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**Accountability for Risk in a
Contestable Environment**

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ACCOUNTABILITY FOR RISK IN A CONTESTABLE ENVIRONMENT

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**1999 DEPARTMENT OF EMPLOYMENT, TRAINING & INDUSTRIAL
RELATIONS BIENNIAL RISK MANAGEMENT CONFERENCE
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I. INTRODUCTION

Thank you for inviting me to speak today at this conference on the subject of risk management in a contestable environment. I welcome the opportunity to engage in public discussion about a significant issue both for management and auditors. Risk is a challenge whether it be an opportunity or a hazard. Therefore it has to be confronted, not ignored, as part of performance management and the control environment.

Dealing with risk is often like venturing into the unknown. Quite often we need to observe the experience and results of others to help us in developing our own approach. The ANAO better practice guides are one important source of ideas on a range of such public management issues confronting all of us. Conferences, seminars and workshops such as this, provide another opportunity for mutually beneficial exchanges and, I rather hope, help to improve performance generally across the public sector.

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I contend that public sector managers, at all levels, have to deal with a different nature and level of risks in the more contestable environment confronting most of us than they have had to do in the past. The new challenges are market-testing, competitive tendering and contracting out, all of which may be considered to present opportunities for, as well as risks to, a public service which has traditionally said to be risk averse. These new elements are central to improved business performance and accountability in the current program of reforms to the public sector. While I will be largely canvassing issues bearing on this changing risk profile, I will also draw on some of the initiatives the ANAO is taking to enhance risk management practices and improve accountability within the context of the environment described above.

At the risk of stating the obvious, we need to recognise that we operate, first and foremost, in a political climate which is values-oriented as witnessed by constant references to the 'public interest' which has always been difficult to define or measure in any generally agreed fashion, except that it is 'real.' Professor Owen Hughes reminds us that:

'The business of government is embedded in politics'.

Hughes Owen E. 1998, *'Public Management and Administration - An Introduction'*, Second Edition, Macmillan Education Australia, Melbourne, p. 225. Hughes Owen E. 1998, *'Public Management and Administration - An Introduction'*. Second Edition, Macmillan Education Australia, Melbourne (page 225).

Although I will be referring to the convergence, or reconvergence, of the public and private sectors and the way in which that focuses the mind on the distinguishing features of the two sectors, public servants, at least, understand the pervasive and often decisive influence of 'politics' as opposed to 'markets' both on public policy and administration. This is a reality we as public servants should never ignore. That reality is reflected in a definition of responsible risk taking as:

'... innovative management efforts that are guided by commitment to ethics and by respect for democratic processes and legal responsibilities.' Berman Evan M and West Jonathan P. 1998. *'Responsible Risk-Taking'*. Public Administration Review, Vol.58, No.4, July/August, p.346.

Lord Nolan has raised the question as to whether there is a danger in today's public service environment that ethical rules are seen as an:

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'... unnecessary bureaucratic burden rather than a signpost to the highest behaviour in the public service.' Nolan Michael, Lord 1998. *'Just and Honest Government'*. Keynote address to the CAPAM Biennial Conference, Malaysia, July, p.3.

The major question about the exercise of risk management in a more contestable environment is who is accountable for what? Again, quoting Professor Hughes:

'It is accountability which is fundamental to a democratic system'. Op.cit., Hughes Owen E. p.225.Ibid, (page 225).

The concept of accountability is not exclusive to the public sector. No one doubts, for example, that the boards of private sector corporations are accountable to their shareholders who want a return on their investment. It is the nature and extent of that accountability which public sector commentators would contend distinguishes the two sectors. The provision of public services is not just about the lowest price, it involves maximising overall value for money for the taxpayer. Issues other than production costs, such as citizen satisfaction, the public interest, privacy and equity must be considered.

Nevertheless, even traditional elements of what might be termed 'public accountability', such as values and ethics, fair and equitable treatment, the environment and community welfare, are being addressed by private sector boards and executives as part of their business strategy to be seen, and accepted, as 'good corporate citizens'. For example, the giant US Corporation General Electric (GE) as part of its management reporting, states that:

'GE is dedicated to the highest standards of integrity, ethics, and social responsibility. This dedication is reflected in written policy statements covering, among other subjects, environmental protection, potentially conflicting outside interests of employees, compliance with antitrust laws, proper business practices and adherence to the highest standards of conduct and practices in transactions with the U.S. government'.

Quoted in Root Steven J. 1998, *'Beyond COSO - Internal Control to Enhance Corporate Governance'*, John Wiley & Sons, Inc., New York, p. 294. Quoted in Root Steven J. 1998. *'Beyond COSO - Internal Control to Enhance Corporate Governance'*. John Wiley & Sons, Inc. New York (page 294). But there are trade-offs. Put bluntly, what is the price of such accountability and what impact does it have on the 'bottom line'? The commitment referred to here is more than simply about creating 'image' or 'marketing' the corporation.

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That brings me to the nub of this address which is about being accountable for our performance, including the management of risks to achieve required results, in an environment where there is fundamental questioning of what government does, or should do, and how public services should be delivered. Allied to this is a perception that government, because of its monopoly and other constraints of public sector administration, delivers inefficient (more costly) and ineffective (poor quality) public services. Put simply, the prevailing view would seem to be that public services can be provided more efficiently and effectively, with greater client satisfaction, in a more market-oriented environment which offers greater flexibility for management decision-making and the discipline of competition. Indeed, history shows varying support for the latter view but with reservations, for example, about market imperfections and public goods arguments - using economic (rationalist) terms.

But, interesting as the latter discussion might be, my focus today is on the exercise of risk management in the changing accountability framework that is developing within the Australian Public Service (APS) with greater privatisation and commercialisation of the public sector, and the increasing involvement of the private sector in the provision of public services (sometimes in competition with the public sector). We are seeing a growing adoption or adaptation of private sector approaches, methods and techniques in public service delivery. Consequently, there is an issue of trade-offs between the nature and level of accountability and private sector cost efficiency, particularly in the delivery of public services and in the accountability regime itself.

The genesis of this latter issue may be seen in the debate about accountability issues canvassed in the then Management Advisory Board/Management Improvement Advisory Committee (MAB/MIAC) Report No.5 of June 1991. MAB/MIAC 1991, *'Accountability in the Commonwealth Public Sector - An Exposure Draft'*, AGPS, Canberra, June. MAB/MIAC 1991. *'Accountability in the Commonwealth Public Sector - An Exposure Draft'*. AGPS, Canberra, June. This was subsequently followed up by what has become the definitive text on *'Accountability in the Commonwealth Public Sector'* in MAB/MIAC's report No.11 of June 1993. MAB/MIAC 1993, *'Accountability in the Commonwealth Public Sector'*, AGPS, Canberra, June. MAB/MIAC 1993. *'Accountability in the Commonwealth Public Sector'*. AGPS, Canberra, June. The Management Advisory Board's foreword describes this "as a summary statement of the main principles and practices in the last decade of the 20th century, which will assist evaluation and understanding by officials of the central role of accountability in their working lives." However, the real issue was plainly stated by Professor Richard Mulgan in an article *'Contracting Out and Accountability'* in December 1997. Mulgan Richard 1997, *'Contracting Out and Accountability'*, Australian Journal of Public Administration, Vol. 56, No. 4, December, pp. 106-

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116. Mulgan Richard 1997. 'Contracting Out and Accountability'. Australian Journal of Public Administration. Vol.56, No.4 December, (pages 106-116). building on an earlier article entitled 'The Processes of Public Accountability' Mulgan Richard 1997, *The Process of Public Accountability*, Australian Journal of Public Administration, Vol. 56, No. 1, March, pp. 25-36. Mulgan Richard 1997. 'The Processes of Public Accountability'. Australian Journal of Public Administration. Vol.56, No.1, March (pages 25-36), as follows:

'... some aspects of accountability are inevitably reduced under contracting out...contracting out, at best involves a trade-off between efficiency and accountability. Denials of such a trade-off are fallacious rhetoric.' Op.cit., Mulgan 1997, *'Contracting Out and Accountability'*, p. 106. Op.cit., Mulgan Richard 1997, *'Contracting Out and Accountability'*. (page 106).

Within the foregoing perspective, I will deal with my topic in three parts. First, I will discuss some of the issues bearing on the perceived accountability/efficiency trade-offs and particular accountability elements which might require change of either, or both, the public/private sectors. The notion of "efficiency" used here is mainly about market price which does not include any provision for public sector accountability requirements. However, the latter usually involves a cost which cannot be ignored. Pearson Des 1999, *'The Cost of Accountability - Getting the Balance Right'*, Presentation to the Australasian Council of Public Accounts Committees, Fremantle, 21-23 February. Pearson Des 1999, *'The Cost of Accountability - Getting the Balance Right'*. Presentation to the Australasian Council of Public Accounts Committees, Fremantle, 21-23 February. That cost might broadly be encapsulated in the often difficult to define 'public interest'.

I will focus mainly on budget-dependent agencies and statutory bodies but observe that the general argument also applies to a degree to Government Business Enterprises (GBEs) that generate their own revenue, including where partially privatised. My perspective will be from the Federal level of government, although I contend that we are increasingly sharing similar challenges to those at State and local government levels.

The second part of the address looks specifically at risk management in the context of project and contract management involving the private sector. This is a major challenge facing the public sector. The third part looks at how we can be more accountable for managing risks to our performance in a more contestable environment; in other words what we can do to handle the challenge and learn from demonstrated good practice as well as from the mistakes we all make.

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As you know, the tone and direction of any organisation are set within its corporate governance framework covering what we do; how we do it; how we manage ourselves; how we control our environment; how we deliver our services; the values/ethics we set; our relationships and commitments to our clients and other stakeholders; our performance assessment and evaluations; and our monitoring, review and reporting approaches. These are all part of the way we govern ourselves. Therefore any discussion of risk management and accountability has to start from within that framework. Particularly relevant elements are our control structures, incorporating sound risk management which is an increasingly important aspect of our performance and accountability.

Some brief concluding remarks will focus on particular aspects of accountability in the riskier environment facing all of us and stress the real opportunities the converging public and private sectors can provide without understating the many challenges such convergence is presenting to public sector managers in a more contestable environment.

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II. ACCOUNTABILITY AND EFFICIENCY TRADE-OFFS : RAISING THE RISK PROFILE

The APS has been steadily evolving towards a more private sector orientation over the last decade, influenced by the momentum of the National Competition Policy reforms. Independent Commission of Inquiry Into National Competition Policy 1993, '*National Competition Policy - Report to Heads of Australian Governments*', AGPS, Canberra. Independent Commission of Inquiry Into National Competition Policy 1993. '*National Competition Policy - Report to Heads of Australian Governments*' AGPS, Canberra. and the Industry Commission inquiry into competitive tendering and contracting. Industry Commission 1996, '*Competitive Tendering and Contracting By Public Sector Agencies*', AGPS, Melbourne, January. Industry Commission 1996. '*Competitive Tendering and Contracting By Public Sector Agencies*', January. More recently, the Government's acceptance of the basic principles set down by the National Commission of Audit for determining what activities should be undertaken within the public sector has led to an increased focus on privatisation and outsourcing of government services and activities.

National Commission of Audit 1996, '*Report to the Commonwealth Government*', AGPS, Canberra, June. National Commission of Audit 1996. '*Report to the Commonwealth Government*', AGPS, Canberra, June.

The Commission has adopted a framework of principles, cognisant of the broad economic and social goals of government to guide its analysis and recommendations for improvements. This framework includes the following decision sequence:

- Assess whether or not there is a role for government.
- Where there is, decide which level of government, and assess whether or not government objectives are clearly specified and effectively provided.
- Assess whether or not effective activities are being conducted on a 'best practice' basis. p.age vii.

In relation to the last mentioned issue, the Committee found that service delivery systems should be market tested against other systems to fully test their efficiency. This involves public sector managers benchmarking their service delivery methods against best practice, re-engineering the way they do their business and contracting-out functions where it is cost effective to do so. p.age 83.

The Committee recommended that agencies should be required to market test all activities over the next 3 to 5 years unless there is a good reason not to do so (p.age 84). This is now government policy. The Government has made it clear that the challenge of public sector

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reform, including contestability with the private sector, remains both substantial and urgent.

It may be helpful if, at this point, I touch briefly on what is meant by 'contestability.' I would like to draw on some remarks made by my colleague, Dr Allan Hawke, in an address to the ANAO in July 1997, when he observed:

'Contestability for economists means that a market can be subject to competition. While there might be only one supplier, the "barriers to entry" are not so high as to discourage others from trying their hand.'

A more prosaic definition might be a version of the "Yellow Pages" test. If it isn't unreasonable to imagine more than one Yellow Pages entry under a particular service, then there's a good chance that the market can be contested.' Hawke Allan Dr, 1997. *'Future Directions of the APS and the Role of Performance Auditing'*. Address to the ANAO, Canberra, 11 July.

Australia is not alone in adopting this new policy direction. The changes which we are experiencing are consistent with an international move towards a smaller public sector with greater privatisation, including private sector involvement in the delivery of public services. The use of contracting has increased significantly in most OECD countries and is widespread, for example, in the United States (USA) and Canada.

Within Australia, the total value of Commonwealth contracts has been increasing. Between 1992-93 and 1994-5 the total value of contracts nearly doubled to around \$8 billion - some 15 per cent of total Federal expenditure at that time. OECD Public Management Service 1996, as reported in MAB/MIAC Report No.21 1997, *'Before you sign the dotted line...Ensuring Contracts can be Managed'*, AGPS, May, p.63. OECD Public Management Service; (1996), As reported in MAB/MIAC Report No.21 *'Before you sign the dotted line...Ensuring Contracts can be Managed'*, AGPS; May 19 (pa During the same period the total value of State and Territory contracts was estimated at around \$3.3 billion (4 per cent of their total expenditure) and local government contracts at around \$2 billion (some 20 per cent of their total expenditure). This is the latest period for which such information seems to be readily available.

More recently, the Commonwealth has undertaken its most significant outsourcing to date, that of employment services. The creation of the new Job Network has involved contracting out some \$1.7 billion of services

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previously provided by the public sector. It is estimated that the value of the next round of contracts, to commence in February 2000 and run for three years, will be around \$3 billion.

While the increasingly business-like approach of the public sector is welcome, it is important to recognise that the provision of public services involves rather more than achieving the lowest price or concepts of profit or shareholder value. Public service agencies must strive to maximise overall 'value for money' for citizens which, as I have mentioned, requires consideration of issues other than production costs, such as client satisfaction, the public interest, fair play, honesty, justice and equity. It also requires proper accountability for the stewardship of public resources, including asset management and use of techniques such as life-cycle costing, as in the private sector.

The Government is accountable to its citizens for the provision of public services, in at least two interrelated ways. First, it has to ensure that the public sector provides high quality services that are appropriate, effective and equitable, at minimum cost to the taxpayer. This is a major driver behind the Government's policy of 'market testing' public services to improve their effectiveness. However, the Government also has to ensure that the accountability, and therefore transparency, of the public sector in the delivery of these services is maintained, and, indeed I would argue, enhanced over time. It is the balance between these responsibilities that is difficult to achieve. My Office's role is to provide assurance to the Parliament and the people on these two aspects, that is, public sector performance and accountability for that performance.

While the public sector reforms demand a greater focus on achieving efficient and effective outcomes for citizens, we also need to recognise that such outcomes also depend importantly on robust and credible administrative and management processes. Managing the risks associated with the increased involvement of the private sector in the delivery of government services, in particular the delivery of services through contract arrangements, will require the development and/or enhancement of a range of skills across the public sector and will be a key accountability requirement of public sector managers.

The various public sector reforms over the last fifteen years, and particularly the recent changes to financial and industrial legislation, have seen a shift from central agency control to a devolution of authority, with enhanced responsibility and accountability being demanded of public sector agencies and statutory bodies and managers working within these. As you would know, there have been concerns expressed by Parliamentary Committees and by individual parliamentarians in debates about appropriate accountability mechanisms in this era of devolved authority.

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I would suggest that devolution of authority and accountability to agency heads, together with contracting out and contestability, has significantly increased the risk profile of agencies. As agencies increasingly have recourse to contractors, some of whom in turn employ sub-contractors, to perform what were once considered core public sector activities, the 'golden thread' of accountability that binds the APS does become strained. At the very least it engenders a higher level of uncertainty.

The public sector must manage the risks inherent in this new environment if it is to achieve the levels of performance required and satisfy whatever accountability requirements have been determined. More than ever, this situation will require a formal, systematic approach to identifying, managing and monitoring risk. The intuitive, and often reactive, approach to managing risk that has characterised public sector management in the past will not be sufficient. We all know that reacting 'after the horse has bolted' is often quite costly and damaging to the credibility of agencies and Ministers. A more strategic approach is required to stay contestable in such an environment.

The growth of outsourcing

A feature of the changing public sector environment has been the increased emphasis placed on the contestability of service delivery and outsourcing of functions which, it is judged, the private sector can undertake more efficiently. Outsourcing advocates point to the opportunities offered:

- increased flexibility in service delivery;
- greater focus on outputs and outcomes rather than inputs;
- freeing public sector management to focus on higher priorities;
- encouraging suppliers to provide innovative solutions; and
- cost savings in providing services. Op.cit., Industry Commission, 'Competitive Tendering and Contracting by Public Sector Agencies'. Industry Commission 1996, 'Competitive Tendering and Contracting by Public Sector Agencies'.

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However, outsourcing also brings risks. As a number of the ANAO's recent performance audits have identified, a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and associated public concern. For example, in October 1998 I tabled Audit Report No. 10 1998-99, *Sale of One-third of Telstra*. The audit concluded that, as an essential element of the outsourcing of project management for future Commonwealth public share offers, overall value for money could be improved by giving greater emphasis to financial issues when tendering for advisers; encouraging more competitive pressure on selling commissions and fees; paying fees only for services actually provided; and instituting a more effective and commercial approach to administering payment for shares by investors. The main message from this experience is that savings and other benefits do not flow automatically from outsourcing. Indeed, that process, like any other element of the business function, must be well managed. Another lesson that can be drawn from such experience is that:

'... understanding the conditions that create unhealthy levels of risk can go a long way toward preventing failure.'

Simons Robert 1999. *'How Risky is your Company'*.
Harvard Business Review May-June, p.86.

In a more contestable environment, failure does not simply relate to errors of commission which, in the past, have been asserted as the main pre-occupation of the public sector but also to errors of omission which are often less visible but can have a greater impact on performance or results. Such observations have been linked to 'inherent differences' in the ownership of organisations in the public and private sectors. Bozeman Barry and Kingsley Gordon 1998. *'Risk Culture in Public and Private Organisations'*. Public Administration Review, Vol.58, No.2, March/April, p.111.

The growth of outsourcing, and other new ways of delivering public services, do not obviate or limit the need for accountability to stakeholders. Less direct relationships through the introduction of a new player in the accountability chain - the private sector service provider - and greater decision-making flexibility strengthen that need. On this issue, another observation by Professor Mulgan continues the theme of an earlier quote:

'Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out because the main increases in efficiency come from the greater freedom allowed to contracting providers. Accountability is also likely to be

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reduced through the reduced availability of citizen redress under such instruments as the Ombudsman and FOI. At the same time, accountability may on occasion be increased through improved departmental and Ministerial control following from greater clarification of objectives and specification of standards. Providers may also become more responsive to public needs through the forces of market competition. Potential losses (and gains) in accountability need to be balanced against potential efficiency gains in each case.' Mulgan Richard 1997, 'Contracting Out and Accountability', Discussion Paper 51, Graduate Public Policy Program, Australian National University, Abstract. Mulgan Richard, (1997); 'Contracting Out and Accountability'; Discussion Paper 51; Graduate Public Policy Program, Australian National University. (see Abstract).

Optimising the trade-off between accountability and a lower market-oriented price requires senior public service managers to ensure they are not risking the efficiency and effectiveness of their core functions by ill considered, *ad hoc*, outsourcing, the effects of which may not be confined to the particular services or activities being outsourced. To do this, *ex-ante* strategic examination of which activities should continue to be provided by the public sector (core business) and which to outsource (non-core business) is essential. This is consistent with the broad framework of principles canvassed by the National Audit Commission referred to earlier. It is also consistent with the generally held view in the public and private sectors that outsourcing is a cost-effective way to make better strategic use of non-core business functions. Tran Minh (Senior Analyst - Gartner Group) 1999. 'Outsourcing can refocus a business', The Australian, 1 June, p.2.

To maximise overall value for money, it is important that the above assessment take place in the context of the total business of the organisation in order to manage the risk that, by considering outsourcing individual activities in isolation, counter-productive and costly outcomes may result from outsourcing in the medium to longer term. In this respect, attention should also be given to the effect of outsourcing on related activities which may be delivered through another public sector agency, for example, through Centrelink, the Commonwealth's one-stop shop.

A further important consideration is how this trade-off between accountability and efficiency might change in relation to core and non-core Government activities. For example, a greater level of accountability may be demanded for certain activities, as they are determined to be more important to the public interest and/or politically sensitive. Indeed, this consideration may well provide the case for maintaining current arrangements, rather than contracting out their delivery to the private

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sector. Prime Minister Howard has offered the following list of those activities that he considers fall within this realm:

'Defence, justice, a social security safety net, the monitoring of outcomes of, and alternatives to, existing policies - all these will require public service output. And there will always be a real need for high quality economic, constitutional and other policy advice.' Howard J., 1997, *'The Sir Robert Garran Oration'*, National Conference of the Institute of Public Administration Australia, September, as cited in Davis Glyn and Wood Terry, 1998, *'Is there a Future for Contracting in the Australian Public Sector?'*, Australian Journal of Public Administration, Vol. 57, No. 4, December, p.95.

The conundrum was expressed another way late last year by Jonathan Boston in terms of the much talked about 'New Zealand Model' as follows:

'The Model has not, for instance, generated a new or enduring consensus on the proper boundary between the public and private sectors, whether with respect to funding or provision.'

Boston Jonathan 1998. *'Public Sector Management, Electoral Reform and the Future of the Contract State in New Zealand'*. Australian Journal of Public Administration. Vol.57, No.4, December, p.42.

In recent times, however, Government activities that might in the past have been considered core functions, such as delivery of services to the unemployed, have been subject to contestability and contracted out to the private sector. The challenge remains, as Professor Mulgan suggests, to maintain an appropriate level of accountability for the effective delivery of these services, whilst maximising the potential efficiency gains available through such arrangements. The Canadian Auditor-General has recently expressed the point succinctly as follows:

'The emphasis should not be solely on greater efficiency or on meeting accountability requirements'.

Desautels L. Denis 1999. *'Accountability for alternative Service Delivery Arrangements in the Federal Government'*. Address to the Institute of Public Administration Conference on Collaborative Government, Ottawa, 22 April, p. 9

The essential issue, as it often is in public administration, is to achieve an appropriate balance which can vary in differing circumstances. Achieving such a balance becomes even more of an imperative when the converging, or reconverging, private and public sectors not only focus on

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the similarities of issues and even responses that confront managers, but more sharply contrasts differences between the two sectors. Nowhere is this more evident, for example, than in workplace relations where the greater flexibility being provided by legislation has made public sector managers more conscious not only of constraints in public employment but also of their responsibilities to their staff in outsourcing situations. In short, the risk profile - including any possible trade-offs - is far more confronting in the more contestable environment.

Although the public sector may contract out service delivery, this does not equate to contracting out the responsibility for the delivery of the service or program. It is the responsibility of the agency and agency management to ensure that the government's objectives are delivered in a cost-effective manner. The agency must therefore specify in the contract the necessary level of service delivery and required quantitative and qualitative service standards and measures. It must also ensure that an adequate level of monitoring of service delivery under the contract is undertaken as part of the agency's contract administration and in line with its broader service delivery responsibilities, such as might be set out in a Client Service Charter. The inclusion of access provisions within the contract for performance and financial auditing, as well as for sound management, is also very important in maintaining the necessary thread of accountability.

Last year I drew attention to the need for standard contracts negotiated with suppliers to the Commonwealth to make provision for access to the suppliers' records both by the purchasing agency and my office. The ANAO has drafted model access clauses (reflecting the provisions of the *Auditor-General's Act 1997*) which have been circulated to agencies for insertion in contracts; these clauses give the agency and ANAO access to contractors' premises and the right to inspect and copy documentation and records associated with the contract.

The clauses are not necessary to provide me with access to information as such, but they are important in flagging to contractors that they must give full access to the Auditor-General for proper accountability. In my view it is a matter of educating both parties, whether public or private sector, to the requirements of a successful relationship or contract. Vague relationships do not assist either party; nor do they lend confidence to the partnership or use of contractual arrangements. Such accountability is an aspect of the public sector environment with which the private sector is becoming more familiar as outsourcing develops further.

Quite recently, the Joint Committee of Public Accounts and Audit (JCPAA) recommended legislative provision:

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'... to enable the Auditor-General to access premises of a contractor for the purpose of inspecting and copying documentation and records directly related to a Commonwealth contract, and to inspect any Commonwealth assets held on the premises of the contractor, where such access is, in the opinion of the Auditor-General, required to assist in the performance of an Auditor-General function.' Joint Committee of Public Accounts and Audit (JCPAA) 1999. *'Review of Audit Report No.34, 1997-98 - New Submarine Project - Department of Defence'*. Report 368, Commonwealth of Australia, Canberra, June p.xiv.

This comment was made in relation to a review of an Audit Report on the New Submarine Project. The Department of Defence disagreed with an ANAO recommendation for such access as unwarranted and not agreed by Parliament. Defence also claimed that their contracts already provide for adequate Commonwealth access for management of contracts. The Committee rejected this claim. A Deputy Secretary of the Department also argued that:

'I believe that will raise Defence's net costs of doing business because people will be more risk averse; and we will pay for that.' Joint Committee of Public Accounts and Audit (JCPAA) 1999. *'Reference : Review of Auditor-General's reports, Second Quarter 1997-98'*, Official Committee Hansard, Commonwealth of Australia, Canberra, 5 March p. PA 110.

Interestingly, the Committee not only disagreed with that view but also were concerned that:

'... some agencies may see a benefit in the reduced accountability that can occur when services are outsourced to the private sector.' Op.cit., JCPAA 1999. Report 368, p.42, para 6.16.

And that:

'... from time to time, agencies are not as cooperative as they could be in assisting the Auditor-general to access contractors' information and records.' Ibid., p.43, para 6.19.

Risks to Audit from Privatisation

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In speaking to you on this subject I should not overlook the experience of my own agency which has been very much caught up in the issues I address with increased exposure to risk. In the last ten years there has been an increased focus on privatisation of government business entities, with more than \$32 billion raised by the Commonwealth over this time. Privatisation also provides an opportunity to transfer risks formerly carried by the Commonwealth to the private sector and has been argued to offer the potential for improved business efficiency.

Privatisation, whether by trade or public share offer, has always impacted on the ANAO's financial statement business through our participation in the activities associated with the due diligence program, which provides the necessary assurance about the accuracy and completeness of information provided to prospective purchasers by the Commonwealth. Information disclosed to potential purchasers typically includes financial performance data for a five year period and the most recent audited financial statements, which emphasises the importance of comprehensive and sound financial statement auditing practices. In the longer term, privatisation also impacts directly on our audit practice because the *Auditor-General Act 1997* and *Commonwealth Authorities and Companies Act 1997* provide that my mandate includes wholly-owned Commonwealth companies or companies in which the Commonwealth has a controlling interest.

We have also undertaken a program of performance audits to examine the extent to which Government sale objectives have been achieved, the effectiveness of the management of the sale and the Commonwealth's ongoing risk exposure. To ensure their effectiveness, our privatisation audits (such as the recent audits of the Telstra share offer, the leasehold sales of Federal airports, and third tranche sale of the Commonwealth Bank) were undertaken by a team of experienced officers who understand the financial markets, the commercial nature of the transactions and the overlaying public accountability issues. In addition, we engage appropriately qualified outside professionals to provide specific technical advice.

The Commonwealth privatisation process itself is now subject to extensive outsourcing under multi-million dollar contracts. This places considerable emphasis on contract management and balancing commercial interests with the overlaying public accountability required of the public sector. One of the key outcomes from our privatisation audits has been the identification of opportunities for significant improvement to the process of tendering and managing these advisory contracts, which would improve overall value for money and project management quality in future sales.

The purpose of a contract is to make a legally enforceable agreement. Our audits have clearly illustrated the value of written consultancy

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contracts that reflect the understanding of all parties to the contract, and which constitute the entire agreement between the two parties. Otherwise the documentary trail supporting the authority for the payment of Commonwealth money and contractual performance requirements, incentives and sanctions may not be clear. It is recognised that contractual performance is maximised by a cooperative, trusting relationship between the parties. But it should never be forgotten that such relationships are founded on a business relationship in which the parties do not necessarily have common objectives.

Commercial confidentiality

Virtually all traditional accountability mechanisms rely on the availability of reliable and timely information. As a result of contracting out to the private sector, the flow of information available to assess performance and satisfy accountability requirements has on the whole been reduced. This situation has arisen where performance data is held exclusively by the private sector or through claims of commercial confidentiality that seek to limit or exclude data in agency hands from wider parliamentary scrutiny. Thus accountability can be impaired where outsourcing reduces openness and transparency in public administration. For this reason, the issue of commercial confidentiality is likely to be of increasing importance as the extent and scope of outsourcing grows.

The risk to accountability associated with claims of commercial confidentiality in relation to government contracts has recently been commented on by the South Australian Auditor-General:

'In situations where government contracting results in a long term transfer of material government responsibility to the private sector, the right of the people to know the extent and terms of that transfer must take precedence over less persuasive arguments in favour of confidentiality. Not only is the public affected by the transfer of what is government responsibility but it is further affected by the creation of a new relationship (often long term) between government and a private entity. A relationship about which the public is entitled to advise, consent to or object to through both their Parliamentary representatives and other forums.' Report of the Auditor-General for the year ended 30 June 1998, 'Government Contracts: A Specific Matter Raised Pursuant to Subsections 36(1)(a)(iii) and 36(1)(b) of the Public Finance and Audit Act 1987'. Report of the Auditor-General for the year ended 30 June 1998, *Government Contracts: A Specific Matter Raised Pursuant to Subsections 36(1)(a)(iii) and 36(1)(b) of the Public Finance and Audit Act 1987.*

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This issue was also addressed by the Senate Finance and Public Administration References Committee in its 1997 Inquiry into Contracting Out of Government Services. Senate Finance and Public Administration References Committee 1998, *'Contracting out of Government Services'*, 2nd Report, May, Chapter 5, pp. 49-52. *Ibid.*, (pages 49 to 52). My submission to that Inquiry noted that:

'For agencies to be in a position to support the accountability obligations of their Minister and ensure adequate performance monitoring of contracted services, it is essential there be, at least, specified minimum levels of performance information to be supplied by the contractor to the agency, and agreed arrangements which provide for access by the agency to contract-related records and information.' Australian National Audit Office 1997, Submission to the Senate Finance and Public Administration References Committee Inquiry into Contracting Out of Government Services, Canberra, 31 January. Australian National Audit Office 1997. Submission to the Senate Finance and Public Administration References Committee Inquiry into Contracting Out of Government Services, Canberra, 31 January.

In making further recommendations to the Committee, the ANAO suggested, as did the Commonwealth Ombudsman, that in relation to commercial confidentiality claims by private sector contractors a reverse onus of proof test should be applied, that is:

'In our view, the question of whether or not commercial-in-confidence information should be disclosed to the Parliament should start from the general principle that the information should be made public unless there is a good reason for it not to be. In other words, what we are saying is there should be a reversal of the principle of onus of proof which would require that the party arguing for non-disclosure should substantiate that disclosure would be harmful to its commercial interests and to the public interest.' *Op.cit.*, Senate Finance and Public Administration References Committee, *'Contracting out of Government Services'*, p. 70. Senate Finance and Public Administration References Committee, 1998. *'Contracting out of Government Services'* 2nd Report, Chapter 5, May. (page 70).

The Committee agreed and in addressing matters of commercial confidentiality concluded that:

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'The committee is firmly of the view that only relatively small parts of contractual arrangements will be genuinely commercially confidential and the onus should be on the person claiming confidentiality to argue the case for it. A great deal of heat could be taken out of the issue if agencies entering into contracts adopted the practice of making contracts available with any genuinely sensitive parts blacked out. The committee accepts that some matters are legitimately commercially confidential. If Parliament insists on a 'right to know' such legitimately commercially confidential matters, the most appropriate course to achieve this would be the appointment of an independent arbiter such as the Auditor-General to look on its behalf and, as a corollary, to ensure that he has the staff and resources to do it properly.' Ibid., p. 71. Ibid (page 71).

One of the difficulties in addressing commercial confidentiality issues is that of precise definition as to what is covered. While there is broad understanding of the kinds of information which contractors might regard as commercially confidential, the question is how to ensure adequate accountability for the use of public funds while ameliorating any justifiable 'confidentiality' concerns. With the growing convergence between the private and public sectors referred to earlier, and the considerable increase in contracting, the issue has become a matter of practical importance and some urgency. A particular concern is that agencies may too readily agree to treat contractors' documents as confidential, notwithstanding the wide access powers provided to the ANAO under the *Auditor-General Act 1997*.

As a way forward, the Administrative Review Council, in its report to the Attorney-General on contracting out, has favoured the development of guidelines for Commonwealth agencies and has recommended that:

'Guidelines should be developed and tabled by the Attorney-General setting out the circumstances in which Commonwealth agencies will treat information provided by contractors as confidential.' Administrative Review Council 1998, *'The Contracting Out of Government Services'*, Report No. 42 to the Attorney-General, August, p. 73. Administrative Review Council, 1998. *'The Contracting Out of Government Services'*, Report to the Attorney-General, No. 42, August. (page 73).

The Parliament's ongoing interest in Commercial-in-Confidence matters was evident during the passage of the new financial legislation to replace the Commonwealth *Audit Act 1901*. This was reflected by the request of the Senate, as part of the motion to adopt the report of the committee with respect to the package of legislation, as follows:

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'... that the Auditor-General include in the annual report on the operations of the Australian National Audit Office for the financial year 1997-98 a report on the appropriateness of commercial-in-confidence practices with recommendations on legislative regulation of such practices.' Senate Hansard, 29 September 1997, p. 7148. Senate Hansard, 29 September 1997, (page 7148).

In addressing the Senate's request, I had one such matter to report to Parliament in 1997-98. An audit of Contracting Arrangements for Agencies' Air Travel Australian National Audit Office Audit Report No. 28, 1997-98, *'Contracting Arrangements for Agencies' Air Travel*, Canberra, p. 20. ANAO Audit Report No. 28 1997-98 *'Contracting Arrangements for Agencies' Air Travel*, Canberra. (page 20). identified some of the risks to the Commonwealth from use of Commercial-in-Confidence clauses. The ANAO recommended that, to facilitate the exchange of information within the Commonwealth, the Department of Finance and Administration (DoFA) amend the standard confidentiality clause that it promulgated in the standing offer for air travel. The Department agreed with the recommendation but has withdrawn from managing a whole-of-government travel contract. Guidelines now include standard contract clauses, developed by Attorney-General's Legal Practice, that deal with accessing Commonwealth records. I canvassed such issues more broadly in a presentation to the recent Australasian Council of Public Accounts Committees in Perth. Barrett Pat 1999, *'Commercial Confidentiality - A Matter of Public Interest'*, Presentation to the 1999 ACPAC Biennial Conference, Perth, 21-23 February. Barrett Pat 1999. *'Commercial Confidentiality - A Matter of Public Interest'*. Presentation to the 1999 ACPAC Biennial Conference, 21-23 February, Perth.

The message here is that external scrutiny (through public reporting and the activities of Auditors-General) is an essential element in ensuring that public accountability is not eroded, by default, through contracting out. Just as it is incumbent upon public sector agencies to ensure they have a sound understanding of the commercial nature of any contract, private sector entities need to recognise that there are overlaying public accountability issues, not present in purely private sector transactions, that need to be addressed. For this reason, to reiterate my earlier comment, outsourcing contracts should include access provisions to fulfil any performance and financial statement auditing requirements as necessary.

The ANAO has developed and disseminated to all Commonwealth agencies and bodies standard contract clauses concerning access by those organisations and the ANAO to relevant records and premises of all service providers. These are available from the Executive Director, Corporate Management Branch in the ANAO.

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Contractors can expect to have their performance scrutinised both by purchasing agencies and by review bodies such as the ANAO, Ombudsman and Privacy Commissioner. Recent audit reports suggest that many contractors have yet to fully appreciate this aspect of working for government or to embrace the higher and/or different standards of accountability that are required when public money is involved. The latter is essentially the issue being covered by this address with any trade-off possibly being more about the nature and level of accountability rather than about efficiency per se. However, it is not difficult to envisage at least some cost for accountability over a purely market-oriented transaction.

Longer-term impacts of outsourcing

In addition to the immediate impact of outsourcing on accountability, the transition to an outsourcing arrangement can have long-term impacts on program administration. There is a particular risk, for example, that incumbency advantages may reduce the level of competition for later contracts because the existing supplier has greater information and knowledge about the task than either the Commonwealth agency or potential alternative service providers. This risk of undue competitive advantage becomes more pervasive when the outsourced activity has a significant impact on core business, or competition in the market is limited. This issue will require increasing attention by public sector managers, as has been recognised by the Joint Standing Committee on Foreign Affairs, Defence and Trade in relation to the Defence Department's Commercial Support Program:

'Frequently, the successful tenderer for the support contract relies on recruiting the trained Defence personnel who have been made redundant in the ADF because of the function's transfer to the commercial sector. Through employing these already-trained personnel, the successful civilian tenderer is able to provide a commercially attractive initial price for a support capability because there is no need to factor in staff training costs in the contract. This process becomes disadvantageous to Defence where the successful tenderer becomes the monopoly supplier of the support service, and Defence must subsequently renegotiate that contract from a position of weakness, having eliminated its own in-house capability to perform the particular function.' Joint

Standing Committee on Foreign Affairs, Defence and Trade 1998, *'Funding Australia's Defence'*, Canberra, p. 35. Joint Standing Committee on Foreign Affairs, Defence and Trade 1998, *'Funding Australia's Defence'* (page 35).

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That brings me to one of the most challenging areas of risk management for public servants, that is project and contract management.

III. PROJECT AND CONTRACT MANAGEMENT

I was interested to read an article in the April issue of the Australian Stock Exchange publication, *Perspective Journal*, reporting on research in Europe and the USA into outsourcing. Willcocks Leslie P and Lacity Mary C, '*Information Technology Outsourcing - Practices, Lessons and Prospects*', *Prospective Journal*, April 1999, pp 44-49. The article illustrates some of the risks involved in contract management, in the specific context of information technology (IT) outsourcing. The authors draw on what appears to be an extensive body of recent research to identify several categories of outsourcing, the risks associated with each and some lessons for Australia. They assert that total outsourcing as practised in Australia is not so dominant a trend overseas as would appear to be the case here. Total outsourcing (which is defined as a situation in which 80 per cent or more of the IT budget is under third-party management) they characterise as "a distinctly high risk practice." The issues identified include the following:

- the organisations involved were in financial trouble and focused on cost reduction, seeing IT outsourcing as a means of improving company position rather than as a way to leverage IT for business value and keep control of IT matters;
- problems arose with longer term (10-to 12 year) single supplier deals which had been initiated by company boards with little input from IT management; and
- companies often found they incurred significant hidden costs and a degradation of service, and experienced a loss of control and exploitation by suppliers.

I might add that the article addresses itself to the outsourcing practices of Australian financial institutions and not the circumstances of the Commonwealth per se. There may well, however, be lessons from this experience for the Commonwealth and other levels of government.

We all know by now that outsourcing represents a fundamental change to an agency's operating environment. It brings with it new opportunities and risks, requiring managers to develop new approaches and skills, placing considerable focus on project and contract management, including

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management of the underlying risks involved, as I have already indicated. It is the unintended risks that can bedevil managers as the following portrays:

'If managed properly, pressure to achieve challenging goals can stimulate innovation, entrepreneurial creativity, and superior financial performance. However, such pressure can also bring unintended risk'. Op.cit., Simons, Robert. p .87.

One problem is that inexperience is likely to result in additional risk. Just as bad is ignorance of the potential consequences of risk taking. It is also as well to take note that:

'Sometimes risk creeps into the organisation at quite a distance from the top.' Ibid., p.94.

The thrust of this changing environment is reflected in the Senate Finance and Public Administration Committee's recently released second report on *Contracting Out of Government Services*:

'Despite the volumes of advice on best practice which emphasise the need to approach contracting out cautiously, to invest heavily in all aspects of the process and to prepare carefully for the actual implementation, and the substantial body of comment in reports from the Auditor-General indicating that Commonwealth agencies have a very mixed record as project and contract managers, the prevailing ethos still seems to promote contracting out as a management option that will yield inevitable benefits. Resources must be made available to ensure that contract managers have the skills to carry out the task.' Op.cit., Senate Finance and Public Administration References Committee 1998, *'Contracting Out of Government Services'*, Second Report, Canberra.

As well, the implementation of an accrual-based outcomes and outputs framework for managing resources in the public sector, with the first accrual budget recently brought down for 1999-2000, has put further pressure on managers to define more clearly measurable performance outputs and outcomes. This requires greater attention to costing and pricing methodologies including the rediscovery, for many of us, of management and cost accounting. Importantly, it means that managers, generally at all levels, are having to become familiar with such methods and techniques as part of their management responsibilities.

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In the latter respect, the ANAO noted in its report on 'Costing of Services' Australian National Audit Office Audit Report No.21, 1998-99. 'Costing of Services', Canberra, December. that only a small number of organisations had progressed to the stage where cost information was being used in a decision-support role. In fact none had reached the stage where full cost information played a big role in overall decision-making at the organisational level. A subsequent inquiry by the Joint Committee of Public Accounts and Audit (JCPAA) on that report Joint Committee of Public Accounts and Audit 1999. 'Reference: Review of Auditor-General's reports first quarter 1998-99'. Hansard, Canberra 28 May, p.43. showed concern about that finding which led to questions about charts of accounts for costing purposes, standard costs, variances, time recording, cost drivers, activity-based costing, skills development and cultural changes, particularly at all levels of management. In terms of risk assessment, as one witness put it:

'[Agencies] underestimated the impact of the government's policy on better financial management and linking that into the delivery of policy or services'. Ibid., p.56.

Addressing the tax risks

Another important issue to be considered by public sector agencies at all levels of government is the likely impact of the implementation of a Goods and Services Tax (GST) on agency operations, including in the area of contract management. Although detailed implementation of the recently approved GST is still to be worked out and will not commence until 1 July 2000, early planning needs to begin now to implement the required systems and procedures. I note that the Queensland Treasury has been coordinating a number of issues groups and has established a GST implementation unit responsible for informing agencies of their roles and responsibilities in relation to GST. The Queensland Auditor-General has suggested that:

'Agencies should establish an implementation team to identify key stakeholders across their respective entities and to highlight any issues which are likely to impact on their organisations'. Auditor-General of Queensland 1999. 'Audits Performed for 1997-98 – Audit Results as at 31 March 1999'. Queensland Audit Office, Report No.5, 7 May, p.69.

GST may need to be paid on part or all of a transaction, contract or agreement that an agency has already entered into or may enter into between December 1998 and the proposed implementation of GST on 1 July 2000. The Department of Treasury and Finance, South Australia, has produced useful guidance material for agencies to assist them in

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preparing for the implementation of a GST. In particular, the Department's GST Administration Unit has prepared a GST Guide relating specifically to contracts Department of Treasury and Finance, South Australia, 1999, *GST Guide No. 2 - GST in Contracts*, GST Administration Project, Adelaide.. The Guide suggests that agencies undertake a review of existing contracts to identify those that will continue beyond July 2000, and assess whether GST will be payable. A number of strategies that agencies might adopt to deal with a GST in relation to both existing and new contracts are provided. Importantly, the Guide points out that:

'In resolving what strategy to adopt, the agency needs to bear in mind the costs and risks of future negotiations, the budget reductions and consequent need for savings (to be achieved). The agency should avail itself of Legal and Treasury advice.'

and

'Agencies will need to consider including provisions in their contracts (to cover GST issues). Given the options and issues that have to be considered, no single set of standard clauses is appropriate.' Ibid., p. 2.

In terms of existing contracts, agencies might consider whether the contract includes any price review provisions that would permit a price change based on a GST (or other taxes). If such a review is possible, then the agency will need to look carefully at the individual contract to determine a strategy to achieve the best price result. For new contracts, one possible approach is to make provision to negotiate a price adjustment based on the costs and benefits from the tax package Ibid., p. 2.. I note that, in releasing its Exposure Draft of the Employment Services Request for Tender 1999, the Department of Employment, Workplace Relations and Small Business has included a section dealing with the new tax system and the GST that states:

'Tenderers need to build into their tender prices for all Job Network services the effects of the Government's tax reform measures...it is expected that tenderers will not seek to simply add the 10 per cent GST to their prices but rather will calculate the cost savings to their operations ... until the Government's tax reforms are implemented you will be paid pre-GST prices'. Department of Employment, Workplace Relations and Small Business, 1999, *Exposure Draft: General Information and Service Requirements for the*

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Employment Services Request for Tender 1999, April, pp 23-24.

For our part, the ANAO has amended its standard contracts to include a clause that relates to the introduction of a GST. The clause provides a mechanism for a possible change in contract charges as a result of a change in a Government tax, duty or charge.

Fringe Benefits Tax (FBT) obligations may add a further complicating factor to contract management. FBT obligations arise when an employer provides a fringe benefit to an employee. Agencies need to be aware of the fact that liability for FBT may arise in contractual arrangements when the person describes him or herself as a contractor but behaves more like an employee (for example, works solely for the agency in question) and receives a benefit such as a car or entertainment arranged by the agency. I understand, with regard to taxation matters, that it is important for agencies using contractors to ensure that they preserve the substance and the form of the contract. Agencies should, of course, always seek expert advice on such technical issues.

Issues arising from audits

One of the major challenges facing public sector managers is the management of large contracts to ensure that they are obtaining value for money for the Commonwealth while maintaining adequate accountability for the results, including quality service delivery. It is important to recognise that managing an outsourcing contract starts before any decision has been taken on the selection process, let alone about the service provider. For this reason, proper project planning is essential to a successful outsourcing partnership. Indeed, the previous Australian Government Solicitor observed that:

'There is often an inverse relationship between the amount of time spent in preparing tender and contract conditions and the resources required to deal with problems in contract administration and disputes after the contract has been formed.' Australian Government Solicitor 1997, Legal Briefing Number 35, *'Competitive Tendering and Contracting - Strategic and Legal Issues'*, p. 2. Australian Government Solicitor 1997, Legal Briefing Number 35, *Competitive Tendering and Contracting - Strategic and Legal Issues* (page 2).

There is a wide body of administrative case law and procedural guidance applying to Commonwealth procurement. The resulting framework

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embodies important principles such as value for money, open and effective competition, ethics and fair dealing, and accountability. The salient point is that the level of procedures required in the selection process should be in direct proportion to the extent and complexity of the services to be provided.

In the appropriate circumstances, the use of competitive tendering and contracting promotes open and effective competition by calling for offers which can be evaluated against clear and previously stated requirements to obtain value for money. This in turn creates the necessary framework for a defensible, accountable method of selecting a service provider. Significantly, a sound tendering process and effective management of the resulting contract are also critical for the efficient, effective and sustainable delivery of programs.

During recent years the management of contracts by public sector agencies has been of particular concern to my office and I have tabled a number of audit reports (mentioned in some detail below) which address this area. The Parliament and the media have also paid particular attention to these issues during the past two years with several agencies receiving significant adverse comments and publicity. This situation has to be addressed as a matter of urgency. The public service has to reverse these concerns to win back the confidence of all stakeholders.

A common theme of recent audit reports dealing with project and contract management has been the deficiencies in the project management skills of agency decision makers, despite the fact that some of these projects involve substantial resources and complexity. As well, reports have flagged a need for care in assessing value for money and negotiating, preparing, administering and amending major contracts. The NSW Ombudsman recently pointed to differences in levels of risk that are acceptable in the public and private sectors Moss Irene AO 1999, *'Risk Management in the Public Sector'*, Address to Public Sector Conference, Canberra, 22 March, p. 6. and observed that:

'The consequences of a failure to properly monitor the performance of a contract range from private contractors failing to deliver what they promise through to corruption.' Ibid., p.16.

My 1997-98 audit report on the new submarine project Australian National Audit Office Audit Report No. 34, 1997-98, *'New Submarine Project'*, Canberra, March. found close parallels with the earlier audit of the Jindalee Operational Radar Network (JORN) Australian National Audit Office Audit Report No. 28, 1995-96, *'Jindalee Operational Radar Network Project'*, Canberra, June. in that there was a need for

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Defence to give a high priority to improving the effectiveness of its contracts for major capital acquisitions and its project management capabilities. Specifically, the ANAO found that the Commonwealth should have been better placed in commercially-based contracts when it came to recourse by way of financial guarantees and damages in the event of late delivery or under-performance. A more business-like and commercial approach by Defence to project management would have better protected the Commonwealth's financial and other interests.

Similarly an audit of DEETYA International Services (DIS), Australian National Audit Office Audit Report No 35, 1997-98, '*DEETYA International Services*', Canberra, March. in looking at the administrative issues and difficulties of establishing and operating a commercial entity in the APS environment, found that, although DIS had been successful in winning tenders and satisfying clients, it had not operated in the sufficiently commercial manner demanded by its business orientation. A key lesson was the importance of adopting a more business-like approach in order to deliver cost-effective and high quality outcomes.

To address some of the contract and risk management issues identified in recent audits my office has developed a better practice guide titled *Selecting Suppliers: Managing the Risk*. Australian National Audit Office 1998, '*Selecting Suppliers: Managing the Risk - Better Practice Guide*', Canberra, October. Australian National Audit Office, 1998. *Better Practice Guide, Selecting Suppliers: Managing the Risk*, October. The aim of the guide is to provide a framework which can be used by the public sector to assess some of the financial and probity risks associated with contracting with non-government suppliers. The guide presents a risk assessment matrix that can be used to make an overall assessment of the ability of a potential supplier to deliver the services being contracted, in order to reduce the risk of the Commonwealth contracting an inappropriate supplier. The guide also discusses possible risk treatment options to reduce risks to a level acceptable to the agency.

As I have already mentioned, the ANAO recognises that an increasing emphasis on outcomes has been a key factor in enhancing the efficiency and effectiveness of the public sector. However, sound administrative processes and effective management are also critical to sustaining long-term performance. The message here is that it is not sufficient to focus on outcomes alone, rather that sound processes and effective management are also necessary to reduce the risk of unfavourable and often costly events.

Notwithstanding the difficulties, we have identified where agencies have effectively achieved outcomes as a result of sound project and contract management skills. An example of this is the implementation of the new Employment Services Market. The Federal Government announced, as

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part of its labour market reforms package in 1996, the replacement of the Commonwealth Employment Service (CES), Employment Assistance Australia (EAA), and the Employment Services Regulatory Authority (ESRA) with a corporatised public provider that would operate and compete on the same basis as competitors in the private and community sectors. This new market (now known as the Job Network) involved linking payment structures and incentives for service providers to the placement of job seekers in work.

In September 1998, I tabled a report which examined the management of this process. Australian National Audit Office Audit Report No. 7, 1997-98, *'Management of the Implementation of the New Employment Services Market'*, Canberra, September. Australian National Audit Office, Auditor-General Report No. 7, 1997-98. *Management of the Implementation of the New Employment Services Market*, September. We found that DEETYA had followed key principles of good project management in implementing the new market arrangements, that each of the project-planning criteria had been met and that risks had been managed in line with good practice. The ANAO identified a range of good practices implemented by the Department examples of which are highlighted throughout the report.

However, there is always scope for improvement, even for well managed projects, and a number of lessons for the future were highlighted in the report. For example, we noted that service providers may have benefited from information which would assist with budget development. I also believe that a built-in review mechanism (which would enable service providers to terminate their contract with no adverse consequences) should have been considered, particularly in light of the infancy of the market. Improvements in these areas may have reduced the likelihood that service providers would face significant financial difficulties in attempting to fulfil their contractual obligations.

Development of the Employment Services Network provides a good example of the inherent difficulties in applying a purely commercial model to the contracting out of community services. With media reports suggesting a number of the original 321 service providers were experiencing financial difficulties, pressure was placed on the Government for additional funding and changes in the commercial relationship. This situation emphasises the need to recognise the complex set of objectives and stakeholder views which must be taken into account when we make decisions in the public sector. There are grounds for believing that, in this instance, not enough consideration was given to the likely impact of a service provider's closure on unemployed clients.

Each of the above examples highlights the importance of having a strong project and contract management skills base which can be drawn upon to

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make decisions and to achieve the required results. This does not necessitate a full time complement of skilled project and contract managers. Rather, agencies should ensure that, if the current decision makers do not have the requisite skills, sufficient external expertise is obtained. Such external expertise may be required, for example, in relation to the financial and legal aspects of contract management.

The significance of agencies having a clear understanding of the legal imperatives associated with contracting was highlighted in a recent seminar on Commonwealth sector issues Blake Dawson Waldron, 1999. Seminar on Commonwealth Sector Legal Issues, Canberra, 21 April. In particular, see Clark John, 'CTC : *Managing the Legal Risks*' and Wedutenko Alexandra '*Contract Performance Management*'. which discussed among other things, the convergence of legal and commercial risks and the need for planning and sound systems for contract management, particularly over the whole life of the contract. Recent judicial decisions have also emphasised the importance of having a legally defensible tender process as an integral part of contracting out. It has always been important for the tender process to be commercially defensible. However, recent rulings have demonstrated that commercial interests are also served by what has to be done to meet legal requirements.

The notion of partnership is increasingly gaining acceptance, that is, the Commonwealth should be working in partnership with the private sector, or indeed that public sector agencies should be working in partnership with each other and with private sector firms, for example through purchaser/provider arrangements, to deliver public services. Partnerships depend on common understanding, trust and goodwill not legal compulsion. However the reality is that there will be testing times even in the best of relationships. Consequently, it is good practice for such relationships to be based on sound tendering and administrative processes and an enforceable contract.

The contract must clearly specify the service required; the relationship between the parties needs to be clearly defined, including identification of respective responsibilities; and mechanisms for monitoring performance, including penalties and incentives, set in place. There should not be any equivocation about required performance nor about the obligations of both parties. I stress that this is as much about achieving the desired outcome as it is about meeting particular accountability requirements. Both require sound, systematic and informed risk management which recognises that:

*'... managing contract risk is more than a matter of matching risk-reducing mechanisms to identified contract risks; it involves an assessment of the outsourcing situation.'*O'Looney John A. 1998, '*Outsourcing State and*

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Local Government Services - Decision-Making Strategies and Management Methods, Quorum Books, London, p. 147. O'Looney John A 1998. *'Outsourcing State and Local Government Services - Decision-Making Strategies and Management Methods'*. Quorum Books, London (page 147).

On the issue of contract preparation and management, the Industry Commission has suggested that public sector agencies tend to transfer as much risk as possible to the agent, thus increasing the risk of contract failure. Conversely, bad contract design leaves too little risk with the agent. This can lead to poor service delivery and political problems for the government. Op.cit., Industry Commission, 1996, pp. 333-335. Again, I draw your attention to an observation based on New Zealand experience on a related risk in the broader principal-agent relationship:

'... despite considerable effort to clarify principal-agent relationships, reduce agency costs and do away with multiple accountabilities, the reforms have failed to overcome the difficulties generated by the existence of complex principal-agent relations.' Op.cit., Jonathan Boston 1998. *'Public Sector Management, Electoral Reform and the Future of the Contract State in New Zealand'*, p.42.

Sound contract management, and accountability for performance, are dependent on adequate and timely information. Therefore it is important that agencies consider the level and nature of information to be supplied under the contract and access to contractors records they require to monitor adequately the performance of the contractor. However, as Professor Mulgan also suggests, the more detailed the performance standards, the specific requirements for rigorous reporting and monitoring and the need for frequent renegotiation and renewal, the closer the contractual arrangements come to the degree of control and accountability exercised in the public sector. Op.cit., Richard Mulgan 1997, *'The Processes of Public Accountability'*, p. 8. Op.cit., Mulgan Richard 1997. *'The Processes of Public Accountability'*. (page 8). Once again, it is a matter of balancing any trade-offs in efficiency and/or accountability if optimal outcomes are to be secured.

The importance of proper management of the contract for the effective delivery of government services cannot be overstated. We are in the process of conducting an audit of the Management of Contracts which is evaluating agency processes in relation to key better practice principles for managing contracts, dealing with:

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- provider performance monitoring frameworks;
- management information for tracking expenditure, milestones and outputs; and
- implementation of purchaser, provider and other contract stakeholder feedback mechanisms.

Contracting, while providing the benefits of cost efficiency and enhanced service delivery, can expose the Commonwealth to increased risk. The Commonwealth is, in many cases, no longer directly responsible for program outputs, instead reliant on a private sector contractor for the provision of particular services or products. Nevertheless, the relevant agency/body is still accountable for those outputs. This is also Parliament's expectation. The Senate Finance and Public Administration References Committee reinforced this concern as follows:

'The Committee believes strongly that contracting-out of services should not diminish public accountability through the Parliament, the Auditor-General and what can be summarised as the administrative law - the role of statutory officers such as the Commonwealth Ombudsman, the operations of agencies such as the Administrative Appeals Tribunal and legislation such as the Administrative Decision (Judicial Review) Act. It has been suggested that contracting-out may improve accountability by requiring services to be defined more precisely and imposing service agreements on providers. That should be seen as a bonus not an alternative.' Senate Finance and Public Administration References Committee 1997, 'Contracting Out of Government Services', First Report, Information Technology, Canberra, December, p. xii. Senate Finance and Public Administration References Committee 1997. 'Contracting Out of Government Services'. First Report, Information Technology, Canberra. December, (page xii).

The competent management of the contract is often the Commonwealth's key means of control over its outputs and their contribution to outcomes. This is why it is essential that we ensure our staff have the capability and capacities to manage contracts effectively if we are to achieve the results required of us. But I again stress that it is not just skills in relation to contracting that are important, there is still a high premium on knowledge and understanding of the functions/business that we are managing. Put simply, we have to be in a position to know what we are actually getting under a contract and whether it is meeting the objectives we set. If we do not, we are virtually risking the success of our agency and its very reason for being.

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IV. ENHANCING OUR ACCOUNTABILITY FOR MANAGING RISK THROUGH SOUND CORPORATE GOVERNANCE PRACTICES

I have outlined some of the issues which agencies face in this new environment. What can we do about them?

It is very clear that public sector agencies must balance complex political, social and economic objectives, which subject them to a different set of external constraints, influences and forms of accountability from those experienced in the private sector. The Chartered Institute of Public Finance and Accountability 1995, '*Corporate Governance: A Framework for Public Service Bodies*', July, p. 7. The Chartered Institute of Public Finance and Accountability, 1995. *Corporate Governance: A Framework for Public Service Bodies*, July, (page 7). Certainly, the demand by citizens and other stakeholders for openness and transparency of all aspects (not only financial status) of public sector agency governance exceeds that required of private organisations. Accountability in the areas of community service obligations, equity in service delivery and a high standard of ethics are particularly critical to public sector agencies. Accordingly, one of the fundamental ways to ensure that we can meet our performance and accountability requirements is through a robust corporate governance framework.

The major elements of corporate governance have been in place in the APS for most of the last decade or so. The concept is basically about how we 'govern' our organisations to achieve required performance and satisfy our stakeholders. It is also about the control and monitoring mechanisms that are put in place by organisations with the object of enhancing stakeholders' value and confidence in the performance and integrity of the organisation. Within a contestable environment, effective corporate governance becomes more pressing and important because of the separation between core business operations and the outsourced service delivery elements.

Principles and Practice of Good Corporate Governance

Corporate governance is largely about organisational and management performance. Effective public sector governance requires leadership from the executive management of agencies and a strong commitment to quality control and client service throughout the agency. It is concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes.

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Key components of corporate governance in both the private and public sectors are business planning, risk management, performance monitoring and accountability. The framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outcomes.

It is important to recognise the basic differences between the administrative/

management structures of private and public sector entities and between their respective accountability frameworks, that is, shareholders, Board, CEO (private sector) versus Minister, CEO, (and possibly) Board (public sector). The political environment, with its focus on checks and balances and value systems that emphasise issues of ethics and codes of conduct, implies quite different corporate governance frameworks from those of a commercially-oriented private sector. It is equally important to recognise that the diversity of the public sector requires different models of corporate governance. That is, one size does not fit all even though there will be common elements of these models.

The values, standards and practices which underpin corporate governance in public sector agencies flow from peak APS values, obligations and standards, which in turn are derived from legislation, policy and accepted public service conventions. In 1996 MAB/MIAC outlined these APS values, obligations and standards in its paper, *Ethical Standards and Values in the APS*. MAB/MIAC 1996, *'Ethical Standards and Values in the Australian Public Service'*, Report No. 19, AGPS, Canberra, May. MAB/MIAC (1996) *'Ethical Standards and Values in the Australian Public Service'* Report No.19, AGPS, Canberra, May. More recently, the Public Service Commissioner has issued a draft discussion paper on the new APS Values Public Service Commissioner 1999, *'APS Values'*, Draft Discussion Paper, Canberra, February. Public Service Commissioner, 1999. *'APS Values.'* Draft Discussion Paper, Canberra, February. to assist agencies to understand and apply these Values in their agency. The new APS Values are a key element in the Government's public sector reform program and have been introduced through amendments to the Public Service Regulations. The following are some of the Values that agency heads are required to uphold and promote within their organisations:

- the APS is apolitical, performing its functions in an impartial and professional manner;
- the APS has the highest ethical standards;

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- the APS is accountable for its actions, within the framework of Ministerial responsibility, to the Government, the Parliament and the Australian public;
- the APS delivers services fairly, effectively, impartially and courteously to the Australian public; and
- the APS focuses on achieving results and managing performance.

The Regulations require agency heads to integrate these values into the culture of their agency and the Public Service Commissioner to report annually on how successfully this had been achieved. My own agency, to take one example, has as its key values independence, objectivity, professionalism, and knowledge and understanding of the public sector environment. These values are guided by the ANAO Code of Conduct which has been developed within the framework of the new APS values and the APS Code of Conduct, together with the Codes of Ethics promulgated by the professional accounting bodies.

The alignment between these core APS Values and those of the contractor are particularly important in any outsourcing arrangement. However, as observed by the well known author and academic Peter Hennessy:

'Pieces of paper are one thing, real belief systems quite another. It is very hard to export the public service ethic into the private contractor hinterland. Commercial contracts are not susceptible to a foolproof, public service ethical override'.

Hennessy Peter 1997, *'The Essence of Public Service'*, The 1997 John L. Manion Lecture. Reprinted in the Canberra Bulletin of Public Administration, vol no. 85, August, p. 5. Hennessy Peter, 1997. *'The Essence of Public Service'*. The 1997 John L. Manion Lecture. Reprinted in the Canberra Bulletin of Public Administration. Volume No.85, August (page 5).

The issues of openness and transparency have to be accepted as essential elements of public sector accountability. The public sector has to act both in the public interest and, in common with the private sector, avoid conflicts of interest. These will be particular challenges for agency managers in establishing credible corporate governance frameworks within public sector agencies that are increasingly being asked to act in a more private-sector manner.

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In recognition of the need for good corporate governance in the public sector, the ANAO in July 1997 circulated a discussion paper, *Principles for Core Public Sector Corporate Governance: Applying Principles and Practice of Corporate Governance in Budget Funded Agencies* Australian National Audit Office 1997, 'Principles for Core Public Sector Corporate Governance', Discussion Paper, Canberra, June. ANAO 1997. 'Principles for Core Public Sector Corporate Governance'. Discussion Paper, Canberra, June.. This paper was designed to fill the gap in core public sector awareness of the opportunities provided for improved management performance and accountability through better integration of the various elements of the corporate governance framework within agencies. As well, the paper included a checklist designed to assist Chief Executive Officers (CEOs) to assess the strengths and weaknesses of their agencies' current governance framework. Although the discussion paper was not meant to provide a comprehensive model for each agency, CEOs should be able to identify those elements of a governance strategy most applicable and useful to their particular agency. The paper identified the following key operating principles that should underpin a sound corporate governance framework in the public sector:

- **openness** is about providing stakeholders with confidence regarding the decision-making processes and actions of public sector agencies in the management of their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information leads to effective and timely action and lends itself to necessary scrutiny;

- **integrity** is based on honesty, objectivity as well as high standards of propriety and probity in the stewardship of public funds and the management of an agency's affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the agency. Integrity is reflected in the agency's decision-making procedures and in the quality of its performance reporting;

- **accountability** is the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities and roles are clearly defined through a robust organisational structure; and

- **leadership** involves clearly setting out the values and standards of the agency. It includes defining the culture of the organisation and the behaviour of everyone in it. Ibid., pp. 9-10. Ibid, (pages 9-10).

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These principles should be reflected in organisational structures and processes, external reporting, internal controls and standards of behaviour of the organisation and were applied in two recent ANAO audits:

- *Aspects of Corporate Governance in the Australian Tourist Commission (ATC)* which suggested a corporate governance checklist for the Board Australian National Audit Office Audit Report No. 10, 1997-98, '*Aspects of Corporate Governance - the Australian Tourist Commission*', Canberra, October. ANAO Report No. 10, 1997-98 '*Aspects of Corporate Governance - the Australian Tourist Commission*', Canberra.; and
- *Corporate Governance Framework - Australian Electoral Commission* Australian National Audit Office Audit Report No. 1, 1998-99, '*Corporate Governance Framework - Australian Electoral Commission*', Canberra, July. ANAO Report No. 1, 1998-99 '*Corporate Governance Framework - Australian Electoral Commission*', Canberra. which made recommendations related to planning and performance information.

In May this year, the ANAO published a related discussion paper which outlines a methodology for developing robust corporate governance frameworks for bodies covered by the *Commonwealth Authorities and Companies (CAC) Act 1997*. As well, it broadly canvasses the legal responsibilities of CAC boards, including some comparison with similar responsibilities of budget-dependent agencies and private sector firms.

Risk and Control as part of an Integrated Corporate Governance Framework

Robust accountability is not the only benefit of good corporate governance. Corporate governance provides the integrated strategic management framework necessary to achieve the output and outcome performance required to fulfil organisational goals and objectives. Risk and control management are integrated elements of that framework. There is really no point in considering each in isolation. As one expert puts it:

'Essentially, control assessment and risk assessment are part of the same thing, the strategic management process.' Ibid., p. 4. Ibid (page 4)

Another makes the point more broadly:

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'Corporate governance is the organisation's strategic response to risk.' McNamee David and Selim Georges 1998. *'Risk Management : Changing the Internal Auditor's Paradigm'*. The Institute of Internal Auditors Research Foundation, Florida, November, p.2.

The growing recognition and acceptance of risk management as a central element of good corporate governance and as a legitimate management tool to assist in strategic and operational planning has many potential benefits for the APS. However, the effective implementation of risk management practices is a major challenge for public sector managers, particularly as the culture under which they have operated has traditionally been risk averse. Parliament itself, and its Committees, are still coming to grips with the implications of managing risks instead of minimising them, almost without regard to the costs involved.

In the past, risk has been related to the possible loss of assets or the emergence of a liability. As a result, risk management has focused on matters that can be covered as insurable losses. However the more contemporary definition of risk is far broader, reflecting the increasing complexity of our corporate and economic environment and incorporating corporate governance, operational and strategic objectives. Risk management can more properly be defined as:

'... the term applied to a logical and systematic method of identifying, analysing, assessing, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable organisations to minimise losses and maximise opportunities.' Standards Australia 1995, *Risk Management: Australia/New Zealand Standard 4360:1995*, Homebush, Sydney. Standards Australia, 1995. *'Risk Management: Australia/New Zealand Standard 4360:1995'*, Homebush, Sydney.

You would know that this is the definition of risk management provided in the Australian/New Zealand Standard 4360:1995 on Risk Management. I note with interest Kevin Knight's account of the work that has been undertaken by Standards Australia in revising AS/NZS 4360:1995 and in producing a series of guidelines to assist in the practical application of the revised standard (AS/NZS 4360:1999). The key drivers of Standards Australia's decision to revise AS/NZS 4360:1995 before 2000, when it would have been subject to review, are a recognition of the changing risk profile of the public sector as a result of the significant and ongoing changes to public administration - corporate governance, contestability and outsourcing, a focus on outcomes and demands for more innovative program delivery to name a few. Undoubtedly, both AS/NZS 4360:1999 and the accompanying guidelines will prove a useful tool to my office, in

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terms of assessing public sector risk management practices and identifying better practice. I am certain that they will also assist agencies in implementing sound risk management practices.

Returning to the above definition, it clearly highlights the ability of an agency to maximise opportunities through the implementation of risk management procedures. This concept is particularly relevant to the APS because risk management applies to more than just the profits and losses of an agency; it is also a tool which can be used to identify realistic opportunities for improved performance and enhanced assurance to stakeholders, both internal and external to the organisation. An effective corporate governance framework assists an agency to identify and manage risks in a more systematic and effective manner. I note that the Auditor-General of Queensland recently reported that, in relation to the nine agencies and sixteen grant schemes covered in a review of the administration of grants and subsidies, various procedures were in place to manage certain risks during the appraisal and acquittal process but:

'... none of the agencies had developed a scheme specific coordinated risk management strategy and fraud control plan.'

Auditor-General of Queensland 1999. *'Review of the Administration of Grants and Subsidies'*. Queensland Audit Office, Report No.6, 17 May, pp.31-32.

I see risk management as an essential, underlying element of the reforms that are currently taking place in the public sector. Management of risk in the public sector involves making decisions that accord with statutory requirements and are consistent with APS values and ethics. Such an approach encourages a more outward-looking examination of the role of the agency or entity, thereby increasing customer/client focus including a greater emphasis on outcomes, as well as concentrating on resource priorities and performance assessment as part of management decision-making. As well, with the increased emphasis on contestability and the greater convergence of the public and private sectors, there will be a need to focus more systematically on risk management practices in decision-making that will increasingly address issues of cost, quality and financial performance.

Another important principle of an effective risk management framework is the transparency of decision-making processes. Transparency is achieved by ensuring that the decision-making process and the reasons for decisions made are adequately documented and communicated to stakeholders. I note that one of the most significant additions to AS/NZS 4360:1999 is the requirement to identify stakeholders and communicate and consult with them regarding their perceptions of risk at each stage of the risk management process. The results of such communication should, of course, feed into any decision-making process. From an ANAO

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perspective, documentation of key risk management principles and management decisions is an essential element of the public sector accountability framework. As the ANAO is a central element of this framework, we have a particular need to understand the reasons behind agency decisions. As well, documenting and communicating key processes and decisions:

- improves the transparency and consistency of decisions made by the agency over time;
- throughout their organisation contribute to the cost-effective achievement of stated outcomes;
- promotes a shared ownership of decisions throughout the agency; and
- places the agency in a considerably stronger position to defend to the Parliament and clients any decisions made.

The establishment in July 1998 of insurable risk managed fund A risk managed fund is a form of self insurance which collects contributions from participating members, accumulates reserves, and meets future losses from those reserves. arrangements for the Commonwealth, called *Comcover*, is another expression of the increased attention being devoted to risk management in the APS and the significant initiatives being developed to support it. *Comcover* replaces the Commonwealth's previous policy of non-insurance. The introduction of the new fund will for the first time require the systematic identification, quantification, reporting and management of risk across Commonwealth agencies.

Comcover provides for a single managed fund to cover all general insurance risks, with the exception of workers compensation, (with formal pooling of risk, premiums and reinsurance) and requires all Commonwealth agencies (including departments) and entities to participate, unless specifically exempted. The creation of such a fund is a timely reminder that failure to identify and treat risks properly and adequately is itself a significant risk for CEOs and public sector organisations particularly as the new financial legislation imposes personal and board accountability and responsibility obligations.

The development of the new fund arrangements responded, among other things, to issues highlighted in the performance audit report on *Commonwealth Guarantees, Indemnities and Letters of Comfort*. Australian National Audit Office Report No. 6, 1996-97, '*Commonwealth*

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Guarantees, Indemnities and Letters of Comfort, Canberra, September. That report revealed:

- a need for improved recording and reporting of Commonwealth exposures;
- minimal risk management actions to limit future exposures; and
- the absence of positive economic incentives for agencies to apply formal management principles to controlling risk exposure.

Although the new *Comcover* arrangements necessitate additional reporting and oversight of the Fund's arrangements, on the positive side *Comcover* aims to provide improved risk management benefits to the Commonwealth by:

- helping to protect programs and the Budget against unexpected insurable losses over time;
- achieving transparency and greater accountability in the management of the Commonwealth's insurable risks;
- requiring the full identification of risk exposures by each agency;
- enabling the Commonwealth to centrally accumulate risk knowledge and expertise;
- reducing costs by pooling and spreading of risk; and
- providing incentives for better risk management with the application of a claims sensitive premium.

Despite the obvious benefits of such arrangements we must remember that only those risks that can be covered as insurable losses are able to be treated through *Comcover*. (*Comcover* does not yet cover all agencies although it is expected to do so in time. There are also other eventualities such as a loss of appropriately skilled staff, for which no cover is possible.) In either case, it remains incumbent on public sector managers to manage risk actively. We should not fall into the trap of failing to manage risk simply because we have an insurance policy as a safety net. With the increasing provision of public services by the private sector, part of our

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accountability to the Parliament and the public for the effective delivery of public services will be to manage, rather than simply insure against, the risks associated with outsourcing.

The key message from the above discussion is that CEOs should aim to ensure that decisions made using risk management are not based on 'risky' management practices. We need to be conscious that mistakes will be made and look to ensure that management learns from such mistakes and implements effective processes to minimise the impact of errors in the future as well as reducing the likelihood of their recurrence. The following observation is apt given the more contestable environment in which the public sector is operating:

'Experimentation and innovation need to be encouraged and supported. It is important to accept that there can be no experimentation without risk. Ministers and senior officials must accept some of the uncertainty implicit in giving up a degree of control. Not every experiment will be a success. Some honest mistakes will be made. This needs to be understood and accepted. Our commitment should be to learn from these situations'. Bourgon Jocelyne 1997, 'Fourth Annual Report to the Prime Minister on the Public Service of Canada', Ottawa, 3 February, p. 26. Bourgon Jocelyne, 1997. 'Fourth Annual Report to the Prime Minister on the Public Service of Canada', Ottawa, 3 February (page 26).

While such a view is encouraging for the public sector, concerns remain, and have been expressed across Australian jurisdictions, that contracting has developed so quickly that it outstrips the capacity of government to monitor what is happening and so learn from mistakes. Op.cit., Davis and Wood, 1998, 'Is there a Future for Contracting in the Australian Public Sector?', p. 85.

There is no doubt that the more 'market-oriented' environment being created is inherently more risky from both performance and accountability viewpoints. To good managers, it is an opportunity to perform better, particularly when the focus is more on outcomes and results and less on administrative processes and the inevitable frustration that comes from a narrow pre-occupation with the latter. Having said this, it is important for us all to remember that the Public Service is just as accountable to the Parliament for the processes it uses as for the outcomes it produces. That is inevitable and proper. In my experience, however, some agencies, faced with the prospect of adverse comment in an audit report about the transparency and accountability of their risk management or other processes, have argued for a greater emphasis on the outcomes achieved by the agency. The following observation made by Senator John Coates,

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then Chairman of the Senate Standing Committee on Finance and Public Administration, reflects well my response to such arguments:

'[Risk management] does not mean that managers can expect to be judged only on the efficiency and effectiveness of their results and be able to claim that the mix of inputs chosen, how they are applied and the selection of who is to supply them is outside the reviewer's area of concern. The fundamental principles of accountability have not changed: information still needs to be readily available to allow reviewers to make their own assessments about the legal and proper use of inputs and the ethical behaviour of the people involved in the processes. Managers cannot simply claim that the ends justify the means.'

Department of Finance, 1991, 'Risk Management - A Parliamentary Perspective', paper presented by Senator John Coates, Canberra, March 1990, 'Risk Management - The theory and the practice. An information and discussion paper', p. 49.

My office will always be obliged to comment on both aspects of agency performance in order to provide the level of accountability expected by Parliament and the Australian people of the public sector in delivering government services.

This brings me to another element of corporate governance that I wish to address - agency controls. In an environment that promulgates the notions of contestability, outsourcing and greater efficiency, the way that agencies implement their corporate governance framework, and particularly how they conduct their risk management, including the control of those risks, will be critical in determining how well the public sector can continue to meet its accountability obligations as well as its performance measures. The private sector needs to do the same to remain viable.

Control structures to manage risk

The control structures within a corporate governance framework provide assurance to clients and the Parliament that an agency is operating in the public interest and has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture.

In a recent ANAO publication entitled 'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control', Australian National Audit

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Office 1997, *'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control'*, Canberra, December. ANAO 1997 *'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes': A Better Practice Guide to Effective Control*, Canberra, December. control is defined as:

'... a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency's objectives.' Ibid., p. 5. ANAO 1997 *'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes': A Better Practice Guide to Effective Control*, Canberra, December, (page 5).

I cannot over-stress the importance of the need to integrate the agency's approach to control with its overall risk management plan in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and emphasis on a systematic approach involving identification, analysis, assessment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively. The achievement of the right balance is important so that the control environment is not unnecessarily restrictive nor encourages risk averse behaviour; on the contrary the right balance can promote sound risk management and the systematic approach that goes with it.

It is useful to point out here that audit committees provide a complementary vehicle for implementing relevant control systems incorporating sound risk management plans. This view is shared by the private sector where corporate representatives have agreed that effective audit committees and risk management plans are an indication of best practice and markedly improve company performance, including decision making. The internal auditing function of an agency plays an important role in this respect by examining and reporting on control structures and risk exposures and the agency's risk management efforts to the agency governance team.

The need to strike a balance between the control environment and risk management is something that auditors, both internal and external, are extremely conscious of. A recent publication by the Institute of Internal Auditors Research Foundation has commented on the emerging shift in

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internal audit from control-based auditing to risk-based auditing. The following is observed as one of the benefits of such a paradigm shift:

'Focusing on controls ... buried the internal auditor in details of the past, limiting the value of any information derived. By focusing on risks to present and future transactions (or activities) the auditor is...dealing with the obstacles for organisation success. The information derived from such exploration has great value for the management governance team.' Op.cit., McNamee David and Selim Georges 1998, p. 5. McNamee David and Selim Georges, 1998. *'Risk Management: Changing the Internal Auditor's Paradigm'*, The Institute of Internal Auditors Research Foundation, Florida, November, (page 5).

The ANAO has adopted, as an integral part of our audit planning processes, a more risk-based approach to auditing aimed at providing agency management with information to improve current and future administration. Providing assurance to the Parliament, agency managers and stakeholders that necessary controls are in place, however, will remain a key function of my Office.

Despite the obvious benefits of effective risk management in terms of improved strategic planning, performance and accountability, there are some troubling indications that the risk management "gospel" has not circulated as widely as we might think. A recent benchmark survey of the risk management practices of more than 260 of Australia's top 2000 organisations (measured by market capitalisation) undertaken by Ernst & Young found the following:

'... (there is) a worrying 'expectation gap' between the level of concern for a large number of risks and how effectively organisations believe they are actually managing these risks. (This) strongly suggests that corporate Australia needs to improve its risk management practices.' Ernst & Young 1998, *'An Australian view of Risk Management'*, Benchmark Survey, Australia, p, 7. Ernst & Young, 1998. *'An Australian view of Risk Management'*, Benchmark Survey, Australia, (page7).

and

'Only 60 per cent of organisations say they have a documented risk management policy and only 61 per cent of

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these say they are confident it is being adhered to. Ibid., p. 10. Ibid, (page 10).

These observations suggest that CEOs, Boards and management have not looked closely at their organisation's control environment and the interrelated nature of the various control mechanisms in order to establish good risk management practices aimed at identifying, assessing, prioritising, treating and monitoring risks to their reputation and performance.

Current risk management practices observed in audit activities

I would now like to reflect on the findings of recent ANAO audits with respect to the risk management approaches of the Commonwealth public sector as an indication of good practices and lessons learnt.

The ANAO's effectiveness is directly related to the extent to which we know and understand the environment in which we work. The ANAO, an agency with a key role in providing assurance to the Parliament and in encouraging improvements to administration, does not stand outside the APS as some kind of interested on-looker or commentator. We are an integral part of the Service and of the changes and reforms which are occurring. We understand that we must not only take account of reforms to public sector operations in the conduct of our own work but also work hard at promoting and facilitating required and desirable change.

Any influence the ANAO has on public administration, particularly on performance and accountability, will be largely through its individual products and services. The value of these individual products and services, in turn, is influenced by the directions we take in our strategic planning and the relationships we establish with all our stakeholders.

At the broadest level, we aim through our strategic planning to operate in such a way as to be valued by the Parliament, the community and Commonwealth entities as a major contributor to achieving excellence in public sector administration and accountability. Accordingly we seek to keep abreast with the changing nature of the public sector and community expectations. That is part of our risk assessment.

In recent years the ANAO has placed increased emphasis on the need for sound corporate governance frameworks, as I indicated earlier, which include establishing effective risk management as part of credible control structures within agencies. During 1994-95, the ANAO conducted, as part of its financial statement work, an assessment of the financial risk

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management processes of 113 public sector entities. Overall, we found that considerable progress had been made in the adoption of risk management philosophies and approaches, with the majority of entities having a financial risk management process in place (50 per cent of those reviewed) or in the process of developing them (48 per cent). Australian National Audit Office Audit Report No. 13, 1995-96, *'Results of the 1994-95 Financial Statement Audits of Commonwealth Entities'*, Canberra, November. Australian National Audit Office, Auditor-General Report No. 13, 1995-96. *Results of the 1994-95 Financial Statement Audits of Commonwealth Entities*, November.

During the 1995-96 round of financial statement audits, the progress made in the development of risk management procedures was followed up and the outcome included in my report to the Parliament on the *Results of the 1995-96 Financial Statements Audits* tabled in December 1996.

Australian National Audit Office Audit Report No. 19, 1996-97, *'Results of the 1995-96 Financial Statement Audits of Commonwealth Entities'*, Canberra, December. Australian National Audit Office, Auditor-General Report No. 19, 1996-97. *Results of the 1995-96 Financial Statement Audits of Commonwealth Entities*, December. The report summarised the progress made by seven major departments and agencies in introducing formal risk management regimes. It indicated that, although some were more advanced than others, agencies were continuing to develop appropriate risk management processes.

Agencies have also been encouraged to broaden their assessments and strategies consistent with the MAB/MIAC *Guidelines for Managing Risk in the Australian Public Service*, released in October 1996. MAB/MIAC 1996, *'Guidelines for Managing Risk in the Australian Public Service'*, Report No. 22, AGPS, Canberra, October. MAB/MIAC Report No. 22, 1996. *Guidelines for Managing Risk in the Australian Public Service*, October. An important message from these guidelines is the need to adopt a systematic, not *ad-hoc*, approach to risk management. There are no short cuts to risk assessment, analysis, prioritisation and treatment. In my view, the best defence of any decision can be a sound risk assessment. That will not necessarily remove any criticism but it will greatly ameliorate it. This has been reinforced by observations made by successive Chairs and Deputy Chairs of the Commonwealth's Joint Committee of Public Accounts and Audit (JCPAA).

On the basis of recent performance audits I have concluded that although there is still room for improvement, risk management techniques are achieving wider acceptance within the APS. Many more decision makers are now relying on a formal evaluation of identifiable risks before committing themselves to a particular course of action. To cite a few recent reports:

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- the ANAO's 1998-99 performance audit of the corporate governance framework of the Australian Electoral Commission Australian National Audit Office Report No. 1, 1998-99, '*Corporate Governance Framework*', Canberra, July. noted that the AEC had established a sound basis for planning, risk management and performance monitoring including a risk management package based on a 'whole of agency' approach which was logically structured and written in a clear and concise manner and appropriately documented;
- the ANAO's audit of the same year on aviation security, Australian National Audit Office Report No. 16, 1998-99, '*Aviation Security in Australia*', Canberra, November. not surprisingly, included risk management among its areas of investigation. My office concluded that aviation-security risk assessment in Australia tends to be based on traditional politically motivated violence threat assessment processes linked with specific national security approaches, rather than on Australia's actual experience to date which mainly involved criminal extortion, family-law matters, domestic violence issues or errant behaviour by individuals needing psychiatric treatment. The current approach did not take adequate account of the wide range of risks in the contemporary aviation environment. Although the agency had not developed a risk assessment strategy/model that could be seen to accord with best practice, we concluded that it was well placed to take the lead in introducing a cohesive and comprehensive risk model to Australian aviation, drawing on information that is already available; and
- again in 1998-99 the ANAO observed, in report No.15, *Postal Operations, Australian Customs Service*, Australian National Audit Office Report No. 15, 1998-99, '*Postal Operations - Australian Customs Service*', Canberra, November. that postal control is an exercise in risk management. Although the ACS explicitly recognised risk management principles and had developed risk management documentation, the ANAO concluded that there were several areas that required attention, such as intelligence gathering, use of screening resources, data analysis and the planning and review stages of postal operations, that would enable ACS to manage community protection and revenue risks more effectively.

I might also mention the progress made by two other agencies, the Australian Taxation Office (ATO) and Australian Customs Service (ACS) in adopting risk management practices. The ANAO conducted performance audits of these two agencies during 1997 These audits are respectively: Australian National Audit Office Audit Report No 37, 1996-97, '*Risk Management - Australian Taxation Office*', June; Australian National Audit Office Audit Report No. 19, 1997-98, '*Risk Management in ATO Small Business Income - Australian Taxation Office*', December; Australian National Audit Office Audit Report No. 6, 1997-98, '*Risk Management in Commercial Compliance - Australian Customs Service*', October. which specifically examined their risk management processes.

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The audits were designed to be complementary and to develop a picture of the adoption, implementation and application of risk management processes as outlined in the MAB/MIAC guidelines.

Since these audits were tabled the ATO has taken on board the ANAO's recommendations and refined its risk management framework. The risk management research conducted by the ACS for its part has been recognised and adopted by several public sector organisations. The publication, *Risk Management: A Customs Perspective* Australian Customs Service 1993, 'Risk Management: A Customs Perspective', November. Australian Customs Service, 1993. *Risk Management: A Customs Perspective*, November., is still a useful guide to the implementation of a risk management framework in public sector agencies. A recent paper prepared by Mr Colin Vassarotti continues the ACS's use of risk management to facilitate cargo clearance and improve enforcement outcomes and overall efficiency. He made a particularly important observation as follows:

'... Risk management depends on quality information. For sound risk management decision making it is absolutely critical that the information upon which decisions are based is accurate, relevant and timely.' Vassarotti Colin 1998, 'Customs Risk Management - Opportunities, Options and Obligations for Freight Forwarders', FIATA World Congress, Sydney, 22 September, p. 7. Vassarotti, Colin, 1998. *Customs Risk Management - Opportunities, Options and Obligations for Freight Forwarders*, FIATA World Congress, Sydney, 22 September, (page 7).

There are aspects of both the ATO's and ACS' systems that represent risk management better practice in the APS. The Customs' approach concentrated on getting the process right in a discrete area before applying it across all areas of the organisation. In contrast, the ATO approach included agency-wide application from the outset with the intention of incrementally improving the process each year.

There are also lessons for auditors and managers to be learned from overseas experience. My Canadian counterpart, for example, has developed a Financial Management Capability Model (FMCM) which I learned about recently. Office of the Auditor-General of Canada, 1999. *'Financial Management Capability Model'*, Minister of Public Works and Government Services Canada. This Model is also available on the Internet at www.oag-bvg.gc.ca. My Canadian colleagues set out to encourage better financial management in government and improve understanding of its role. They developed this FMCM as a basis for future audits in this area but also argue that the Model provides a tool which can be used more widely by agencies, to determine their requirements, assess

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existing capabilities against these, identify and address the gaps. Ibid., p. 6. The model identifies three essential elements for financial management, the first of which is risk management and control, the others being information and management of resources. These three elements overlap with, and relate to, other elements of management. As the authors observe:

'Ultimately, an organisation must have good management overall before it can have good financial management.' Ibid., p. 5.

Risk management is a central part of the model. The report states:

'We would expect that in determining and establishing the financial management capabilities their organisation needs, managers would assess the nature of their operations and the risks they face. In this context, we consider risk to be any factor that may affect the organisation's ability to achieve its objectives. Risks are identified through a process of first identifying potential hazards, then assessing the consequences to the organization should one occur, and finally determining the likelihood of the hazard's occurrence, given the control environment of the organization. Such a process is outlined in Exhibit 6.' Ibid., p. 14.

I offer for your consideration the above-mentioned Canadian model (Exhibit 6 in the report) which is attached to this paper. My staff are currently comparing it with an ANAO draft better practice guide on the use of financial information. At first blush it seems to me to offer a logical, coherent and graduated process for assessing organisations' management capabilities, including of course their risk management arrangements. I like to think that it may be useful, because I feel strongly that, when pointing to an organisation's problems, ANAO should also take the trouble to help with the solutions.

The impact of technology on accountability and risk management

Following on from Colin Vassarotti's above-mentioned observation regarding the need for quality information to inform agency decision-making and risk management, I would like to make a few comments regarding the role of Information Technology (IT) in this respect and also of the risks inherent in the management of IT systems themselves, particularly relating to the security of agency data in a contestable or outsourced service delivery environment.

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The past decade has seen a radical transformation take place in the role of IT within organisations worldwide, not to mention the impact it has had on individuals' lives. I know that my staff derive enormous benefit from the information about management and audit practice in Australia and elsewhere which they increasingly obtain from the Internet, amongst other sources. This increased ability to capture and store information has, however, created problems with the ability of organisations to sift, disseminate, interpret and use the vast amount of information currently available.

An example of the use of IT systems as 'enabling technology' that provides quality information to assist in decision-making can be seen in the increasing use by Commonwealth Government agencies of rulebase decision systems (or expert systems) to administer complex legislative and policy material. While the widespread adoption of rulebase systems to support administrative decision-making has been foreshadowed for some years, the recent adoption of such systems by agencies such as the Department of Veteran's Affairs, Defence and Comcare indicates that they will be increasingly used to support, control and improve administrative decision-making based on legislative or policy rules. Indeed, the introduction of such technology is being considered by the Australian Taxation Office and has been identified by Centrelink as a major part of its new service delivery model.

A recent paper on this topic, presented to the Institute of Public Administration Australia Johnson Peter and Dayal Surendra, 1999, *'New Tricks - Towards Best Practice in the use of Rulebase Systems to Support Administrative Decision-Making'*, paper presented to a Seminar of the Institute of Public Administration Australia, Canberra, April, p. 1., identifies both opportunities and risks associated with the use of rulebase systems. There is a need to balance both in order to make the most effective use of this technology. Opportunities include improvements in the quality, accuracy and consistency of decisions and administrative processes, and hence improved client service. Such opportunities may be realised as a result of managing, reducing and removing different risks from aspects of the decision-making process by providing staff with access to information relevant to their decisions. The risks involved relate to the complex IT development processes needed as well as the lead times involved in system development, the potential for a loss of staff skills and knowledge of policy over time and an over-reliance on IT systems to produce the right answer every time.

Importantly, the authors assert that such systems cannot be introduced in isolation and should be accompanied by a broader redesign of the decision-making process and environment, including changes to service delivery arrangements, work structures and practices, staff skill sets and quality control practices. This type of technology does not replace the need for judgement or skills on the part of staff. However, it does provide

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a new model for decision-making based on a risk management perspective.

The greater level of access to data has also brought with it security issues, such as unauthorised access and entry of virus infected programs, which have raised the risks to agencies' computing environments and which are being addressed through so-called 'firewalls' (which are basically software protection) or through physical separation. Data encryption systems have been, and continue to be, developed to provide a degree of assurance. These have seen a move towards some kind of public key encryption arrangement. No doubt we will hear more of this latter initiative in the near future.

All Commonwealth agencies wanting to connect to the Internet are required to do so via a Defence Signals Directorate (DSD) approved firewall. To reduce the costs involved, a number of agencies access the Internet through a shared firewall, known as the Secure Gateway Environment (SGE), that is DSD certified. The SGE provides a firewall between each of the agencies (because individual agencies have different security needs) as well as an overall firewall to protect against unauthorised access from outside sources.

The SGE is currently owned and administered by the Department of Agriculture, Fisheries and Forestry Australia (AFFA). However, AFFA has sought and received the agreement of the Office of Asset Sales and Information Technology Outsourcing to sell the SGE. Bidding was to close towards the end of May. Under the privatised arrangement DSD will continue to evaluate and certify the SGE and considers that, provided the contract is adequate, the security of agency IT environments will not be affected by the sale. However, a recent Gartner Group comment is apposite to such environments:

'... information security investments contribute to a desired level of manageability of computer-based business processes and are critical to business risk management.' Gartner Group 1999. "Top CIO Issues for 1999 'Like Juggling Eggs'". Inside, Vol.XV, No.19, 12 May, p.6.

The move to electronic commerce and the greater use of the Internet for business purposes, will also put increasing pressure on management of our information systems and systems controls. Electronic commerce is, of course, a product of the Internet which 'opens up the possibility of global, open system electronic commerce.' Sneddon Mark 1999, *'Electronic Commerce'*, Australian Company Secretary, May, Vol 51, No 4. I think that many people are interested in the opportunities presented by E-Commerce but constrained by their understandable reluctance to transmit

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unencrypted data containing credit card details across the Net. Ibid. Mark Sneddon reports on the efforts to replace early payment models that involved payment by credit card details being supplied by email or other insecure means over the Net with some more recent mechanisms which offer more but not necessarily complete security. However, I note that, as reported by Professor Mark Sneddon, Special Counsel - Electronic Commerce for Clayton Utz, in the May 1999 issue of Australian Company Secretary, Ibid, Australian Company Secretary, p. 190-2. new Net payment mechanisms are being developed which ameliorate these risks. Nevertheless, a recent research survey Prodromou Angela 1999. 'E-Comm: the next frontier'. Information Age - Editorial, May, p. 1. of 309 companies in Australia and New Zealand indicated that 43 per cent of respondents indicated that security is a factor that had a high degree of influence on whether they moved into electronic commerce. The main reasons cited were identification and authentication and firewalls.

My office is currently undertaking an audit of the use of electronic commerce or business in Commonwealth agencies. The audit has been conducted by surveying agencies on their present use of technologies such as the Internet to conduct business and their expectations of what will be their position in 2001. You may be aware that the Prime Minister, in his *Investing for Growth* policy statement of December 1997, committed the Government to *all appropriate services being deliverable on the Internet by 2001*.

Delivery of Government services on the Internet has the potential to:

- ' give access to a wide range of government services to a large group of the population, including those in remote areas of Australia;
- give access to government services and information 24 hours a day and seven days a week;
- allow the public to navigate to the government information source without the need for prior knowledge of where to look; and
- be a relatively inexpensive form of service delivery compared with other forms.

Commensurate with the potential for improved service and reduction in costs is the increased risk in the following areas:

- the security of information transferred over the Internet;

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- the privacy of information on individual or business; and
- the ability to authenticate the user requesting government services or financial assistance.

Recent ANAO financial statement audits have identified several emerging issues regarding the security and internal control mechanisms of IT systems in public sector agencies. IT supports various entity programs and can be integral to the validity, completeness and accuracy of financial statements. Consequently, the audit of IT systems and processes is fundamental to forming an opinion on the adequacy of proper accounts and records that support entities' financial statements. The 1997-98 financial statements identified several IT control issues, including:

- system access rights found to be excessive or unauthorised;
- inadequate review and approval of users' access to systems;
- an external service provider having unlimited access which was not monitored; and
- inadequate review, approval and testing of changes to applications.

Australian National Audit Office Audit Report No 33, 1998-99, *'Audit Activity Report: July to December 1998'*, Canberra, March.

The need to focus on effective systems controls is further highlighted by a recent report of the Australian Institute of Criminology which indicates that the increased usage of information technology will lead to a major rise in white collar crime against governments Gibbons Patrice, 1999. *'New report warns of IT fraud'*. Article in The Financial Review, 7 May. (page 12). Refers to Smith Russell G. 1999, *'Defrauding Governments in the Twenty-first Century'*. Australian Institute of Criminology, Trends and Issues in Crime and Criminal Justice, Canberra, April. (page 6).. Allied to this concern are warnings about growth in the use of E-Mail not just in terms of adequate systems controls to prevent compromising network performance and the efficient conduct of functions or business but also the possibility of litigation where communications are not subject to executive review but could involve liability for the organisation. Braue David 1999. *'Reducing the E-Mail risk factor'*. The Sydney Morning Herald, 25 May, p.3c.

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With the increased involvement of the private sector in the provision of public services, the security of agency data is a critical issue. Contracts negotiated between public service agencies and their private sector providers must include provisions which acknowledge Commonwealth IT security requirements.

In addition to the technical issues associated with the protection of the data held by Commonwealth agencies from unauthorised access or improper use, there are also issues associated with the security of, for example, personal information held by Commonwealth agencies which falls within the scope of the Privacy Act. A watchful citizenry will want to be certain that agencies and their contractors cannot evade their obligations under such legislation.

The ANAO is seeking to bring the issue of IT controls and security to the attention of all public sector agencies and our first step in this process has been the production of a better practice guide (released in October 1998) in relation to security and control for the SAP R/3 system. Australian National Audit Office 1998, *Better Practice Guide: Security and Control for SAP R/3*, Canberra, October. Australian National Audit Office, 1998. *Better Practice Guide: Security and Control for SAP R/3*, October. SAP R/3 is the most widely-used financial management information system in the APS today with 31 Commonwealth entities currently using it. The areas covered by the guide include the amount of time and investment necessary for effective implementation of the system to minimise the risk of future security problems. While the guide deals specifically with SAP R/3, generic risk management controls are discussed which can be applied to other financial management information systems.

Another technology issue examined recently by the ANAO is the challenge faced by the public sector in ensuring that the information technology systems they have in place are Year 2000 compliant.

In December 1997, I tabled a report on managing the Year 2000 problem which involved a survey of a wide range of Commonwealth agencies' Year 2000 preparedness and their management of the problem. Australian National Audit Office Audit Report No. 27, 1997-98, *Managing the Year 2000 Problem Risk Assessment and Management in Commonwealth Agencies*, Canberra, December. Australian National Audit Office, Auditor-General Report No. 27, 1997-98. *Managing the Year 2000 Problem Risk Assessment and Management in Commonwealth Agencies*, December. One of the key messages this report reinforces is that the Year 2000 problem is not simply an Information Technology problem. Rather, it is a whole-of-business problem, with potential ramifications which go well beyond immediate impacts upon particular business systems or processes. It places at risk the credibility and, indeed, the viability of individual businesses. Put simply, organisations (whether public or private

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sector) which have not taken steps to identify their Year 2000 exposures and implement strategies to minimise the likelihood of Year 2000 compliance failure, risk not being able to deliver required results and make effective decisions. That risk also extends to related or dependent program outputs or outcomes, quite possibly in ways not immediately evident.

A follow-up report Australian National Audit Office Audit Report No. 22, 1998-99, *'Getting Over the Line: Selected Commonwealth Bodies' Management of the Year 2000 Problem'*, Canberra, December. tabled in December 1998, found that, while there had been some welcome supplementation in a number of agencies to assist with the problem, there have been shortages of both people and financial resources. This second report stressed the fact that management of the problem was primarily a question of priority setting and appropriate risk management practice. It also noted that the situation was made more urgent where Commonwealth agencies had not yet developed adequate Year 2000 contingency, disaster recovery or business resumption plans.

It is obvious that the gravity of this problem makes it necessary for agencies to ensure they have not only taken steps to eliminate the Year 2000 problem, but have also put contingency plans in place which deal with possible failure scenarios. This includes setting clear priorities for action and identifying resource implications. An important assurance is provided by having testing programs for all systems likely to experience a Year 2000 problem. Nothing can be taken for granted.

An important recent development in relation to the Year 2000 problem has been the passage of the *Year 2000 Information Disclosure Act 1999*. The primary objective of this Act, which became operative on 27 February 1999, is to encourage voluntary disclosure by organisations, including the public sector, of their readiness to combat the Millennium Bug. To do this, the Act provides limited liability protection to organisations that make such statements between the date of Royal Assent (27 February 1999) and 30 June 2001. The legislation aims to remedy the current situation in which organisations appear to have been managing the risk of liability by refraining from issuing public statements. The Audit Office of NSW 1999. *'Awareness - Accounting and Auditing Newsletter'*, Issue 99/03, Sydney, April, p. 7. However, recently, reservations have been expressed about the usefulness of the legislation because of its 'numerous exemptions' and 'legal limitations'. Clout Jason 1999. *'Good Samaritan law 'not much help' against Y2K bug'*. The Australian Financial Review, 11 May, p. 26.

A useful summary of how best an organisation sharing information about its preparedness for the Year 2000 should protect itself was recently provided by Deacons, Graham & James as follows:

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'... a risk management methodology in place and an ability to convey information that accurately reflects its position. This includes identifying potential risks, carrying out technical audits, contacting critical suppliers and customers and establishing contingency plans to manage and minimise the effect of any Year 2000 difficulties.' Deacons, Graham & James 1999. *'Newsletter - Year 2000 Statement'*, Canberra, 15 June, p.3.

V. CONCLUDING REMARKS

The provision of government services by contractors is one of the most significant issues in contemporary public sector administration. There is a new emphasis on the contestability of services, the outsourcing of functions to the private sector, ensuring a greater APS orientation towards outcomes rather than processes, and a focus on continuous improvement to achieve better performance. In effect, we are witnessing a convergence between the public and private sectors.

Within the APS, old paradigms are being replaced; the new paradigms require us to make substantial adjustments to what were, for some of us, the practices of many years. We are all, my agency included, on a steep learning curve in this new environment. Public servants who may have helped deliver a benefits program, or perhaps were responsible for an agency's IT requirements now find that their responsibilities have been delegated to a private sector operator. New skills and new mechanisms are demanded as agencies divest themselves of particular responsibilities but not, they come to realise, their accountability requirements.

Public servants, usually characterised as risk averse, are perhaps more likely to focus on the risks associated with market-testing, contracting out and competitive tendering than to see the opportunities they present. My recent audit reports on contract management in the APS may well reinforce this conservatism because they accent, more often than not, the problem areas of the contestable environment. That should not be surprising but, I hasten to add, they also include recommendations for improvement as well as guidance on better practice to achieve the required results.

Agency heads undoubtedly feel that the accountability expected of them is greater than previously, as not merely do they have to manage their own activities but also oversee the contractors now performing what were previously core APS functions. Although their goal in employing

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contractors is greater efficiency, this objective, as they very quickly discover, may be confronting in relation to their obligation to adhere to expectations of accountability. The latter could be less robust, by default or deliberate decision, or require additional efforts (and cost) by the agency concerned. The accountability/efficiency trade-off goes to the very core of their heightened risk profile.

The growing convergence between the public and private sectors gives focus to the distinctions between the two, while also offering opportunities for greater partnership and synergy between them. Private sector providers clearly feel under pressure from the openness and transparency required by the public sector's accountability relationship with the Parliament and the community. Public sector purchasers for their part are under pressure to recognise the commercial 'realities' of operating in the marketplace. In my view, there needs to be some movement towards striking a balance on the appropriate nature and level of accountability and the need to achieve cost-effective outcomes. There are a number of realities to recognise, such as the following observation:

'The private sector has no real equivalent to political accountability, for which precise measures are never likely to be found.' Op.cit., Hughes Owen E., *'Public Management and Administration - An Introduction'*, p. 229. Op.cit., Hughes Owen E. *'Public Management and Administration - An Introduction'*. (page 229).

However, are these necessarily roadblocks to consideration of a different kind of public accountability? This is an issue basically for the government and the Parliament to resolve. In the meantime we have to deliver the 'expected' accountability by those stakeholders and seek the cooperation of private sector providers in doing so. Hopefully, this will be more likely to be in partnership mode where both parties understand and act on public interest and commercial imperatives that need to be met by public sector purchasers and private sector providers respectively.

I would argue that corporate governance provides the mechanism to bring all of this together - not simply to manage the risks but to transcend them. I said earlier that corporate governance becomes more pressing in a contestable environment because of the separation of core business operations and the outsourced service delivery elements. This is because a sound corporate governance framework assists business planning, the management of risk, monitoring of performance and the exercise of accountability. While we can, and should, learn from private sector experience in such areas, public sector managers would do well to be mindful of the need for transparency and the interests of a broader range of stakeholders particularly when assessing and treating risk. We may not

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always be responsible for delivering public services but inevitably we will be held accountable for results.

Attention to the principles of corporate governance requires those involved to identify and articulate their responsibilities and their relationships; consider who is responsible for what, to whom, and by when; acknowledge the relationship that exist between stakeholders and those who are entrusted to manage resources and deliver outcomes. It provides a way forward to those, whether in the public or private sectors, who find themselves in somewhat different relationships than either have experienced before. Therefore they need to look beyond what have become their expectations over time particularly in view of the changes that have occurred in both sectors in recent years.

It is not sufficient though to simply analyse relationships, although that is a necessary step. Planning must also embrace issues of risk management and control, questions of information flow around the organisation and the management of its resources. If we take the Canadian Financial Management Capability Framework that I mentioned earlier as an example, those who are defined as belonging to the corporate governance framework cannot simply muddle through. They are also obliged to consider, in a systematic manner, the issues facing the organisation and to plan, as well as conduct, its business and monitor its performance.

Our Canadian colleagues, whose work I mentioned to you earlier, have produced a useful working model of how to proceed. I consider that it offers something practicable for managers. It complements a range of ANAO better practice guides that you might find useful in managing the risks you are confronting in a more contestable environment. Audit Offices should aim to offer preventative measures as well as cures, and not just be part of the triage team in the Casualty Ward. If we are to do that, we need to recognise the complex and demanding environment in which agencies have to operate and, within our accountability primarily to the Parliament, take on a shared responsibility for dealing positively and pro-actively with the challenges of that environment. I see conferences, such as this, being a useful vehicle for such sharing and am therefore grateful for the invitation to contribute here today.

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ATTACHMENT

Framework for Establishing Financial Management (FM) Requirements

Define Purpose of Organisation

- Mission, mandate, objectives
- Nature of Business
- Prepare Business Plan

Assess Risks

- Identify risks to the organisation, including financial
- Assess probability of occurrence and likely consequence of occurrence

Develop Management Framework

- Establish overall management framework
- Establish FM requirements (using FMCM*) within overall management control framework, e.g.:
 - required FM capability
 - controls, skills and resources to satisfy FM requirements
 - FM information and activities to support effective accountability
 - linkages between Finance and operational results

**If Risk
Not Acceptable**

Assess Residual Risks

- Identify residual risks and determine if acceptable to management

If Risk Acceptable

Implement Financial Management Framework

- Oversight controls

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- Organisational controls (people, culture, etc)
- Process specific controls
- Integrated information and advice

Monitoring and Assessment

- Ensure requirements and capabilities are still in balance
- Amend risk analysis, control framework etc. as appropriate

* FMCM = Financial Management Capability Model

SOURCE: Office of the Auditor General of Canada 1999. *Financial Management Capability Model*. Ottawa. (Exhibit 6).