

**MANAGING AND MONITORING  
PRIVATISATION AND OUTSOURCING  
INITIATIVES - CHALLENGES IN  
MAINTAINING ACCOUNTABILITY**

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## I. INTRODUCTION

Privatisation and/or commercialisation of public services is occurring in Australia on a significant scale. Privatisation in Australia involves three principal contexts:

- the opening up to competition of areas previously reserved to government, such as telecommunications;
- contracting out by public sector entities to private sector suppliers of goods and services in areas such as employment services and information technology; and
- the outright sale of part or all of Commonwealth assets or businesses to private sector owners.

Having made the decision to privatise (by whatever means) activities previously undertaken by the public sector, important issues need to be addressed concerning the ongoing administration of the public interest, including proper accountability for public resources. Public service agencies must strive to maximise overall 'value for money' for citizens which requires consideration of issues other than production costs, such as client satisfaction, the public interest, fair play, honesty, justice and equity.

The following observation is probably not too far from the reality confronting many countries now:

*'Public management has undergone a revolution. Rather than focusing on controlling bureaucracies than delivering services, public administrators are responding to admonishments to "steer rather than row" and to be the entrepreneurs of a new, leaner, and increasingly privatised government'.<sup>1</sup>*

### **Audit Mandate**

Auditors-General are a fundamental part of the public accountability framework, providing a unique blend of independence, objectivity and professionalism. It would be generally agreed it is important that this role is maintained in an increasingly 'privatised' public sector.

My responsibilities as Commonwealth Auditor-General are outlined in the *Auditor-General Act 1997* and in a range of entity-specific legislation. The legislative arrangements for the appointment of the Auditor-General and the establishment of the Australian National Audit Office (ANAO) mean that I am, by statute, independent of the political environment. The results of audits are reported to the Parliament, thus providing the Parliament and the community with an important source of information about the way public resources are being administered. The mandate of my Office is to undertake audits of:

- financial statements, which provide an essential independent attestation of the financial statements of public sector entities; and

- performance audits, which evaluate the economy, efficiency and effectiveness of the management of public sector entities.

Essentially, performance audits focus on those core activities that are vital for good management, including the governance framework, performance management, contract management, operational (such as purchasing) guidelines, financial instructions, monitoring and review practices, systems development, integrity and ethical checklists, legal compliance and audit trails. The ANAO's mandate does not extend to examining matters of government policy per se: the setting of policy objectives is the prerogative of Executive Government. I am empowered to examine how well government programs and policies (outputs and outcomes) are administered and whether they are meeting stated policy objectives.

My Office has undertaken a series of performance audits of major asset sales and outsourcing tenders. These audits have identified a number of areas in which particular focus needs to be placed in order to support the maintenance of accountability in the management and monitoring of privatisation and outsourcing initiatives and achieve required results. This paper discusses relevant issues in the context of, first, the full or partial sale of government businesses, and second, the outsourcing of services and other activities to the private sector. It also briefly addresses the issue of the control structures needed to manage risks. I contend that the environment in which we are now operating presents greater challenges to risk management. My focus will be largely on the significant challenges to accountability, and consequently audit, in this environment.

## **II. OBJECTIVES OF FULL OR PARTIAL SALE OF GOVERNMENT BUSINESSES**

In Australia, the last ten years has seen an increased focus on privatisation of government business entities, with some \$A50 billion<sup>2</sup> raised by the Federal Government through such asset sales over this time. These sales are invariably conducted by way of public share offers or trade sales. The scale of such offers emphasises the importance of sound administrative practices because small deficiencies can have significant adverse financial implications. As well, opportunities forgone can make a large difference to the results achieved.

My Office has undertaken a program of performance audits to examine the extent to which government sale objectives have been achieved; the effectiveness of the management of the sale; and the ongoing risk exposure. The assurance provided by such audit activities plays an important role in enhancing accountability for the stewardship of the sale process and including whether post-sale performance is meeting the objectives set by government.

For example, we have examined the three largest public share offers conducted in Australia, namely the sale of two tranches of shares in Telstra Corporation (our major telecommunications supplier), which collectively raised proceeds of \$A30.24 billion, and the third tranche sale of shares in the Commonwealth Bank, which raised proceeds of \$A5.15 billion. The audits of those sales examined the key factors that affect the success of any public share offer, such as:

- the level and structure of fees paid to stockbrokers and advisers, as these fees significantly influence the motivation for these firms to act in the vendor's interest;
- the 'price discovery' process which is important to achieving value for money in initial public offers; and
- the logistics of the settlement process, which are important if the vendor is to receive the full proceeds from the share sale in a timely manner.

The public accountability aspects of such elements of the sales process are outside the experience of most public servants and, for the most part, are not well understood by private sector participants. There is therefore an ongoing learning process for all participants, not least for the auditors concerned.

A common objective of any privatisation is to obtain a fair value from the sale. In trade sales, fair value can be achieved through an open, competitive tender process that enables a market value for the assets or business to be established. For this reason, a clear focus of performance audits of trade sales has been on the tender process and the evaluation of tenders. From these audits, my Office has identified a number of principles of sound administrative practice to guide future Commonwealth trade sales, including:

- the advantages of flexible data access arrangements to maximise potential buyers' knowledge and understanding of the business and to minimise the costs of developing their bids;
- adopting administrative structures such as tender evaluation committees to enhance transparency and accountability; the composition and operational probity of such committees have to give relevant agencies a high degree of confidence that any evaluation is fully informed, properly conducted and will identify the best possible offer for each business;
- the development of appropriate priorities which set out the relative importance attached to each evaluation criterion and which can be understood and assessed, as necessary, by all concerned;
- carefully considering the nature of fees paid to commercial advisers to ensure advisers do not have a pecuniary or other interest in, and thus a potential fee conflict with, the outcome of the tender process;
- seeking early resolution of the government's position on future service requirements, and any ongoing subsidies or payments to the business, so that bidders have a full picture of the potential for the business and can frame their bids accordingly; and
- undertaking a credible assessment of the net financial benefits of all tenders in order to maximise financial returns from the sale.

It has been satisfying to observe that these trade sale audits have had a generally agreed positive impact on the way sales are being conducted. This can be illustrated

with the privatisation of Federal airports in Australia, which have been sold in two tranches, with each tranche being audited by my Office. Not surprisingly, one aspect of my Office's approach to auditing the second tranche sale was to examine action taken in response to recommendations made in the audit report on the first tranche sale. We found that all eleven recommendations in our 1998 report were implemented by agencies, even though not all had been fully agreed to by the agency responsible for Federal asset sales. The improved processes resulting from implementation of these recommendations supported an effective overall outcome for the Phase 2 sales. This outcome was also due to the greater understanding of the accountability requirements by private sector contractors who not only addressed audit comments but also initiated related discussions with the auditors concerned.

### *Achieving the full benefits of privatisation*

Often in trade sales, bidders include in their tenders ongoing commitments that are consistent with the ongoing objectives of the privatisation. These commitments often relate to advancing the public interest. For example, recent trade sales of Federal airports and of the intrastate freight and interstate rail businesses of a former Government Business Enterprise (GBE) have involved purchasers committing in the respective sale agreements to future capital expenditure on infrastructure development and, in the latter case, the continuation of concessional rail travel for pensioners, blind pensioners and incapacitated war veterans.

Such commitments can be an impressive adjunct to the financial returns from the sale, and often contribute significantly to non-financial sale objectives. However, the benefits of these commitments will be lost unless appropriate administrative procedures are implemented to monitor and enforce compliance with the terms of these sale agreements. Indeed, my privatisation audits have identified that these issues are often overlooked. For example, in relation to the airport trade sales:

- the legal documents associated with the sale, which governed maintenance and development of the airport sites, have a life of up to 99 years but arrangements had not been made for the ongoing storage and safe custody of these important legal documents;<sup>3</sup>
- comprehensive administrative procedures to monitor ongoing development of the airports sites had not been developed and implemented. This put at risk the benefits offered by the development commitments. In the event that the airport lessees did not undertake all contracted expenditure, the lack of monitoring could also have denied the Commonwealth the opportunity to have the expenditure shortfall paid to it;<sup>4</sup> and
- security funds totalling \$A197 million were not deposited into Commonwealth bank accounts as required by the sale agreements. The sale agreements were also found to be incorrect in relation to the payment of interest on these funds.<sup>5</sup>

These performance audits added value by identifying deficiencies in the administration of commitments by purchasers, including prompting agency action to rectify the identified deficiencies as well as action to prevent recurrence of similar problems in future sales. Administration of the long-term contractual commitments is a possible area of future audit activity to provide added assurance that the full benefits

of privatisation are achieved. As with other areas of contracting-out, there is an ongoing shortage of appropriate skills and experience in the public sector in the area of contract management. This adds to the risks of securing appropriate, if not required, contract performance.

### **III. PRIVATE SECTOR DELIVERY OF PUBLIC SERVICES OR OUTSOURCING**

The contracting out, or outsourcing, of functions previously delivered by public sector agencies has also been a feature of the changing public sector environment. The following three examples are illustrative at the Federal Government level in Australia:

- The Defence Department's Commercial Support Program which was introduced in 1991. This program seeks to make greater use of civilian infrastructure and national resources by contracting out support functions where this is operationally feasible, practicable and cost-effective. By 1998, 94 activities had been market-tested, including in-house bid participation, with a total value over \$A1.5 billion.
- More recently, the Commonwealth undertook a significant outsourcing of employment services. This initiative (now known as the Job Network) involved contracting out some \$A1.7 billion of services previously provided by the public sector with payment structures and incentives for service providers linked to the placement of job seekers in work. The second round of Job Network contracts commenced in early 2000, involving around \$A3 billion.
- The decision in 1997 to outsource information technology and telecommunications (IT&T) services across budget-funded agencies, subject to the outcome of competitive processes to be undertaken within a 'whole of government' framework. The measure was directed at achieving long-term improvements in the structuring and sourcing of IT&T services across agencies to facilitate greater integration in the delivery of programs and realise significant cost savings. A key element of the initiative was to gather the IT&T of Commonwealth agencies into a number of groups to be offered to the market. To date, five of the eleven contracts have been let.

Outsourcing advocates point to the opportunities offered in terms of increased flexibility in service delivery; greater focus on outputs and outcomes rather than inputs; freeing public sector management to focus on higher priorities; encouraging suppliers to provide innovative solutions; and cost savings in providing services.<sup>6</sup> However, outsourcing also brings risks which need to be actively managed. You may be interested in the following checklist of risks and benefits of contracting versus in-house provision which was provided in a report<sup>7</sup> of a study conducted into government contracts in the State of Victoria.

<p><b><i>Contracted provision: benefits</i></b></p> <ul style="list-style-type: none"> <li>• Services precisely specified</li> <li>• Capacity to enforce</li> <li>• Duties and responsibilities of parties clear</li> <li>• Risks can be allocated to most suitable party</li> </ul>	<p><b><i>Contracted provision: risks</i></b></p> <ul style="list-style-type: none"> <li>• Inflexibility</li> <li>• Litigation</li> <li>• Transaction costs</li> <li>• Policy options may be committed for many years into the future</li> </ul>
<p><b><i>Direct public provision: benefits</i></b></p> <ul style="list-style-type: none"> <li>• Flexibility</li> <li>• Staff can be directed to remedy errors without resort to litigation</li> </ul>	<p><b><i>Direct public provision: risks</i></b></p> <ul style="list-style-type: none"> <li>• Vague specification leading to poor cost control</li> <li>• State may bear wide range of risks</li> </ul>

Reporting at an Outsourcing Summit on the experience of the private sector with regard to the risks involved in outsourcing, one speaker recorded that:

*... the main reason for outsourcing failures was that companies without clear sets of objectives entered agreements with providers.  
... other reasons included poor choice of provider; no strategic or cultural fit; inflexible contracts that did not accommodate change; and providers' lack of understanding of an organisation's corporate direction.*<sup>8</sup>

All three of the major outsourcing initiatives I identified above have been the subject of performance audits by my Office, the most recent being the audit of the IT outsourcing initiative which was reported on in September last year.<sup>9</sup> The main message flowing from those audits is that savings and other benefits do not flow automatically from outsourcing. Indeed, that process, like any other element of the business function, must be well managed. The experience of my Office has been that a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and considerable public concern about associated outcomes.

For example, the Job Network arrangement I referred to earlier provides a good example of the inherent difficulties in applying a purely commercial model to the contracting out of community services. With media reports at the time suggesting a number of the original 321 service providers were experiencing financial difficulties, pressure was placed on the Government for additional funding and changes in the commercial relationship which were subsequently provided, and put in place, respectively. This situation emphasises the need to recognise the complex set of objectives and stakeholder views which must be taken into account when such decisions are made in the public sector. There are also grounds for concluding that, in this case, not enough consideration was given to the impact of a service provider's closure on unemployed clients.

A sound tendering process and effective management of the resulting contract are also critical for the efficient, effective and sustainable delivery of programs. I will now expand on these two elements to reinforce their inherent characteristics which often seem to be overlooked or disregarded by public sector decision-makers.

### ***Tender process***

In the appropriate circumstances, the use of competitive tendering and contracting promotes open and effective competition by calling for offers which can be evaluated against clear and previously stated requirements to obtain value for money. This, in turn, creates the necessary framework for a defensible, accountable method of selecting a service provider. The reasons for a particular source selection need to be written up and be able to withstand external scrutiny, including from the Parliament.

My Office's recent performance audit of the IT outsourcing initiative highlighted a number of areas in which the management and monitoring of that outsourcing process could be improved to enhance the robustness, transparency and accountability of the basis for the selection of preferred tenderers, particularly in regard to the transparent assessment of tenderers against the published evaluation criteria.

For example, the public tender documents identified the achievement of substantial and acceptable savings as a precondition to the awarding of a contract. The audit found that the methodology employed to provide the assessment of tenderers against that criteria did not capture all of the relevant costs and, as a result, overstated the potential savings from outsourcing. Also, in two of the three tenders reviewed, the formal evaluation documentation did not set out the responsible evaluation committees' conclusions as to whether that precondition had been satisfied.

Further, the evaluation planning documentation did not articulate how two key evaluation criteria, savings and industry development, would be combined in order to select the preferred tenderer in accordance with the process set out in the Request for Tender provided to tenderers. Given the importance placed on achievement of significant savings as a justification for IT outsourcing, any shortfall would seem to place commensurate pressure on other perceived benefits to justify the initiative and maintain confidence in the original decision.

### ***Contract Management***

Outsourcing represents a fundamental change to an agency's operating environment. It brings with it new risks, including opportunities, which require managers to develop different approaches and skills. Managing the risks associated with the increased involvement of the private sector in the delivery of government services, in particular the delivery of services through contract arrangements, will require the development and/or enhancement of a range of commercial, negotiating, project and contract management skills across the public sector and will be a key accountability requirement of public sector managers. We have quickly learnt that outsourcing places considerable focus and emphasis on project and contract management, including management of the underlying risks involved both within and outside the public sector. The problem has been to achieve both management understanding of, and action on, these imperatives in a reasonable time period.



Although the public sector may contract out service delivery, this does not equate to contracting out the total responsibility for the delivery of the service or program. The current Government and Parliamentary expectation of each agency, and agency management, is to ensure that the government's objectives are delivered in a cost-effective manner, and to be accountable for that outcome. The bottom line, as is often reiterated in the Parliament, is that accountability cannot be outsourced.

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

*'... managing contract risk is more than a matter of matching risk-reducing mechanisms to identified contract risks; it involves an assessment of the outsourcing situation.'*<sup>10</sup>

However, I should point out, as I have done elsewhere<sup>11</sup>, that the increasing development of more networked systems can change notions of a simple neat dichotomy of contractual obligations between the public and private sectors.

The ANAO has released a Better Practice Guide aimed at addressing some of the financial and probity risks associated with contracting with non-government suppliers.<sup>12</sup> The focus was on managing the risks. This is an issue, or theme, that I aim to address in my performance audit activities, for example:

- In 1997, the supplier of passenger and commercial vehicles to the majority of Commonwealth bodies (known as the DASFLEET) was finalised for a price of \$A408 million. Associated with the sale, a five year tied contract was signed for vehicle leasing and fleet management to be provided by the purchaser to the Commonwealth. The audit of the sale found that the financial implications of the tied contract are such that the Commonwealth is exposed to a range of commercial risks including increased leasing charges (the sale was intended to reduce costs) and potential responsibility for the cost of terminating the contract. As a result of an audit recommendation, the relevant agency initiated a comprehensive review of the Commonwealth's financial exposures under the contract.
- The IT outsourcing audit, referred to earlier, found that, under three outsourcing contracts, the contractual arrangements for the provision by the outsourced provider of IT equipment to agencies over the term of the agreement represented finance lease arrangements, rather than operating leases as had been intended by the Commonwealth. The Commonwealth has substantially underwritten the capital risk associated with dedicated assets used by the outsourced providers in the delivery of the outsourced services such that the Commonwealth has contracted to keep the respective providers 'whole' in respect of their capital investment in those assets. Therefore, it is the Commonwealth that is exposed to the ownership risks of loss of value below net

book value of the assets and of obsolescence at the end of the contract term. However, this was not taken into account in the assessment of savings from outsourcing in the tender evaluation.

The last mentioned audit highlighted the difficulties that can be experienced when the service contract is ambiguous as to the actual services required to be delivered for the contracted price; or where the required service standards are not framed in such a way as to unambiguously focus the management attention of both the provider and the customer on the aspects of service delivery most relevant to the customer's business requirements.<sup>13</sup> Interestingly, the Government subsequently appointed an independent Reviewer with Terms of Reference which:

*'focus in particular on the implementation risks associated with transitioning from the provision of IT infrastructure from the in-house IT operations of Commonwealth Agencies to an external service provider in contracts let under the initiative to date.'*<sup>14</sup>

Among other available materials, the Reviewer was requested to have regard to the Audit Report. The Reviewer was to report by the end of December last which I understand occurred but had not been publicly released at the time of preparation of this presentation.

It has been the experience of agencies involved, in at least one outsourcing contract we reviewed, that poorly framed or overly stringent service standards or requirements become unnecessary cost drivers that distract the service provider's resources and focus from the areas of most importance to the achievement of agencies' overall objectives. Alternatively, they may cause the price tendered by contractors to be unnecessarily increased. Equally, the service standards originally contracted for were found to not provide appropriate incentives for the provider to focus on the areas of service most important to agencies' business.

The competent management of the contract is often the Commonwealth's key means of control over its outputs and their contribution to outcomes. An agency must ensure that an adequate level of monitoring of service delivery under the contract is undertaken as part of its contract administration and in line with its broader service delivery responsibilities, such as might be set out in a Client Service Charter.

For example, the outsourcing contracts reviewed in the IT outsourcing audit placed certain obligations on the private sector service providers in regard to ensuring that agency data held on the outsourced IT infrastructure was protected to identified security and privacy standards. That audit<sup>15</sup>, and a subsequent audit of fraud control in the Australian Taxation Office<sup>16</sup>, found that agencies had not developed adequate strategies for monitoring the providers' compliance with those obligations, and recommended improvements in this regard.

It is during the transition period, as accountability arrangements and changed organisational structures are bedded down, that the greatest risk to effective decision-making arises. This was particularly apparent in the audit of the implementation of the IT outsourcing initiative, where it was found that both agencies and tenderers had underestimated the complexity involved in managing the delivery of services to a group of agencies, particularly in simultaneously transitioning those services to an

outsourced provider.<sup>17</sup> This lack of appreciation by the parties concerned contributed to service delivery failures and significant delays in the provision by the service providers of reliable invoicing and performance reporting.<sup>18</sup>

The latter problem also related to a gap in expectations between the agencies and the private sector providers as to the level of documentation and substantiating material needed to support public sector accountability requirements. This created difficulties for agencies in satisfying their own accountability requirements in terms of the expenditure of public resources and the achievement of agency outcomes. We are hoping to alleviate such problems with the release of a Better Practice Guide on Contract Management later this month. The Guide has been prepared on the basis of agency experience and lessons learnt as well as some original research into best practice implementation strategies.

### **Commercial confidentiality**

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

*'... the use of commercial-in-confidence contracts allows governments to avoid their accountability responsibilities to the public, and the secrecy surrounding their activities under those contracts can reduce the potential benefits from outsourcing.'*<sup>19</sup>

A particular concern has been the insertion of confidentiality clauses in agreements/contracts which can impact adversely on Parliament's 'right to know' even if they do not limit a legislatively protected capacity of an Auditor-General to report to Parliament.

In making recommendations to the Federal Senate Finance and Public Administration References Committee in its 1997 Inquiry into Contracting Out of Government Services, we suggested, as did the Commonwealth Ombudsman, that in relation to commercial confidentiality claims by private sector contractors a reverse onus of proof test should be applied, as follows:

*'In our view, the question of whether or not commercial-in-confidence information should be disclosed to the Parliament should start from the general principle that the information should be made public unless there is a good reason for it not to be. In other words, what we are saying is there should be a reversal of the principle of onus of proof which would require that the party arguing for non-disclosure should substantiate that*

*disclosure would be harmful to its commercial interests and to the public interest.*<sup>20</sup>

With the growing convergence between the private and public sectors referred to earlier, and the considerable increase in contracting, the issue has become a matter of practical importance and some urgency. A particular concern is that agencies may too readily agree to treat contractors' documents as confidential, notwithstanding the wide access powers that may be provided to the Auditor-General.

My Office is currently undertaking a performance audit of the use of confidential provisions in the context of commercial contracts. The audit is seeking to:

- assess the extent of guidance on the use of confidentiality clauses in the context of commercial contracts at a government wide level or within selected agencies;
- develop criteria that could be used to determine whether information in a commercial contract is confidential, and what limits on disclosure should apply; and
- assess the appropriateness of agencies' use of confidentiality clauses and the effectiveness of the existing accountability and disclosure arrangements for the transparency of contracts entered into by the Commonwealth.

Another challenge for Auditors-General in the move to increased contracting with the private sector for the provision of government services is our ability to access the relevant records. At present I do not have a legislative provision similar to that which I understand applies in the United States of America that guarantees access by government auditors to the private sector service providers' records. However, my Office is currently encouraging the inclusion of a suitable access clause in contracts of this nature. My Office has drafted model access clauses (reflecting the provisions of the *Auditor-Generals Act 1997*) which have been circulated to agencies for insertion in contracts. These clauses give the agency and my Office access to contractors' premises and the right to inspect and copy documentation and records associated with the contract. Subsequently, the Parliamentary Committee of Public Accounts and Audit (JCPAA) recommended that the Minister for Finance make legislative provision for such access<sup>21</sup>. There are grounds for being hopeful of at least a positive response.

The model clauses are not necessary to provide me with access to information as such, but they are important in flagging to contractors that they must give full access to the Auditor-General for proper accountability. Indeed, such access can save a considerable amount of time, resources and problems of misunderstanding for all concerned. In my view, it is a matter of educating both parties, whether public or private sector, to the requirements of a successful relationship or contract. Vague relationships do not assist either party; nor do they lend confidence to the partnership or use of contractual arrangements. Such accountability is an aspect of the public sector environment with which the private sector is becoming more familiar as outsourcing develops further. It is being tested now in the context of the release of drafts of Performance Audit Reports for comment by relevant parties under Section 19 of the *Auditor-General Act 1997*.

#### **IV. CONTROL STRUCTURES TO MANAGE RISK**

This brings me to the issue of good corporate governance and associated agency controls, which is particularly important in relation to privatisation of the public sector. In an environment that promulgates the notions of contestability, outsourcing and greater efficiency, the way that agencies implement their corporate governance framework, and particularly how they conduct their risk management, including the control of those risks, will be critical in determining how well the public sector can continue to meet its accountability obligations and determine/report its performance measures.

The control structures within a corporate governance framework provide assurance to clients and the Parliament that an agency is operating in the public interest and has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. Weak internal controls provide an environment where there exists an opportunity to commit fraud.<sup>22</sup> As well, the ex-post costs of rectifying a control problem have been generally shown to be considerably higher than the ex-ante costs of establishing a sound control environment.

Simply put, corporate governance is about how an organisation is managed, its corporate and other structures, its culture, its policies and the ways in which it deals with its various stakeholders. The concept encompasses both assurance to the latter and performance measures and/or assessments by which an organisation's results can be judged. The focus is on managing risks, including taking advantage of any opportunities they provide, not on just avoiding them. This aspect of corporate governance was subject to considerable debate last year in the private sector in Australia with its attendant ramifications for the public sector.<sup>23</sup>

Corporate governance is another specific issue we look to address in our performance audits. For example, the IT outsourcing audit found that improvements in the approach taken to the monitoring and enforcement of the contractor's compliance with contractual obligations would enhance agencies' capacity to ensure there was appropriate accountability for the expenditure of public resources and for the outcomes achieved. In particular, the audit highlighted the need for strong corporate governance arrangements to ensure accountability and transparency in all dealings between agencies and the private sector service providers.

For example, the outsourcing contracts reviewed provide the agencies with a discretion as to whether to require payment to them by the service provider of service credits available under the contract due to the non-delivery of contracted service levels. As the service credits represent valuable resources contractually available to the Commonwealth, the manner in which contract managers within agencies exercise that discretion is an important corporate governance issue. The audit recommended improvements to the transparency and accountability of the consideration by contract managers regarding the exercise of that discretion through the development of procedures for the conduct and documentation of the processes followed in evaluating options for the use of those contractually-available resources.

## V. CONCLUSION

The message here is that external scrutiny (through public reporting and the activities of Auditors-General) is an essential element in ensuring that public accountability is not eroded, by default, through privatisation or outsourcing. Just as it is incumbent upon public sector agencies to ensure they have a sound understanding of the commercial nature of any contract, private sector entities need to recognise that there are overlaying public accountability issues, not present in purely private sector transactions, that need to be addressed.

The public sector, in recent years, has recognised that ‘proper’ accountability and improved performance management stem from an integrated, effective corporate governance framework. Such recognition includes the realisation that we have something to learn from the private sector in this respect while acknowledging the public interest factor and the associated wide-ranging public accountability requirements, including transparency. However, as well, in an era of privatisation and outsourcing, private sector participants have to be aware and understand the rights of citizens, not just as customers or clients, and the expectations of a range of interested stakeholders.

Some of my recent audit reports suggest that many contractors have yet to fully appreciate this latter aspect of dealing with government or to embrace the higher and/or different standards of accountability that are required when public money is involved. The latter is essentially the issue being covered by this session with any trade-off, possibly being more about the nature and level of accountability rather than about efficiency per se. However, it is not difficult to envisage at least some cost for accountability over a purely market-oriented transaction. In that connexion, the following observation by the Australian Senate Finance and Public Administration References Committee is instructive:

*‘Additional transparency provisions may be a cost that we have to meet to ensure an acceptable level of accountability.’<sup>24</sup>*

That said, there are also challenges with the so-called ‘automated state’ in this era of real time communications, in particular the use of the Internet. It has been suggested that governments might wish to establish and manage contracts for project and/or service delivery largely through the use of information and communications technology. Futuristically, the imperatives of technology use are said to be creating the conditions for ‘virtual government’. There are many issues to be confronted, such as legal, privacy, security and availability (to all citizens) concerns. From an audit viewpoint, for example, it makes the prospect of continuous auditing a reality. And there is the ongoing concern, particularly by the Parliament, of appropriate accountability mechanisms, particularly where responsibilities may be diffuse.

More immediately, the notion of partnerships and alliances within and between the public and private sectors and concepts such as ‘relational contracts’ are challenging the current public management view of accountability. In my view, audit offices should be able to work positively with public sector managers to explore different partnership/cooperative arrangements that can accommodate both public and private

interests. In that latter respect, I found the ideas underlying the seven principles of the “New Public Service” suggested by two academics in a recent volume of the Public Administration Review<sup>25</sup> to be worthwhile considering for discussion. Of course, whatever is attempted needs the support and endorsement of the Government and Parliament if it is to succeed. The ongoing challenge for all of us will continue to be meeting our various stakeholder performance and accountability expectations, whatever the approach taken to our changing public sector environment.

It would not seem to reflect responsive public service to citizens if we are unable to define adequately performance and accountability requirements or, indeed, fail to secure private sector acceptance of such requirements in a more networked environment that focuses mainly on outcomes and not on methods of delivery. A particular challenge will be to establish agreed modes of network governance to ensure proper integration and coordination of all networking activities essential to the effective operation of strategic partnerships and alliances. Day by day the technology appears to be increasingly able to deliver the necessary capability. The question then becomes whether we collectively can develop the skills and management capacities to take full advantage of that capability. As I have indicated, this is as much a challenge for audit offices as it is for the rest of the public sector and those elements of the private sector that wish to participate in the provision and delivery of public services to citizens.

## NOTES AND REFERENCES

- <sup>1</sup> Denhardt Robert B. and Janet Vinzant 2000. *'The New Public Service : Serving Rather than Steering'*, The Public Administration Review, November/December, Vol. 6, No. 6 (page 549).
- <sup>2</sup> ANAO Report No. 47 1997-98, *'Management of Commonwealth Guarantees, Indemnities and Letters of Comfort'*, Canberra, 23 June, (page 17, Exhibit 2.3).
- <sup>3</sup> ANAO Report No.38 1997-98, *'Sale of Brisbane, Melbourne and Perth Airports'* Canberra, 24 March (pages 66-68).
- <sup>4</sup> Ibid., (pages 74-75).
- <sup>5</sup> ANAO Report No.48, *'Phase 2 of the Sales of the Federal Airports'*, Canberra, 21 June (pages 59-65).
- <sup>6</sup> Industry Commission, *'Competitive Tendering and Contracting by Public Sector Agencies'* .
- <sup>7</sup> Audit Review of Government Contracts 2000, *'Contracting, Privatisation, Probity and Disclosure in Victoria 1992-1999 : An Independent Report to Government'*, Report, State Government of Victoria, Melbourne, May, page 31.
- <sup>8</sup> Broockman, B. 2000, reported in the Risk Report, Issue No. 92, 3 August, (page 10)
- <sup>9</sup> ANAO Report No.2 1998-99, *'Commercial Support Program'*, Canberra, 10 July; ANAO Report No. 7, 1998-99, *'Management of the Implementation of the New Employment Services Market'*, Canberra, 7 September; and ANAO Report No.9 2000-2001, *'Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative.'* Canberra, 6 September.
- <sup>10</sup> O'Looney John A. 1998, *'Outsourcing State and Local Government Services - Decision-Making Strategies and Management Methods'*, Quorum Books, London, (page 147).
- <sup>11</sup> Barrett Pat AM, 2000, *'Managing Compliance for Assurance and Performance'*. Presentation to *'Setting the Course - Integrating Conformance with Performance'*, A joint Department of Finance and Administration, Attorney-General's Department and Australian Competition & Consumer Commission Seminar, Canberra, 7 September, (pages 51 to 54).
- <sup>12</sup> ANAO 1998. *'Selecting Suppliers – Managing the Risk'*. A Better Practice Guide, Canberra, October.
- <sup>13</sup> Op. cit., ANAO Report No.9 2000-2001, *'Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative'*, (pages 212-217 and 221-224).
- <sup>14</sup> Minister for Finance and Administration 2000. Media Statement. Release 67/00, Canberra, 14 November.
- <sup>15</sup> Op. cit., ANAO Report No.9 2000-2001, *'Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative'*, (pages 226-228 and 232-235).
- <sup>16</sup> ANAO Report No.16 2000-2001, *'Australian Taxation Office Internal Fraud Control Arrangements'*, Canberra 29 November 2000 (pages 74-92).
- <sup>17</sup> Op. cit., ANAO Report No.9 2000-2001, *'Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative'*, (pages 180-194).
- <sup>18</sup> Op. cit., ANAO Report No.9 2000-2001, *'Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative'*, (pages 198-204 and 236-242).
- <sup>19</sup> Barton Allan D. Professor 2000. *'Commercial-in-Confidence Outsourcing Contracts and Accountability in Public Sector Activities'*, Australian National University, Canberra (page 2).
- <sup>20</sup> Senate Finance and Public Administration References Committee, *'Contracting out of Government Services'*, 2<sup>nd</sup> Report, May, (page 70).



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<sup>21</sup> Joint Committee of Public Accounts and Audit 1999, *Review of Audit Report No. 34, 1997-98, New Submarine Project Department of Defence*. Report 368, June, (page xiv).

**Recommendation 5**

The Committee recommends that the Minister for Finance make legislative provision, either through amendment of the Auditor-General Act or the Finance Minister's Orders, to enable the Auditor-General to access the premises of a contractor for the purpose of inspecting and copying documentation and records directly related to a Commonwealth contract, and to inspect any Commonwealth assets held on the premises of the contractor, where such access is, in the opinion of the Auditor-General, required to assist in the performance of an Auditor-General function. (paragraph 6.20).

<sup>22</sup> Fulwider Donald G. 1999. *Recognizing Fraud Indicators*. International Journal of Government Auditing, Vol.26, No.2, April (page 13). The author provides examples of signs, signals and patterns indicating fraud which may be encountered during an audit such as Weak Management with its failure to enforce existing controls, inadequate oversight of the control process, and failures to act on fraud; and Loose Internal Controls with inadequate separation of duties involving cash management, inventory, purchasing/contracting and payments systems which allow the perpetrator to commit fraud. (page 13).

<sup>23</sup> Barrett Pat AM 2000, *What's New in Corporate Governance*. Presentation to the CPA Australia Annual Congress, Adelaide, 17 November (pages 22 and 23).

<sup>24</sup> Senate Finance and Public Administration References Committee (SFPARC) 2000, *Inquiry into the Mechanism for Providing Accountability to the Senate in Relation to Government Contracts*. SFPARC, Canberra, June (page 35).

<sup>25</sup> Op.cit. Denhardt Robert B. and Janet Vinzant, 2000. (pages 553-556)

The seven principles of the New Public Service suggested are:

- 1) Serve, rather than steer. An increasingly important role of the public servant is to help citizens articulate and meet their shared interests, rather than attempt to control or steer society in new directions.
- 2) The public interest is the aim, not the by-product. Public administrators must contribute to building a collective shared notion of the public interest. The goal is not to find quick solutions driven by individual choices. Rather, it is the creation of shared interests and shared responsibility.
- 3) Think strategically, act democratically. Policies and programs meeting public needs can be most effectively and responsibly achieved through collective efforts and collaborative processes.
- 4) Serve citizens, not customers. The public interest results from a dialogue about shared values, rather than the aggregation of individual self-interest. Therefore, public servants do not merely respond to the demands of "customers" but focus on building relationships of trust and collaboration with, and among, citizens.
- 5) Accountability is not simple. Public servants should be attentive to more than the market; they should also attend to statutory and constitutional law, community values, political norms, professional standards, and citizen interests.
- 6) Value people, not just productivity. Public organisations and the networks in which they participate are more likely to succeed in the long run if they are operated through processes of collaboration and shared leadership based on respect for all people.
- 7) Value citizenship and public service above entrepreneurship. The public interest is better advanced by public servants and citizens committed to making meaningful contributions to society rather than by entrepreneurial managers acting as if public money were their own.