

Australasian Evaluation Society –
International Conference

**Evaluation and Performance
Auditing: Sharing the Common
Ground**

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1. INTRODUCTION

The role of public audit, to scrutinise and review government operations, is essential to ensure that Ministers' and departments are held accountable for their use of funds on behalf of the general public. Independent external audit has long been held to be important in Australia as evidenced by the fact that the Audit Act was the fourth piece of legislation passed by Parliament in 1901. Probably the most emphatic support by government and Parliament was the passing of the *Auditor-General Act 1997* which, among other things, made the Auditor-General an independent officer of the Parliament and the Joint Committee of Public Accounts the Audit Committee of the Parliament.

The major role of public auditing in its earlier years was to provide assurance that the government's financial management and reporting was sound. This is a narrow interpretation compared with our current approach which is to provide an independent view of the performance and accountability of Commonwealth agencies and entities. As well, we endeavour to add value by working closely with those organisations to help identify and resolve problems, as well as making constructive recommendations for change. Our emphasis is on developing a comprehensive, integrated set of audit products that not only provides all stakeholders with adequate assurance about the use of public resources, but also gives them a credible assessment of administrative performance as well as identifying better practice.

Evaluation and performance auditing share similar aims, approaches, analytical methodologies and techniques. It is interesting to trace the developments in evaluation and performance auditing over the last few decades having regard to a number of significant reports and reviews, such as the Coombs Report¹, at the Australian federal government level, and their contribution to accountability and decision-making in each of those decades.

It is also interesting to make some comparisons between experiences in Australia and Canada, the latter having a considerable reputation in evaluation over many years. In particular, I will discuss the changing role of the Australian National Audit Office (ANAO), the legislative framework in which it operates, the ANAO's contribution to performance auditing, the main purposes of evaluation and audit and how the two disciplines might be better integrated to enhance resource management and contribute to improved performance and accountability.

Recent developments, such as contract management, the greater use of information and communications technology (ICT) for management and service delivery, and outsourcing of activities to the private sector, have the potential to exert considerable influence on the tasks of evaluation and audit. It is also useful to identify such changes that may affect the future business environment in which audit and evaluation need to be performed and the impact on our strategic and operational thinking to produce the most effective results. I will offer some views on how evaluation and performance audit can be further developed and integrated in my concluding remarks. I will simply observe, at the outset, that a successful outcome very much depends on acquiring a sound knowledge and understanding of that environment.

The following definitions provide some indications of the similarities, as well as differences, between evaluation and performance audit:

- ***Evaluation** is the systematic assessment of the appropriateness, effectiveness and/or efficiency of a program, or part of a program, and its objectives are to:*
 - *provide a better information base to assist managers in improving program performance;*
 - *assist government decision-making and setting priorities, particularly in the Budget process; and*
 - *contribute to improved accountability to the Parliament and the public.*²
- *A **performance audit** is an independent, objective and systematic examination of the management of an organisation, program or function for the purposes of:*
 - *forming an opinion on:*
 - *whether the organisation, program or function is being managed in an economic, efficient and effective manner; and*
 - *the adequacy of internal procedures for promoting and monitoring economy, efficiency and effectiveness; and*
 - *suggesting ways by which management practices, including procedures for monitoring performance, might be improved.*³

Differences between evaluation and audit include the following:

- evaluation often has a strong focus on policy and is able to make a qualitative assessment of policy effectiveness whereas a performance audit is focused on evaluating economy, efficiency, and effectiveness of administration;
- audit is independent, while evaluation is not necessarily so; and
- in the public arena, independent audit is reported direct to Parliament and evaluation is reported to the Minister or Secretary (Head of agency/entity) and is often not made public.

The more important issue, that is, the similarities between evaluation and audit and how the concepts can complement each other, will be covered later. However, as background, I hope you will find interesting some historical perspectives on the developments in performance audit and evaluation that have been put in place at the federal level of government in Australia. These have caught my attention this year in the preparation of the one hundred years' history of the ANAO.

2. AN HISTORICAL PERSPECTIVE – EARLY DEVELOPMENTS

During the 1960s and 1970s the audit and evaluation framework and related roles in the Australian public sector were significantly changed and clarified. Large scale evaluations were undertaken by the Treasury, mainly investment appraisals, as well as important commodity, industry, trade and infrastructure reviews by independent research bureau and other similar organisations, such as the then Bureaux of Agricultural Economics and Transport Economics, as well as the Tariff Board. These organisations had close links with the various tertiary institutions and often employed university staff on secondment or as consultants.

Efficiency audits commenced within the ANAO; the Public Service Board continued efficiency improvements through the use of joint management reviews (effectively a form of internal audit – process evaluation - within the Public Service as a whole); and the Department of Prime Minister and Cabinet provided oversight of evaluation of government programs, often involving policy analysis. The major driver for the change was the increased focus on the concept of value for money. The move towards ‘performance’ audits commenced, following the lead of the General Accounting Office in the United States of America (US) in the 1960s. Such audits had the advantage of a reasonably well developed framework of evaluation methods and techniques and a sound analytical approach.

Performance audit growth in Australia

Prior to the mid-1970s, the main task of the ANAO was to undertake financial statement audits that concentrated on confirming information in the financial statements of Commonwealth agencies. In contrast, efficiency audits, or performance audits as they have become known, focus on broad aspects of policy administration, and lack the specific, well-defined boundaries of financial statement audits. The movement into performance audits is explained as follows:

The more recent requirement for performance auditing, from which the expanded functions of Auditors-General are mainly derived, arose as part of the managerialist revolution in public management. The managerialist emphasis on results and on accountability in terms of stated objectives provided a new role for auditors as assessors of results.⁴

The commencement of performance auditing fundamentally changed the relationship between the ANAO, the agencies it audited and the Parliament. Up until the 1970s, Australia’s culture of public administration remained relatively unchanged from its early origins, being primarily concerned with issues of process, probity and accuracy. Over the 1970s and 1980s, the structural and institutional features of the Australian public sector changed substantially, rapidly bringing new demands for accountability and performance. Nevertheless, the foregoing issues continued to be important, particularly for the Parliament.

In part because of concerns at the growing level of government expenditure, there was increasing government, Parliamentary and public interest in securing efficiencies in administration, and achieving value for money from government programs. There was also a change in focus, from process-orientation to results, best described with sporting terminology: it’s not necessarily *how* that’s important but *how much*. A similar sentiment was expressed as ‘*not just doing things right, but also doing the right things*’. In addition, there was a growing emphasis on cost recovery and a more commercial approach to

providing services by public sector bodies and, along with this, an increased emphasis on the effectiveness, including appropriateness, of achieved outcomes. As a consequence, accountability concerns were more directed to value for money questions than the traditional focus largely on assurance issues. It was imperative that, while remaining independent, the ANAO should be pro-active in adjusting its focus to become more relevant and useful to a changing Commonwealth public sector as a result of on-going public sector reform.

The commencement of performance audits further contributed to the oversighting and accountability mechanisms in place and to an executive government and public sector that is more accountable to the Parliament and citizens. There are many oversighting mechanisms at the federal level – provided by the Auditor-General, other statutory bodies and parliamentary committees (in particular, the public accounts committee and specialist administration or functional committees). Within these mechanisms, performance audits provided an important source of intelligence about accountability of the executive to Parliament and the public.⁵ In my view, this initiative also markedly improved the level of audit assurance to all stakeholders.

Public Sector reforms influencing evaluation and performance audit

The most significant factor impacting on the public sector environment in which audit and evaluation operated in the 1970s was the ‘Coombs Report’, the report of the Royal Commission on Australian Government Administration (RCAGA). The Royal Commission was established in 1974, with the late H C Coombs as chairman. The report was published in 1976. The Coombs Report provided the first comprehensive review of Australia’s modern federal bureaucracy. It recognised that the bureaucracy had ceased to be a ‘neutral’ instrument of ministers. Indeed, it was argued that there were large areas of administration in which neither ministers nor the bureaucracy were accountable to Parliament. In addition to the perceived shortcomings in the accountability mechanisms, there were the new demands for ‘responsiveness’ of officials and increasing demands for greater accountability to the public. Changes to the assessment of government administration were deemed necessary as the so-called central agencies, such as the Public Service Board and Treasury that had some legislative responsibility for assessing departmental and agency performance, were not overly active in doing so. Lack of public comment on achievement of value for money and the efficient administration of programs within departments may well have been a factor leading to the establishment of the efficiency audit function within the ANAO.

The Coombs Report recommended that the responsibility for efficiency (performance) auditing should be vested in the Auditor-General and should have statutory backing. Performance audit was to be a means by which the executive government and Parliament could review the ‘performance’ of departments. As such, these audits were not likely to be popular with the bureaucracy. In this respect, the personal efforts of the then Auditor-General, Mr Steele Craik were important, not only in his presentations to the Commission, but also in his personal approaches to Departmental Secretaries to get their support in undertaking such audits. Further to the establishment of the performance audit function in the ANAO, the need for departmental evaluation was highlighted:

The Commission believes that it is desirable and practicable to establish a regular practice of assessing departmental performance by means which

*provide ministers and Cabinet with the basis on which to form their own judgement.*⁶

Performance audits were an attractive solution to address public concerns about wasteful use of money and other resources, and inefficiencies in collecting revenue in the Commonwealth public sector. The Coombs' Royal Commission, initiated under the Whitlam Labor government, finally reported to a Liberal Coalition government which accepted the notion of performance auditing but not without some opposition, as well as support, within the public service.

The Coombs Report recommended that the ANAO receive a mandate to conduct economy and performance audits (and not 'program results' audits which were equated to effectiveness (policy) reviews). The ANAO would thus have a wider mandate to examine the way in which the policies of the executive government were being carried out, without considering the appropriateness of the policies themselves. The main orientation of the performance audit function was directed as follows:

- towards accountability to the Parliament, the executive and ministers, and to taxpayers;
- towards providing advice to agencies on how to better manage their resources; and
- assisting the implementation of policy.⁷

Performance auditing heralded a new era for the ANAO. In 1979, the *Audit Act 1901* was amended to include the mandate for performance auditing. It gave the Auditor-General power to conduct performance audits of government agencies. However, in the case of government companies, performance audits were to be conducted only at the relevant minister's request or by resolution of both Houses of the Parliament. The Act specified that, once a performance audit had been carried out, the Auditor-General would table a report to Parliament, prepared after considering the auditee's comments.

The then Joint Committee of Public Accounts (JCPA) or the then House of Representatives Standing Committee on Expenditure (HRSCE) would review each performance audit report. The success of the performance auditing program was to be evaluated after a period of three years. The passing of the Act clarified the authority of the ANAO and provided a formal set of mechanisms to review Commonwealth Department's operations. In part, the new legislation was belated confirmation of a perceived need. However, the new provisions of the *Audit Act* gave the necessary legislative sanctioning for a process that had already begun in the ANAO.

Involvement of the Public Service Board and Department of Prime Minister and Cabinet in evaluation and audit

The Coombs Report envisaged that the Public Service Board would have continuing responsibilities for coordinating efficiency improvement activities under section 17 of the Public Service Act 1922 and that the Department of the Prime Minister and Cabinet

would carry responsibility for evaluating the effectiveness of government programs. Statutory provisions for efficiency audits were passed in 1979 with those audits officially commencing in 1980. The Public Service Board was given authority to continue its management improvement functions, including efficiency and staff utilisation reviews. Effectively, the Public Service Board became an 'internal auditor' to the public sector. The Public Service Board's program of *joint management reviews* (JMRs) aimed to address significant management issues, selected in consultation between heads of departments/agencies and the Board, with a requirement to give broad coverage to administrative (mainly corporate) processes in the Service as a whole over a period of about five years.

The JMRs were to consider a range of aspects including the effectiveness of operational systems and procedures, as well as a general evaluation of the overall management performance of the unit or activity under review. By 1979-80, the Board reported the JMRs as a means of promoting efficiency and economy in the Service as well as considering the development, introduction or enhancement of systems to monitor changes in performance. In contrast to the relatively small number of program effectiveness reviews performed in the late 1970s under the auspices of the Department of Prime Minister and Cabinet, the JMRs were quite numerous.

The profile of internal audit, particularly in the area of training, also received greater emphasis from the Board with a follow-up survey in 1982 indicating - among other developments - a growing coverage of economy, efficiency and effectiveness issues in departments. Whether this occurred because the ANAO was now conducting an independent assessment of efficiency in departments is difficult to tell. The Board may well have felt under some pressure and wanted to enhance its position, a concern that was later justified by its abolition.

The Coombs Report recommended that the Department of Prime Minister and Cabinet develop a small policy unit to 'evaluate the effectiveness of ongoing programs against the general philosophy, policies and priorities of the government'.⁸ With the exception of the results of this recommendation to undertake evaluation of government programs, there was only limited formal evaluation of departmental activities undertaken within the Australian public sector. Certainly, whatever might have been done was not generally published. The various research bureaux and some Commissions were exceptions in this respect.

Let me now compare such experiences with major developments in the public sector review environment in North America as their experiences and developments have progressed along a path that Australia would later follow in some important respects.

Evaluation developments in North America

In Canada, a Royal Commission on Government Organisation, known as the Glassco Commission, was in place from 1960 to 1963 and gave rise to Canada's federal evaluation system and capability. The Glassco Commission's report resulted in significant amendments of the Financial Administration Act in 1967. The Commission promoted

management reforms, with decentralisation of authority to ministers, departments and agencies to allow managers greater autonomy in managing. The importance of checks and balances and ensuring accountability of managers to the government was highlighted. As a result, the focus of the Canadian Office of the Auditor General changed from strictly financial management to a more comprehensive, operational management perspective.⁹

Canada's Treasury Board was a major driver of program evaluation with the issue of the *Financial Management Guide* in 1966. The Guide highlighted the need to monitor and evaluate the performance of government activities, using modern management techniques. The creation of a Planning Branch of the Treasury Board Secretariat and a new financial management approach called the Planning, Programming, Budgeting System (PPBS) began the move from central control to decentralised departmental management.

It is worth noting that the USA also commenced using PPBS during the 1960s, starting with their Defence Department. However, they found numerous problems with the system, such as a lack of appropriate data systems, and development and testing of measures with which to evaluate program outcomes.¹⁰ It was found that:

*the lack of an evaluative information base that could speak to actual experience with existing programs weakened the credibility of estimates for the future made by the various analytical techniques used by PPBS.*¹¹

In 1969, the *Planning Programming and Budgeting Guide of the Government of Canada* was published. It expressed the need for program monitoring and assessment. This was addressed as follows:

*Development of a framework for the evaluation of the results of ongoing government programs was initiated by the Treasury Board Secretariat in 1969. Thus departments in the 1970s were encouraged to devise strategies for conducting comprehensive evaluations of their programs' effectiveness and efficiency. Program monitoring was also recommended and was known then as part of a concept called operational performance measurement (OPM). The OPM system was the focus of Treasury Board policy in the 1970s.*¹²

Canada's Treasury Board was involved in developing an evaluation framework throughout the 1970s and was responsible for the first formalised program evaluation policy in Canada. As part of that policy, managers were reminded that they were required to conduct "periodic evaluations in carrying out their responsibility for the management of their programs."¹³ The creation of the Office of the Comptroller General in the late 1970s, and particularly the Program Evaluation Branch, further assisted departments in undertaking the evaluation function.

Canada's program evaluation development experienced an intuitive, rather than systematic, beginning and was significantly influenced by central government leadership and control.¹⁴ Two analysts of the history of program evaluation in Canada from the early 1960s to 1980s describe the development as "a solid decade – almost two – has gone into changing the words and the forms."¹⁵

Those analysts identified the following shortcomings in Canada's program evaluation:

- lack of agreed theory and purpose;
- general (that is, group/organisational) resistance to evaluation activities; and
- attempts to establish comprehensive evaluation systems that failed to consider the true nature and information needs of the user.

Another critic stated that Canada's federal program evaluation had failed and that, rather than being an objective field of study, program evaluation had become a political process.¹⁶

The development of evaluation at the federal level in Australia has great similarities with that of Canada but with a substantial time delay. Put simply, in Canada reform started with the decentralisation of authority to the departments, secretaries and ministers to pursue the approach of 'letting the managers manage'. Then the Treasury Board's actions in implementing the Planning, Programming, Budgeting System to introduce a new financial management approach reinforced this move to decentralisation. A framework for the evaluation of results of on-going government programs was created by the Treasury Board Secretariat but the evaluations were undertaken by the departments. Australia's experience with evaluation progressed along the same broad path, but predominantly during the 1980s and 1990s, with devolution of authority, emphasis on managers managing, and a program management and budgeting approach. Evaluation was made the responsibility of departments with some oversight through mechanisms such as occasional reviews, coordination guidance and advice on relevant topics from central bodies, such as the now Department of Finance and Administration (Finance), which have had a major role in driving the evaluation strategy. This comparable development within the Australian public sector is more evident in the next section outlining the changes in evaluation during the 1980s.

As I noted earlier, the increased importance of achieving value for money and improving government administration were two important drivers behind the commencement of performance audits within the ANAO. There was a greater focus on efficiency improvement by the Public Sector Board and the Department of Prime Minister and Cabinet which generated increased performance assessment of departmental performance. Independent review of public sector performance by the ANAO furthered a growing results-oriented approach and was undoubtedly a catalyst to the growing interest in evaluation of government programs and their management. The development of this framework pursued a path similar to that which had occurred in both the US and Canada and its importance continued to grow and intensify throughout the 1980s. I am personally in no doubt that many public servants and their organisations learnt a lot about evaluation approaches, methodologies and techniques from their North American counterparts during this period.

3. MARKED PROGRESS IN THE 1980s

The 1980s witnessed a period of growth and consolidation of the performance audit function and expansive development in the framework for evaluation of government programs. Performance audit became more structured and methodical in both its planning

and conduct of audits. Numerous reforms to government administration were undertaken leading to the creation of a public sector wide evaluation strategy for programs which was oversights and administered by the then Department of Finance.

Performance audit development

The performance audit function ran into early problems within the ANAO, largely due to the Office's inability to properly set the scope for the audit, manage the project and define an appropriate methodology. This was made worse by difficulties then being experienced with staffing the performance auditing division. Not surprisingly, there was not a great deal of evaluation expertise in the public sector, other than in the specialised areas previously referred to, and in academia. Such expertise largely had to be developed in-house, and/or brought-in by recruitment or contract. The growing demand for evaluation exacerbated this shortage of skilled personnel.

Despite the problems, successive Auditors-General were keen to ensure the performance function was successful. Keith Brigden, Auditor-General from 1981 to 1985, brought new perspectives on performance auditing. In an effort to dispel the disquiet surrounding the performance audit function, Brigden disbanded the efficiency audit division and integrated the staff back into the main office. He also turned his attention to the methodology being employed and started to document procedures and develop a framework for conducting performance audits – a framework that has been generally retained and refined to this day.

As a first step in the performance audit process, areas of materiality and vulnerability were to be identified as the source of a possible study. A preliminary study was to be undertaken to determine the suitability of an area for an in-depth efficiency audit. The audit's focus, scope, timing, staffing, review process and resources were then determined, and the auditee was formally advised that an efficiency audit would be conducted. As the audit was carried out, preliminary audit findings were discussed with auditee management. An 'issues paper', a 'preliminary draft report' and finally a formal management letter then followed. Auditee responses to these documents were taken into account in a report provided to the auditee for final comment in accordance with provisions in legislation. Positive interactions with auditees were crucial to the success of an audit, but they also had the potential to blow out audit time and costs. This had to be managed. This new framework was a notable advance in giving performance auditing a considerably more structured approach and methodology.

The improvements in performance audits and their ability to add value to the public sector is evidenced by the JCPA statement that 'there is no doubt that parliamentary committees eagerly await the arrival of efficiency audit reports'.¹⁷ Considerable attention was given to audits where recommendations had been made for major improvements in public management and administration; significant cost savings; or increased government outlays to overcome administrative deficiencies. This focus enhanced the importance of audits addressing these issues and contributed to enhancing the strategic fit of performance auditing with developments within the public service, with an emphasis on results and efficiency and away from what has been described as a 'burdensome concentration on process and procedures'.¹⁸

By the late 1980s, advances in performance audit procedures and progress on defining the scope of audits had been made. Projects were smaller in scope, and reports were taking approximately twelve months to complete. The ANAO had begun to document various aspects of its methodology. Further, the costing of audits had been examined and the previous costing approach, which identified only the direct costs of the performance section, had been replaced with a method which included an allocation of all general overheads. In addition, for audits conducted after 1988, cost estimates were prepared on each audit in advance and variances reported at the end of the audit. This more structured and methodical approach to performance auditing was mirrored by the move toward a more formal and effective strategy for evaluation within the public sector.

Public Service reforms and their impact on evaluation

The first part of the decade was dominated by significant Parliamentary and Government reviews such as the *Review of Commonwealth Functions (Lynch Report 1981)*, the *Review of Commonwealth Administration (Reid Report 1983)* and far-reaching reviews by the new Labor Government - *Reforming the Australian Public Service – a Statement of the Government’s intentions* (December 1983) and *Budget Reform – A Statement of the Government’s Achievements and Intentions in Reforming Australian Government Financial Administration* (April 1984). The latter reviews emphasised the continuing responsibility of departmental managers to monitor and assess the effectiveness of programs.

Two major initiatives, the Financial Management Improvement Program (FMIP) and Program Management and Budgeting (PMB) were at the centre of the various financial reforms. For example, the Budget Reform paper endorsed the development of the FMIP as a major vehicle for improved performance and indicated that:

*Fundamental to improved management will be encouragement of managers to devote more attention to the results and outcomes of their work, and not just compliance with established rules and procedures.*¹⁹

These two initiatives aimed to shift management emphasis from a compliance orientation toward performance by allowing greater flexibility and the managerial discretion to pursue the objectives of a program in a manner considered to be most appropriate and which would result in efficient and effective outcomes.

During 1984-85, the Public Service Board reviewed its own programs and priorities to align its management improvement activities with the goals of the Government’s public service reforms. The Board noted that the various management reviews were mainly directed to administrative efficiency in program delivery and decided that in the future it would consider whether the objectives of a program were sufficiently well defined in terms of relevant policy aims and the extent to which program activity was being directed efficiently to those objectives. The Board emphasised it would always consult Secretaries of departments before commencing any review and, perhaps more importantly:

*would obtain relevant ministerial endorsement where its reviews are likely to impinge upon policy issues and would not become involved in the evaluation of policy per se.*²⁰

In future, the review program would be termed Program Management Performance Review (PMPR) and replace the JMRs. As noted earlier, the responsibility for effectiveness assessments was now allocated to individual Ministers and their departments.

On the efficiency front, there was at least one more initiative I should mention, if only because it turned out to have far reaching consequences for much of what I have described. That initiative was the establishment, at the end of 1986, of the Efficiency Scrutiny Unit (ESU) located in the Department of Prime Minister and Cabinet. The ESU was modelled on the so-called Rayner unit which had existed in the United Kingdom since 1979. The ESU was to operate for a period of three years and oversee an extensive program of scrutinies of selected areas of public sector administration. The unit was headed by Mr David Block, a prominent Australian businessman with extensive financial sector experience. A total of 44 scrutinies were completed in just less than two years of the ESU's existence.

The JCPA, while noting the major differences between the efficiency audits and the scrutinies, was sufficiently impressed to recommend the undertaking of efficiency audits within six months to determine the effects on resources, selection of topics and accountability to Parliament. These audits were to be undertaken for two years on an experimental basis. Three days after the 1987 election, the then Prime Minister announced that the Government had accepted recommendations in a report from the ESU to abolish the Public Service Board and replace it with a much smaller Public Service Commission. The management improvement programs were to be devolved to departments, with some specific responsibilities going to central agencies such as Finance and Industrial Relations. Along with many other provisions, the long-standing section of the Public Service Act 1922 was repealed. It was truly the end of an era.

Even though management improvement was devolved to the departments after the demise of the Public Service Board there was not a vacuum in terms of assistance for departments in regard to management issues. A Management Advisory Board (MAB) was established under section 22(2) of the Public Service Act. Chaired by the Secretary of the Department of Prime Minister and Cabinet, MAB was to be a policy advisory and information-sharing body. To assist it to perform this function, MAB established the Management Improvement Advisory Committee (MIAC) in December 1989. MIAC comprised Senior Executive Service staff from a range of central and line agencies to provide advice and prepare discussion papers. Sixteen such papers were prepared, on subjects highly relevant to this conference such as performance information, accountability, and performance management. These were generally well regarded and well received as useful review material and desirable practice.

The numerous reforms and changing roles within the public sector and the trend toward decentralisation, as well as devolution of authority, within the public sector framework led to the government's implementation in 1987 of a public sector wide evaluation strategy. This strategy was to assess the results of programs and would also be used as the basis for analysing funding for future program proposals. The broad objectives of the evaluation strategy were as follows:

- to encourage program managers within portfolios to conduct and use evaluation as a standard and commonplace management tool;

- to provide fundamental information about program performance to aid Cabinet's decision making and prioritisation, particularly during the annual budget process when there is a large number of competing proposals being considered; and
- to strengthen accountability in a devolved environment by providing formal evidence of program manager's stewardship of program resources.²¹

This new strategy encouraged a much more decentralised, methodical approach to performance assessment than undertaken previously and would provide a suitable framework to assess the outcomes achieved by a program, assistance in decision making and a public sector more accountable for its results.

The evaluation strategy consisted of the following three formal requirements:

- each portfolio is required to prepare an annual portfolio evaluation plan (PEP) covering the major evaluations to be conducted over the three years;
- new policy proposals submitted to Cabinet must include arrangements for the evaluation to be conducted if the proposal is accepted; and
- completed reports of evaluation are to be published, thereby permitting wide dissemination of evidence on program performance and permitting scrutiny of the rigour and objectivity of the evaluation.²²

The then Department of Finance had considerable involvement with the strategy. It promoted evaluation extensively in conferences, seminars and workshops, assisted with training programs and gave instruction to managers, monitored the evaluation process, provided staff for management (oversighting) committees, and even for working groups for certain evaluations on request by agencies, and offered advisory assistance in conducting others. Finance attempted to maintain relevance for evaluations by linking their outcomes to the allocation of resources. The approach taken by Finance in assisting departments to conduct their evaluations had great similarity to that utilised in Canada, as outlined earlier, particularly by the Office of the Comptroller General in overseeing evaluations. The success of this evaluation strategy, implemented in the late 1980s, will be addressed in the following section focusing on audit and evaluation in the 1990s.

Evaluation and performance auditing experienced significant growth and prominence during this decade, as they became more important with the devolution of authority and decentralisation of the public sector and the development of numerous government administrative reforms. Performance audit developed into a more methodical and structured tool in assessing departmental efficiency and evaluation established itself as government strategy that would assist performance assessment, decision-making, and provide greater accountability. In my view, the success of evaluation at the Federal level of government was largely due to its full integration into the budget processes. At least where there was a resource commitment, some form of evaluation was necessary to provide justification for virtually all budget bids.

4. MATURITY IN THE 1990s

The last decade has seen performance audit become a legitimately accepted form of auditing within a well developed framework and structure for the function. Procedures and methodologies have been further refined and relationships improved, in most cases, between the ANAO and departments and agencies. The use of suitably qualified personnel, either internal personnel or through the contracting of specialist skills, and surveys to obtain feedback from auditees has played a significant part in this improvement.

Evaluation has experienced an apparent reduction in importance within the public sector with the demise of portfolio evaluation plans (PEPs) and a desire for evaluation to become less process-oriented and more a part of the regular performance management framework within agencies. Nevertheless, an ongoing requirement for reference to any evaluation as part of a Cabinet submission has maintained a degree of discipline in the process. As well, the focus on performance (results) and its measurement has put emphasis on evaluation, particularly in relation to performance targets and actual performance achieved.

Performance audit function consolidation

In 1989, the JCPA conducted a comprehensive inquiry into the ANAO²³. Their report made many recommendations reinforcing the ANAO's role and capacity as well as endorsing the importance of the performance audit function to Parliament and the ANAO's responsibility for this function. The 1990s consequently saw significant growth in the performance audit function. Performance audit established itself as a legitimate tool for the ANAO to add value to the public sector's performance, as well as to provide a credible level of assurance to stakeholders, particularly the Parliament, about conformance as well as performance.

While confirming that performance audits were of value, the JCPA questioned the prevailing situation at that time where the *level* of performance audit activity was determined by the funds remaining after discharge of the financial statement function. This reflected the non-discretionary nature of the latter function. This situation was considered totally inappropriate. Instead, an increase in allocation for the performance function (to approximately 50 per cent of total audit activity), was recommended that would signal the equal importance of performance auditing to financial statement auditing. The ANAO's response to the JCPA's report recommended a separate determination of the Auditor-General's budget for both financial statement and performance audits, arguing that performance auditing was an 'evolutionary discipline to be built up over an extended period – the point has well and truly been reached now where a separately funded program should be introduced'²⁴.

The JCPA endorsed the use of multi-disciplinary teams to carry out performance audit functions, arguing that topics should be selected so they covered more than one program, and in consultation with the Department of Finance and relevant Parliamentary committees. The JCPA also stated that audits should be shorter (approximately six months) and that the main results should be reported in the biannual reports to Parliament.

Of greatest consequence, however, was the JCPA's recommendation to overhaul the *Audit Act*. This led, eventually in 1997, to the replacement of the *Audit Act* with the *Auditor-*

General Act, Financial Management and Accountability Act, and the Commonwealth Authorities and Companies Act. These acts formed the legislative framework within which performance audits were to be conducted, including the powers and responsibilities of the Auditor-General and the accountability framework with which Commonwealth bodies were to comply. These Acts were principles, not process, based and thus reinforced the notion of devolution of authority and perceived responsibility of the Agency Head, as well as that of all delegates. Any prescription of required practice was set out in Chief Executive's Instructions (CEIs).

In the ANAO, one of the most significant developments in relation to performance auditing in the 1990s was the formation of a separate 'Performance Audit Business Unit' and a separate 'Financial Audit Business Unit' in 1992-93. This mirrored the two core products of the organisation. The performance audit function was treated as a separate entity and is currently of equal importance to financial auditing. The separation of the two functions meant that significantly more resources, especially management resources, were applied to the performance auditing. The performance audit function was clearly identified and became more accountable for its own performance as a business unit.

The relationship with auditees had long been an area of concern for the ANAO. Due to the very nature of a performance audit, examining, as it does, management processes and systems, requires an on-going cooperative relationship between the ANAO and the auditee for an effective outcome. ANAO and auditee relationships in the previous decade were not particularly good, as aspects of the performance function were often disputed by agencies. To address these areas of concern, the ANAO in the early-1990s adopted three strategies to improve the effectiveness of performance auditing:

- audit planning processes were implemented;
- appropriate personnel with relevant skills were selected; and
- best practice guidance was documented.

These strategies were relatively piecemeal in the early stages of the decade, but they were progressively better developed and integrated as a coherent planning and operational framework, thus contributing to the transformation of the performance auditing function to an effective element of the integrated audit products being delivered by the end of the decade.

The first strategy adopted to overcome the combative culture which existed between the ANAO and auditees was to improve the planning processes in the selection of audits. Early in this decade, the ANAO identified a cycle of audit coverage for every Commonwealth portfolio, and future work was planned accordingly. A balanced program of performance audits was developed and for the first time this contained performance audits which examined issues across Commonwealth public sector agencies. In 1990-91 the first two of these were completed: *The Survey of Internal Audit in the Commonwealth Public Sector*²⁵ and *Specific Purpose Payments to and through the States and Northern Territory*²⁶.

Not only were these audits conducted across public sector agencies, they were the first audits in which data was gathered by surveys. In a further effort to improve the service to

auditees and the wider community, some audits were conducted with the expressed focus being on a thematic issue. In these audits, the savings were likely to be more comprehensive than just monetary savings and hence more difficult to quantify. Although the use of themes was not well articulated at that time, their use was to prove to be the beginning of a comprehensive strategy that provides an overall coherence to audit selection reflecting the development and priorities of the public sector as a whole and those of individual agencies and entities.

The second strategy to encourage confidence in the performance auditing process was the attention given to personnel selection and continuity as far as organisational requirements permitted. In addition, expert consultants were contracted in an increasing number of audits to provide specialist advice and assistance to the performance audit teams. Furthermore, the ANAO, for particular audits, adopted the practice of seconding a member, or members, of the auditee department to the performance audit team.

The third strategy focussed on the refinement and documentation of audit methodology. Continuing to refine the products offered was also one part of the strategy employed to add value to the service being offered.

The ANAO's Auditing Standards were first publicly issued in Commonwealth Gazette No S451 on 8 September 1986, and subsequently re-notified on 7 August 1987 in Gazette No. S200. Subsequent revisions were made and included in an ANAO publication on 1 October 1991²⁷. These Standards continued to be regularly revised and made public. A basic guide on elements of efficiency auditing was published in 1986²⁸. In 1992, the ANAO first published *A Guide to Auditing Program Evaluation*,²⁹ and a *Performance Audit Guide*³⁰ for assistance to ANAO's staff. During 1992-93 *A Practical Guide to Public Sector Internal Auditing*³¹ was produced to provide guidance to both public sector managers and internal auditors.

Use of the above documents, in conjunction with Australian Auditing Standards established by the professional accounting bodies, assisted the ANAO to give credence to the view that performance audits were being conducted with professional guidelines and with a technical and intellectual rigour. Finally, the ANAO produced general guidance for entities on the conduct of performance audits in 1996.³²

This technical and intellectual rigour is further demonstrated by the various skills that the ANAO brings to bear in its performance audits. In a number of instances, the ANAO undertakes audits that require a variety of specialist skills and in which value can be added through the input of particular specialists. Consultants provide the ANAO with access to specific skill sets and knowledge that may not be available internally and are only required for audits of a specific topic. The wide-ranging coverage of over 50 performance audit reports a year poses a considerable challenge for our audit methodologies, analytical approaches and available skills.

For example, in conducting an audit on the management of the National Highway System, administered by the Department of Transport and Regional Services, the ANAO engaged a prominent academic to advise on econometric techniques to benchmark road maintenance efficiency. This enabled the ANAO to utilise a linear programming tool to:

*identify those links displaying best-practice performance and then develop a measure of the technical efficiency of the practices used for the management of each link.*³³

In 1997 an audit was undertaken to address the issue of performance management of inventory in the Department of Defence. This particular audit, which has gained significant international recognition, utilised a well credentialled consultant to research and prepare a report on better practice principles and to assist the audit analysis. The consultant's input assisted the ANAO in developing the following findings,

*Defence has much to gain from the use of both internal and external benchmarking as part of its logistics performance management strategy. It would provide a useful mechanism for enhancing progress already made in improving inventory management practices.*³⁴

The expert knowledge that such a consultant can bring to audit topics of a specific nature is essential in demonstrating to auditees and Parliament that the ANAO will seek personnel with the most appropriate skills to ensure that our recommendations are professionally supported and suitable for the organisation. An important internal outcome for the ANAO is the knowledge and skill transfer than can occur with such arrangements.

A good example of the foregoing is the audit report on Bank Prudential Supervision³⁵. There was some early resistance in previous years to any performance audit in this area because of the 'limited expertise in Australia necessary to conduct such an audit'. The clear implication was that the ANAO did not have the necessary skills or experience and would not be able to acquire them. The later report reflected not only the auditors' knowledge and detailed understanding of the supervisory environment but also the skills necessary to deal with assessing adherence to international standards for prudential supervision and the associated risk management practices. All recommendations were accepted.

The ANAO's Report on *Commonwealth Foreign Exchange – Risk Management Practices*³⁶ is another good illustration of the usefulness of a well structured approach, sound methodology and analysis in a technical area where there is quite limited public understanding of the issues and operations, including management of risks. Treasury commented that it considered the report to be important and well prepared. We did engage a financial adviser who was important in examining, among other aspects, hedging strategies.

Statistical analyses and surveys are often embraced in performance audits to contribute to the technical rigour of the information published. The ANAO recently undertook a performance audit of Centrelink to assess the extent to which new claims for Special Benefit had been determined in compliance with the *Social Security Act*, the Guide to the Act and other relevant guidelines, and whether Centrelink and the Department of Family and Community Services had appropriate procedures to help ensure such compliance. To obtain the most accurate approach possible for the sample, the ANAO contracted the Australian Bureau of Statistics (ABS) to design a sampling strategy that would enable reliable estimation of assessment error rates in the population. Specifically, the ANAO sought written advice from ABS concerning:

the development of an appropriate sampling methodology in terms of how many assessments would need to be examined and how those assessments would be drawn from the various Centrelink Customer Service Centres throughout Australia; and

the development of specifications for the actual selection of assessments from particular Centrelink Customer Service Centres.³⁷

The ABS is of considerable assistance to the ANAO in constructing surveys and undertaking sampling and ensuring that our findings are based on a true and accurate representation of the data examined.

These three tools mentioned - the use of academics, consultants and the ABS - are just examples of the various approaches that the ANAO has utilised in preparing audit analyses and reports that are based on a wide range of expertise to ensure stakeholder confidence and to add value to the public sector's performance.

However, some performance audits are still contentious. It is often argued that one way to judge whether performance audits add value to public administration and accountability is related to the acceptance of the recommendations. For a performance audit to be regarded as a success, the majority of recommendations should be accepted and implemented by the auditee. It is to be noted that, from the mid 1990s, approximately 90 per cent of the ANAO's recommendations were accepted. However, we also had a recent report where not one recommendation was accepted by the agency concerned³⁸ - the first issue was taken with the audit analysis which was subject to a degree of public debate. That, in itself, can be very healthy for good governance, particularly where any areas of difference are clearly specified. At least the government's approach is to be reviewed as a result of the audit.

To further help overcome the relationship issues experienced between the ANAO and agencies, and as part of the commitment to add value to its products, from 1995-96, a survey of auditees has been conducted after each performance audit is tabled. Carried out by an independent analyst, these surveys seek the views of senior management of the agency audited by utilising questionnaires and interviews. One of the most discernible trends has been a widely held perception that the ANAO has moved from a 'gotcha' mentality to one of 'adding value' to the client product. It is a further indicator that the ANAO sees itself as having two main clients: its primary client being Parliament, and the auditee being regarded as a client also. This is a relationship issue, which is also important in undertaking evaluations.

Another significant change in the relationship with auditees, as the performance auditing process has become more established, is the move toward a more joint approach. Although it is always up to the Auditor-General to decide whether to engage in audits, agencies now actually solicit work from the Office and seek its cooperation in joint work. Members of Parliament, as well as Ministers, have also sought to involve the services of the ANAO to undertake particular audits.

To help make ANAO reports more user-friendly, each performance audit now contains a short brochure detailing the major features of the audit. A survey conducted in 1997 showed that, although the ANAO needed to improve the mechanisms of consultation with parliamentary committees, ANAO reports were regarded as a credible information source

for parliamentarians, and 50 per cent of survey respondents considered that the reports produced desirable change in public sector administration. Such feedback is essential for any review, audit or evaluation.

Continuing the refinement of the 'products' offered has been one part of the strategies employed to add value to the service being offered to auditees. Two relatively new ANAO products to help improve performance in the public sector emerged in the later part of this decade: Financial Control and Administration Audits (FCAs) and Better Practice Guides (BPGs).

FCA audits (performed under section 18 of the *Auditor-General Act 1997*), are general performance audits that are across-the-board reviews, typically involving between ten to fifteen organisations, where business processes that support the delivery of outputs are examined. The results are reported generically to Parliament, and are not attributable to specific agencies. FCAs can also form the basis of a BPG. BPGs aim to improve public administration by ensuring that examples of best practice employed in public sector and/or private sector organisations are promulgated to the whole of the Commonwealth public sector. The guides may be produced in conjunction with an audit, or might be prepared as a result of a need to provide guidance material in a particular area of public administration.

Initially the guides were somewhat *ad hoc*. The first, produced in 1993-94, was *A Best Practice Guide for the Administration of Grants*. During the latter part of the decade, the production of these guides was an integral part of the performance audit strategy, with six produced in each of 1995-96, 1997-98 and 1999-00, and eight produced in each of 1996-97 and 1998-99. BPGs are well received by agencies, as they do not target any problems with a particular agency but are seen as important and useful for agencies generally as Central Agencies now provide less guidance to agencies under the more devolved approach to public administration. I stress that the latter was not a factor in our decision to increase our BPG activity.

Despite early problems, performance auditing has emerged as a constructive tool in improving public administration in the 1990s as earlier problems were addressed. The relatively short history of performance auditing reveals that the ANAO has been dynamic in its approach and able to maintain its relevance and add value to public sector performance. This outcome is only possible where the quality and professionalism of its approach, methodologies, analyses and recommendations are accepted by our stakeholders.

Developments in the Public Sector evaluation strategy

The acceptance of the evaluation strategy was mixed during the early 1990s. Between 1989-93, major evaluations in progress increased from 55 to 250, indicating that departments had adopted the approach. Finance stated that although there was room for improvement, 'the spread of an evaluation culture in departments has improved the rigour and objectivity of the studies'.³⁹ The increased development of an evaluation culture within the public sector can be further evidenced by the continued growth of the Canberra Evaluation Forum, which is strongly supported by the ANAO. This provides yet another avenue for issues related to evaluation to be discussed and communicated throughout the public service. However, there were other indications of some reluctance to utilise the

evaluation strategy. Submissions to Cabinet proposing a policy initiative involving more than \$5 million per annum were required to outline a strategy for evaluation, yet Finance reported that only 30 per cent of proposals met this requirement in 1992-93.⁴⁰

The use of evaluation, in its previously described form, experienced its most expansive growth during the late 1980s to the mid 1990s. In July 1990, Cabinet agreed that the results and reports of evaluations included in the annual portfolio evaluation plans should normally be made public. Evaluation activity had been included in annual reports. However, this was later complemented by a Register of Published Evaluation Reports⁴¹ compiled in cooperation between Finance and all other portfolios. However, the contribution of evaluation outcomes to government performance appeared to be variable. Early reports stated that, in 1992-93, policy initiatives that had utilised and been influenced by evaluation were experiencing a success rate similar to those initiatives which had not used evaluation.⁴² In the years following, Finance released a discussion paper on the use of evaluation in the 1994-95 budget suggesting that 'even though evaluation may only be one source of information influencing proposals and Cabinet's deliberations, it is playing an increasingly significant role'.⁴³ These findings seem to indicate that evaluation has a part to play in contributing to government performance but it is not the sole answer to all performance management issues.

In the late 1990s, a new approach to evaluation was developed by Finance in consultation with other APS agencies due to the view that the formal requirements of the Government's evaluation strategy resulted in a predominantly process-oriented approach to evaluation. The new approach aimed to allow secretaries and other heads of agencies to take charge of performance management in their organisation. Finance developed a number of principles for agencies to aim for. These were for agencies to use to improve their performance management approach incrementally and to enable evaluation to become an integral part of a performance management framework across the APS.⁴⁴ The most relevant of the Good Practice Principles put forward by Finance, in regard to evaluation, is the following:

*Ongoing performance monitoring and periodic program evaluation are balanced and used appropriately: program performance is monitored on an ongoing basis and complemented by periodic program evaluation, generally within at least a five year cycle.*⁴⁵

This further decentralisation of evaluation to agencies as part of their performance management framework, if utilised effectively, can have many positive outcomes for those agencies. The approach allows personnel within the organisation who have a strong working knowledge of the business, the processes, and the culture, to undertake timely evaluation, and not to meet a standardised timeframe set for the whole public service. Ongoing evaluation of business performance, combined with periodic, far reaching reviews of particular programs or issues, will contribute to the use of an effective evaluation framework. It will also enable organisations to gain a more informed strategic view of the organisation's performance and of any changes that need to be made to improve that performance. The use of information obtained from evaluations at all management levels is crucial to ensure that evaluation remains relevant and adds value to the organisation. Importantly, evaluation can be a basis for both identifying and testing performance measures or indicators.

I have noted that technical and intellectual rigour, through the use of appropriate procedures, relevant methodology, and the employment of particular expertise where required, have contributed to greater success and acceptance of the performance audit function during the 1990s. The development of products such as Better Practice Guides has shown responsiveness toward agencies and provided them with valuable information and a tool that can assist them to improve their performance in particular areas. The formal evaluation strategy adopted by the government during the late 1980s had some success during the early part of the decade but to achieve a less process-oriented form of evaluation the function has been further decentralised to agencies to enable evaluation to become a contributor to organisation's performance management framework. This approach, if used effectively, can enable departments to better utilise evaluation results to improve their performance.

The next section addresses a few topics that have, in recent times, become of great interest to public sector managers and will undoubtedly influence the functions of evaluation and performance audit for the foreseeable future .

5. IMPACT OF SOME RECENT PUBLIC SECTOR REFORM DEVELOPMENTS

Contract Management

The growth of contracting-out government functions during the 1990s has resulted in a new focus for evaluation and audit. The entire process from the request for tenders through to the implementation and contract expiry must be assessed to ensure that the government is achieving value for money and that accountability and transparency are maintained and that identified outcomes are achieved. This is the challenge that agencies, the evaluation community and the ANAO must seriously tackle to address the numerous issues involved in contract management so as to properly assess contract performance and subsequent outputs and outcomes, using budget terminology. Not least of these issues is the involvement of the private sector, particularly as a supplier of government services, with the agency concerned still being accountable for the overall results being achieved.

Proper risk management is an essential element of the evaluation process as, indeed, it is in all areas of public administration. It is certainly a useful, pro-active step in pre-empting contractual problems and contributes to effective corporate governance. Risk management requires the identification of all risks, determining their priorities and evaluating such risks for their potential impacts on the resources required and outputs/outcomes achieved in accordance with the risk assessments made. Contracting-out can create a number of significant risks but these have to be balanced against the major benefits. The latter were identified in an Industry Commission report in 1996 into competitive tendering and contracting by public sector agencies, which found that contracting-out can yield cost savings from efficiency gains, lower labour costs and a clearer outline of outcomes and responsibilities.⁴⁶

Risks to be addressed by agencies include external risks such as legal issues, policy changes, contractor business failure and internal risks such as lack of appropriate skills/knowledge for awarding and managing contracts, failure to meet performance targets, and management information system failures. These risks need to be analysed

prior to the commencement of the contractual relationship as well as during the life of the contract. By utilising a risk management process, as part of contract management, agencies' approach to corporate governance is enhanced and able to provide greater assurance that risks are managed to ensure the achievement of the agency's objectives.

The establishment of the contractual relationship between agencies and contractors can play a significant role in successful management of the contract. Forming a genuine relationship between the public and private sectors contributes to a cooperative arrangement where parties operate in tandem rather than at arms' length and where there is some room for appropriate trade-offs. This approach to contractual management also assists in the creation of a win/win situation. A more networked or alliance/partnership approach can also help to overcome the inflexibility of a contract and can generate efficiencies as well as reducing transaction costs. However, more networked arrangements either between public sector agencies at one or more levels of government, or with the private sector, can create governance issues where both managers and evaluators need to consider both the performance of the individual agency itself as well as its performance as part of the networked arrangements. This 'dual accountability' for performance does pose challenges for the approach taken in both evaluation and audit.

Communication is a key to developing a successful relationship and a contract will generally be successful if the purchaser/provider relationship is positive. The ANAO Better Practice Guide on Contract Management states that the following are some of the essential communication issues in achieving a successful relationship:

- *it is important that, if conflicts or performance issues do arise, adequate time is taken to obtain the facts and find a mutually agreed solution; and*
- *building rapport with the other party may also help communication, eg. by identifying and exploring common interests and views.*⁴⁷

Recent legal developments have effectively resulted in most contracts having a relationship perspective as the Australian courts have accepted in a number of recent cases that to perform in good faith and to act reasonably is an implied term in every contract.⁴⁸ The implications of these developments and the resulting variations in contracts that can occur as a result of the day to day purchaser/provider relationship were outlined at a recent seminar on Commonwealth sector legal issues.⁴⁹ During this seminar Dr. Nick Seddon, who spoke positively about the ANAO's Better Practice Guide on Contract Management, outlined in his paper on contract performance management that:

*No matter what you draft, it can be changed because of the basic proposition that the parties can change the contract by their conduct, including the way the variation procedure operates.*⁵⁰

Contract variation can take place in an informal manner as a result of conversations and be legally binding. This has implications for contract management, as the issue becomes management related and not confined to a legal arrangement, therefore requiring tight management practices to avoid unintended variations.⁵¹ Most public servants have not had to consider such issues and, consequently, there is a steep learning curve for all involved.

Developing a culture of ongoing performance management supported by clear lines of accountability is arguably the single most important aspect of successful contract management. Organisations that are successful in achieving a credible, robust and trusted performance management framework will earn stakeholders' confidence and support. Performance assessment with respect to contract management has a number of problems. These include agencies failing to take responsibility for contractor actions, difficulty in specifying needs and outcomes as well as being able to effectively measure those outcomes.⁵²

As outlined in the Better Practice Guide on Contract Management, ensuring measurement and monitoring of actual performance in relation to the planned or desired performance is the responsibility of the contract manager. To enable the contract manager to achieve this, effective performance criteria or standards must be established and performance indicators used to contribute to performance assessment. Where there is a discrepancy between actual and expected performance, analysis should identify the reasons for non-performance and corrective action should be taken. This should be a standard approach to evaluation, yet a number of agencies have experienced difficulties in implementing such a framework, as shown by a recent audit in Defence:

*There is no procedure for regular review of contractor performance or for formal review at specified stages throughout the life of a contract... It would be preferable for DEO (Defence Estate Organisation) to monitor, through a planned program of focused reviews, contract work involved in the delivery of the FACOPS Program to ensure that work is being delivered as required under contract.*⁵³

Two areas of this contract assessment process which have been identified as problematic include management information systems and performance measures or indicators. It is increasingly important to develop management information systems able to gather relevant and timely contract performance data in a format which can be utilised by a contract manager in making decisions and evaluations in regard to performance achievement. These systems can be further utilised in achieving continuous improvement and best practice by recording information such as feedback on performance, new techniques, new evaluation approaches as well as lessons to be learned from the evaluation process.

The Audit Review of Government Contracts conducted in Victoria, known as the Russell Report, found that systems implemented to monitor contract performance were often short term, quantitative, and unable to capture important performance aspects.⁵⁴ The following statement further supports this view of unsatisfactory systems: "many senior executives (government) do not yet have management information systems which allow them to meet basic reporting requirements".⁵⁵ This leads on to the issue of performance indicators. Selection of performance indicators appears to be a major area of importance but little practical guidance is available on the topic:

*(Neither) Australian nor international evaluation literature give credible guidance on criteria for selection or design of performance indicators and are silent on the issue of assigning decision rules for action consequent on 'indications'.*⁵⁶

The popularity and use of balanced scorecards within organisations have grown due to the fact that indicators for various aspects of performance can be addressed by using this tool. As well, it can link short term, operational goals to longer term, strategic objectives. This is a positive outcome as it is important to utilise not only quantitative but also qualitative measures to assess performance, particularly where these aspects of performance are of equal importance, and to link these indicators into the strategic evaluation of contract management.

I would like to touch briefly on a number of other issues that have implications for the effective management of contracts and the subsequent performance. Succession planning and the associated issues are frequently overlooked during contract negotiations, but are important. A contract needs to be reviewed before deciding to renew, market test or bring the function in-house. This is of particular importance given the fact that a number of Commonwealth Government agencies will have contracts expiring in the near future as a result of the substantial outsourcing that occurred during the 1990s. Such reviews should involve external and internal environmental analysis to address strategic changes that may have occurred since the awarding of those contracts. These could include changes in policy, technology available or environmental legislation that must be complied with.

Once these strategic issues have been identified, a contract-needs evaluation can identify changes in the organisation which may require variations in the contract, development of new, more relevant performance measurement criteria, or disengagement and new market testing. This evaluative review will also need to address the purchaser/provider relationship, actual performance, financial factors, customer satisfaction, and procedural issues.⁵⁷ Such a review provides agencies with the best opportunity to assess contract performance. It can demonstrate how effective the strategy has been in achieving the government's outcomes as well as providing essential information to support decision-making and assists in providing assurance and accountability to the Parliament that the contract provides an efficient and effective means to achieve required outputs.

Another significant contract management issue relates to the extent to which accountability and transparency of processes can be assured when commercial-in-confidence and access to contractors' records and premises become issues. These questions were addressed by the Senate Finance and Public Administration References Committee in its 1997 inquiry into Contracting Out of Government Services. It is important for the ANAO to have access to records and information relating to contractor performance in order to fulfil its statutory duty to Parliament. Agencies also share this need, as managers must be able to meet their accountability requirements and, in this respect, regular contract monitoring and milestone review is essential.

The Auditor-General Act allows me access to contractors' records and commercial-in-confidence documentation but there is no provision for access to contractors' premises. I am pleased to report that this issue has been recently addressed as a result of a Joint Committee of Public Accounts and Audit (JCPAA) recommendation, with the Minister for Finance agreeing that standard access clauses should be in contracts between agencies and contractors to address accountability and managerial issues to meet both the ANAO's and agencies' needs. The Senate Finance and Public Administration References Committee in a recent report on Commonwealth contracts⁵⁸ supported the set of criteria developed by the ANAO for determining whether a sound basis exists for deeming information in contracts confidential. As well, the Committee recommended changes to

the Senate Order of June 2001 which increased the openness and accountability of all Commonwealth contracts with a value of \$100,000 or more aimed at strengthening and clarifying the order.⁵⁹

Growth in the use of information technology and outsourcing

The expansive and dynamic growth in information technology (IT), including communications, in the delivery of government and private services will continue to have an ever-increasing impact on the nature of evaluation and audit of these business strategies. Evaluation of IT and its role within the business environment will require an assessment of the following areas:

- the actual capabilities of a system and their role in the strategic management of the organisation;
- the development of the specialist skills required to conduct IT evaluation and audit; and
- the outsourcing of IT.

Evaluation and audit, particularly internal audit, will need to be considerably more proactive to add greatest value to an organisation's performance in a continuously changing technological environment, particularly where the technology is an integral part of the service delivery. In terms of assessing IT system capabilities against expected outcomes, involvement during the implementation process will become more necessary and prevalent. Given the time, expense and business risks associated with the introduction of new technology, which is often untried, it is essential that effective evaluation is conducted throughout this process. The evaluation of IT will also require the development of new methodology, tools, and suitable measures of performance to compare actual capabilities with expected capabilities during implementation. This will enable performance information to be communicated to decision-makers responsible for formulation and implementation of IT strategic management.⁶⁰ A recent financial statement audit by the ANAO reported that the following problems were experienced by departments during system implementation:

- *continuing difficulties in finalising system implementation processes;*
- *continuing failure of many systems to achieve planned functionality;*
- *inadequate user involvement in system design, testing and training;*
- *lack of staff expertise in system management and reporting; and*
- *inadequate reconciliations with interface systems.*⁶¹

An evaluation framework, similar to that outlined above, operating during the implementation of IT, will assist in overcoming these issues. The dynamic environment that many organisations compete in today, and the immense pace of change in

information technology, virtually demands that evaluation is commenced concurrently with implementation as:

*There are many changes within a company that can potentially scupper an evaluation process, or reduce its potential impact...the evaluation team needs to be aware of any forthcoming changes, and to accept the need to have sufficient flexibility in the evaluation process to accommodate these changes.*⁶²

By undertaking IT evaluation and audit simultaneously there is a greater chance of success in ensuring the availability, security and integrity of information processing to support business objectives. Such complementary activity can both ensure better coverage of the range of management issues as well as make best use of resources.

The Commonwealth's growing investment and reliance on IT in pursuing its key business objectives make the development of an effective evaluation framework crucial to organisational success. The involvement of executives in the evaluation of IT, and evaluation in general, is an essential step to ensure that the systems are integrated into the organisation's strategic planning. To conduct effective IT auditing, performance assessment needs to be a continuous process, with reporting to an audit committee comprising relevant executives and stakeholders. This contributes to sound corporate governance and gains greater commitment to implementing necessary action plans once evaluations are completed.

Linking evaluation with overall performance management will assist in achievement of corporate and business plans and is useful for program management and accountability.⁶³ Evaluators must have a strategic view of IT's role within the organisation. They need to analyse and identify whether IT programs and strategies will be complementary with other business plans and strategies to allow programs to be successful or, if not, to allow timely corrective action.

Specialist IT skills will become more sought after in the field of evaluation and auditing as one would expect given the growth in the use of IT. Due to the high demand experienced in both the private and public-sector for people with suitable skills in IT, being able to recruit into an organisation the necessary skills may become increasingly difficult and expensive. One possible strategy to overcome this will be a return to identifying people in the organisation with potential for development and targeting these individuals pro-actively to provide them with the relevant training to meet the organisation's needs. This strategy has a number of advantages over the use of external consultants and contractors. Firstly, the organisation will have the opportunity to develop its own skill base and this will contribute to the organisation's ability to achieve its outcomes.

The knowledge management and corporate memory of an organisation can be further enhanced if key personnel who have the required skill sets can be further utilised in transferring this knowledge to the organisation. As IT audit and evaluation increases, having individuals who can contribute to the learning and development of other personnel will become crucial in gaining greater access to suitable leading edge IT and communications knowledge and capability. This challenge is experienced not only in IT specific audits but on audits of various topics as a result of organisations' greater reliance

on IT in everything they do. The ANAO has already confronted situations where traditional forms of documentary evidence are not available. In such situations we are having to make links in the chain of decision-making in organisations which no longer keep paper records, or having to discover audit trails in electronic records, desk-top office systems or archival data tapes. Essentially, auditors are expected to possess a level of IT and communications skills they have not traditionally had to possess. In this context, I should mention that my Office, in close partnership with National Archives, has recently initiated an Assurance and Control Assessment audit that focuses on agencies' record-keeping, including their transition to electronic record-keeping.

A contemporary issue that has already had a substantial impact on the public sector and will create future challenges in evaluation and audit is the convergence of the public and private sectors. The Whole-of-Government Information Technology Outsourcing Initiative is an example of what can occur when the business strategy of utilising contractors to provide services is not successfully pursued. The Government decided in 1997 to outsource its IT infrastructure subject to the completion of successful competitive tendering and contracting processes by aggregating services within and across budget-funded agencies. The measure was directed at achieving long-term improvements in the structuring and sourcing of IT services across agencies to facilitate greater integration in the delivery of programs and realise significant cost savings.

The ANAO's performance audit report on IT outsourcing, titled *Implementation of Whole-of-Government Information Technology and Infrastructure Consolidation and Outsourcing Initiative*, concluded that key areas on which agencies should place particular focus in order to enhance the efficiency and effectiveness of IT outsourcing arrangements include:

- *identification and management of 'whole-of-contract' issues, including retention of corporate knowledge, succession planning, and industrial relations and legal issues;*
- *the preparation for and management of, including expectations from, the initial transition to an outsourced arrangement, particularly where a number of agencies are grouped under a single Agreement;*
- *putting in place a management regime and strategy that encourages an effective long-term working relationship with the external service provider (ESP), while maintaining a focus on contract deliverables and transparency in the exercise of statutory accountability and resource management requirements;*
- *defining the service levels and other deliverables specified in the Agreement so as to unambiguously focus the management effort of both the ESP and agencies on the aspects of service delivery most relevant to agencies' business requirements; and*
- *the ESP's appreciation of, and ability to provide, the performance and invoicing information required by agencies to support effective contract management from both a performance and accountability viewpoint.⁶⁴*

These audit findings further support the view stated earlier that IT auditing and evaluation is best conducted on a pro-active and ongoing basis and will add most value to the strategic management of the organisation if approached in that manner.

The Humphry Review, completed in December 2000, focused primarily on the implementation risks of the IT outsourcing process. The review found that senior management in agencies did not accept that the Initiative was the most appropriate approach to IT outsourcing, a lack of focus on the managerial and operational aspects of implementation by the Office of Asset Sales and IT Outsourcing (OASITO), and an insufficient understanding of agency's business.⁶⁵

The findings of the Humphry Review support the evaluative framework outlined earlier and integration of that framework with strategic management. The Review set out some key success factors for implementation as follows:

- *securing senior management buy-in;*
- *identifying a strategic reason to outsource;*
- *ensuring a well-defined and stable IT platform;*
- *ensuring a well understood and documented business and IT environment prior to outsourcing;*
- *developing agreed baseline performance information;*
- *being organisationally and culturally ready for outsourcing; and*
- *securing commitment by both the ESP and customer agency to appropriate IT governance management structures.*⁶⁶

The Australian Senate Finance and Public Administration References Committee has recently completed a comprehensive review of the IT agenda in the Australian Public Service⁶⁷. The Committee focussed on strategic improvements to many facets of outsourcing, including probity and contract management, data security, intellectual property, succession planning, privacy, savings, industry development, and the development of a central body of experience and expertise that will assist agencies to productively and successfully outsource their IT requirements in a truly devolved environment. While there were factors which needed to be addressed, the Committee also found that:

*...agencies have succeeded in building genuine partnerships with their providers and have consequently set standards for what both agencies and business should be working for.*⁶⁸

As such, this provides a sound basis for future evaluations and performance audits not only to assess agency (and private sector provider) results, but also to help develop future strategic directions and implement better practice.

The Whole-of-Government IT Outsourcing Initiative also highlights the potential problems that can be encountered as the public and private sectors become increasingly intertwined but where agencies still need to develop and measure performance, ensure proper accountability and contribute to their organisational outputs and outcomes. The most important point of all for the public sector to bear in mind when addressing the strategic question of whether outsourcing or contracting of a function is to be undertaken, is that, even though the function may be outsourced, the responsibility and accountability for the outcomes produced still rest solely with the particular agency concerned. This has been continuously reiterated by the Parliament and its Committees.

6. CONCLUDING REMARKS

I would like to conclude by offering some views on the importance of evaluation and performance auditing and how the relationship between them can be further integrated and improved.

There are, inevitably, similarities and differences between audit and evaluation, as I observed in my opening remarks. However, I would like to stress the significant similarities between the two concepts and how we can build on them. In a way, this focus arises from necessity - the realisation of the enormous task that confronts us and the need to gain maximum synergies from our respective work. At least for the foreseeable future, we cannot afford the luxury of distinctions based on perceptions of a significant gulf between the two groups. I prefer to see any such gap tested in practice rather than operating on the assumption that it precludes any kind of integration because of a presupposed different orientation.

Both audit and evaluation rely on the objectivity, integrity and professionalism of those conducting them. Both are diverse in the range of activity they cover. Both have annual planning schedules; employ common methodologies and analytical tools; and have similar reporting approaches. However, the similarity that I believe to be the most compelling argument in favour of a strong, harmonious approach between the two disciplines is that they have reasonably common goals:

- both are fundamental links in the accountability chain;
- both contribute to better program management and accountability for performance by commenting on a program's 'value for money' albeit sometimes from rather different perspectives; and
- both endeavour to identify better practice.

I think we can all agree with John Bowden's comment, at a public administration conference in 1992,⁶⁹ that 'audit and evaluation (are) part of a continuum'. He went on to say that they are 'a progressive development and refinement of the objectives and methodology of a process of examination of the range of operations undertaken by an entity'.

I would add that both audits and evaluations can range across agencies. Indeed, a strength of many performance audits is that they can be directed to the operation of common functions or activities across a range of public sector entities. In the context of accountability then, is it possible to say anything credible and acceptable about where one finishes and the other starts on the continuum of review activity? It is, at least in the area of policy prescription, including appropriateness. Audits may bear on the merits of a particular policy but do not comment on them or suggest alternative policy approaches. Evaluations often do.

In my view, performance auditing is best seen as a type of evaluation, since it focuses on improving program administrative efficiency and operational effectiveness, both of which are important aspects of program evaluation as well. The distinguishing feature of program evaluation is that it goes one step further along the continuum and looks at the effectiveness of program outcomes and, even further on some occasions, to make judgements about the appropriateness of the program, and policy, as a means of meeting current government policy and community needs. This tool enables a responsiveness of the government sector to public requirements and the move toward a greater outcome focus than in the past where the orientation was process and input aligned.

Most would agree there is a role for a structured and well-directed program of evaluation in addition to performance audit to meet the Parliament's need for a comprehensive and effective accountability framework within which to assess the performance of government agencies. It is of paramount importance that agencies, utilising suitably skilled personnel, undertake proper evaluation of programs, utilising relevant performance measures and reporting frameworks (with suitable frequency and detail) to address the intensifying focus on government accountability by taxpayers and the Parliament. Audit will be most effective where it complements such activity and, indeed, may often review it as a meta-evaluation. Hopefully, the latter will be viewed in a positive manner, first as a means of assurance and second as a means of improvement as necessary.

The need for evaluation, in both the public and private sector, has taken on even greater significance in addressing issues of corporate governance. As outlined in a 1997 ANAO report:

... program evaluation is a key component of corporate governance. Along with performance indicators and other measures, evaluation assists in providing credible accountability information to assure the Chief Executive Officer (CEO) on internal control and management of the organisation, the planning and review of its operation and progress, and ensures consultation and constructive feedback on agencies' program activities.⁷⁰

An integral player in an entity's corporate governance arrangement is its audit committee. I was particularly interested to see last week with the release of Professor Ian Ramsay's Report on 'Independence of Australian Company Auditors' that he recommended the amendment of the Australian Stock Exchange Rules to require all listed companies to have an Audit Committee.⁷¹ This is a requirement for Commonwealth bodies under both the *Financial Management and Accountability Act 1997* (Section 46) and the *Commonwealth Authorities and Companies Act 1997* (Section 32). An effective audit committee can improve communication and coordination between management and internal as well as external audit, and strengthen internal control frameworks and accountability structures. Corporate governance is enhanced as more effective decision-

making can occur and the identification and management of risk can occur in a more systematic manner.

The following areas have been identified in the past as areas where evaluation activity could be improved:

- establishing a formal framework aimed at ensuring that evaluation planning considered major issues of strategic importance;
- linking corporate/business plans to the evaluation strategy to ensure that evaluation activities are relevant to, and directly inform, decision-making; and;
- ensuring that the findings of evaluations are used to review performance information, particularly to test the validity of performance indicators and refine their usefulness.⁷²

An integrated approach to audit and evaluation can result in significant benefits for the public, and private, sector by allowing more effective utilisation of available resources as well as generating a better outcome and adding greater value to the organisation's performance. The extent to which evaluation and audit are truly a continuum and that the two fields have great similarities, can be evidenced by the growth of the Canberra Evaluation Forum. The success and value of this forum, to auditors and evaluators alike, demonstrate that a culture of evaluation is persisting and that the approach is becoming increasingly rigorous and methodically oriented.

Both auditors and evaluators must stay focussed on identifying and adapting to the ever-changing public sector environment. We have an ongoing commitment to the development of different practices and procedures in the face of new and emerging issues. We must continue to work to attract and retain staff with the right mix of skills and attributes. To meet the challenges of the future, we need to continually develop new and better strategies to deal successfully with these challenges. Our ability to do so will be enhanced if we can achieve an environment that is conducive to that result, including sustaining the professionalism and commitment of our staff and positive relationships with all our stakeholders, in case of my Office, most notably the Parliament.

While in past decades the prime focus of the ANAO may have been on ensuring compliance with legislation, this has now been subsumed as part of a broader approach to assist agencies in improving public sector administration. To be successful, this approach requires considerable co-operation between my Office and the agencies and bodies we deal with. As stated in my Annual Report for 2000-01, I am pleased to say that the latter is overwhelmingly the case⁷³. It bodes well for the future.

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