g. a register) was not observed. Additionally, there is a requirement in the Directive for the Minister to sign-off on each declaration form. Evidence was not observed to support this sign-off for forms prepared by the Chief of Staff. Furthermore, the Declaration of Interest forms provided as a template in the Appendix of the Ministerial Handbook do not provide a section for the relevant Minister to sign and date as required by the Directive. The Executive Manager, Office of the Premier advised that the Chief of Staff personally submits his completed forms to the Premier and that these forms are provided to the Executive Manager to file securely in the Premier’s Office.
- A change of interest in the number of shares held by the Chief of Staff in Fortress Capstone, during the scope period (31 July 2017), was observed. This was an additional investment of \$99,975, which equates to approximately 0.6% change in proportion of shareholding individually and jointly through a trust. The total individual and joint shareholding after this change in interest was approximately 12%. This resulted in the Chief of Staff acquiring additional shares and seven other shareholders also acquiring additional Fortress Capstone shares. The Act requires changes of interest to be disclosed to the employing member based on the requirements of the Directive. The Directive requires “significant” changes in interest to be disclosed. It is not clear however, from the Act or the Directive, whether a change in interest, as noted above, is “significant” as defined by value, proportion and/or nature of interest. Additionally, the template forms for Declaration of Interest do not require ownership of interest to be detailed (e.g. proportional change, change number of shares, dollar value). The Chief of Staff advised that this was the sixth round of capital raising for Fortress Capstone, and that he had committed to the additional investment prior to joining the Premier’s Office.
- The application and award of the Advance Queensland Business Development Fund to Fortress Capstone may constitute an interest that conflicts or may conflict with the discharge of responsibilities for the Chief of Staff under section 25 of the Act. Even though the Chief of Staff indicated that he advised both the Premier and Director-General DPC at time of application of co-funding, and at the time of the success of the Fortress Capstone Fund application, evidence was not observed to support this communication. There are no standard forms, templates or additional guidance provided by the Ministerial Handbook on the method for reporting and disclosure of conflict of interests under section 25 of the Act.
- The advice sought from the Integrity Commissioner on 28 February 2018 was subsequent to the award of the funding (11 August 2017). The execution of the Shareholder’s Agreement was on 28 February 2018 and the transfer of funds occurred on 8 March 2018. The Integrity Commissioner responded to the Chief of Staff via email on 1 March 2018 requesting additional information. Evidence of further correspondence was not observed.



2. Detailed Results

Scope Area 2. Compliance with the *Ministerial and Other Office Holder Staff Act 2010 (Act)* and Ministerial Handbook in relation to the declaration of interests and disclosure of conflicts of interest processes specifically in relation to Fortress Capstone Pty Ltd (cont.).

Recommendations

Consideration should be given to:

1. Clarifying the process to lodge the Declaration of Interest forms including method, location and recording mechanism.
2. Clarifying what constitutes as “significant” as defined by the Directive in order to declare a change of interest. This could consider:
 - > Value of change
 - > Proportion of change
 - > Nature of interest subject to change.
3. Updating the Declaration of Interest forms (F2F1 and F2F2) to allow for the Minister to sign as per the requirements stipulated in the Directive. In addition, the forms should be structured to enable specification of ownership in shareholdings.
4. Providing clear guidance within the Ministerial Handbook for the process to declare potential, actual and perceived conflicts of interests under s25 of the Act. This should include the method to be used to formally declare and process to record actions directed and taken (if any).



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Appendix A – Investment Process

Figure 1: The investment process from the time of application to the investment stage as outlined in the Advance Queensland Business Development Governance Framework (26 April 2017)*.

1. APPLICATION

- CO-INVESTOR applies on-line.
- QIC reviews application against key criteria.
- QIC performs due diligence on key persons.
- QIC sends eligible applications to PANEL Members.



2. SHORTLISTING

- PANEL Members review applications.
- PANEL Members to advise QIC and/or PANEL of conflicts of interest.
- QIC arranges PANEL meeting for shortlisting.
- PANEL selects applicants to present at investment pitch.
- QIC advises applicants and CO-INVESTOR of progression and sends invitations.



3. EVALUATION

- CO-INVESTOR provides draft Term Sheet with commentary to PANEL.
- CO-INVESTOR and founder present to PANEL at investment pitch.
- PANEL Members declare an intention to invest.
- PANEL deliberates and votes on proposals.
- PANEL notifies QIC of successful applications and offer terms.



4. OFFER

- QIC presents offer to CO-INVESTOR and founder for consideration.
- CO-INVESTOR and founder choose if they will accept offer.
- QIC executes investment documents and makes investment.
- QIC notifies QUEENSLAND GOVERNMENT of executed investment.

* Source: Governance document provided by QIC



Appendix B – Chronology of the decision-making process

May 2017

March 2018

Business Development Fund Process

20 July 2017

Fortress Capstone application submitted to the Fund by lead co-investor, ACAC Innovation Ltd.

24 July 2017

Application sent by QIC to the Investment Panel for shortlisting via circular resolution.

25 July 2017

Seven out of eight Investment Panel members respond to circular resolution submission approving the application to progress to the next stage.

27 July 2017

Lead co-investor and Company (CEO) invited to present to the Investment Panel on 11 August 2017.

11 August 2017

The investment of \$267,500 in Fortress Capstone approved by the Panel, noting that this was half of the amount requested.

12 August 2017

ASIC search for Fortress Capstone performed.

30 September 2017

Term Sheet executed in full.

11 October 2017 to 31 January 2018*

Background checks on Fortress Capstone Directors completed.

* The background check for one Director was completed on 15 March 2017 as part of another application process.

28 Feb 2018

Investment transaction documents executed in full by the Fund and Transaction Parties.

8 March 2018

Fund's subscription money, of \$267,890, transferred to Fortress Capstone nominated account.

10 March 2018

Queensland Treasury notified of the investment in Fortress Capstone.

Disclosure of interests under the Act, Handbook and Directive

15 May 2017

Chief of Staff commenced employment.

20 July 2017

A copy of a calendar invite between the Chief of Staff and Integrity Commissioner for 20 July 2017 was observed.

31 July 2017

The Chief of Staff acquired additional shares in Fortress Capstone resulting in an increase of approximately 0.6% in the proportion of shareholding held individually and jointly through a trust. The total individual and joint shareholding after this change in interest was approximately 12%. Other members of the co-investment syndicate also increased shareholding to meet the Fund's co-investment requirements.

28 February 2018

Chief of Staff sent a letter to the Integrity Commissioner to seek advice in relation to whether a conflict of interest existed in respect of the award of the Advance Queensland Business Development Fund to Fortress Capstone

26 May 2017

Chief of Staff completed and signed the Declaration of Interest form. The investment in Fortress Capstone was included in the "Public and private companies" section of the form.

Chief of Staff completed and signed a Declaration of Interest form yearly thereafter (F2F1 on 19 June 2018, and an Annual Review of Declaration of Interest - No Variation form F2F2 on 30 May 2019).

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