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**Privatisation of State Activities –
Role of SAIs**

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I. INTRODUCTION

This paper addresses the role of SAIs in the *Privatisation of State Activities*. The central theme is the development of SAIs' role in protecting the public interest and providing objective assessments of governments' administration of their electoral mandates when, more than ever before, that administration is in the hands of the private sector.

An introductory discussion of accountability is followed by a short summary of the changing governance environment. Having set the scene, the third and main section discusses a number of specific audit examples from the Australian experience, exploring important aspects of SAIs' growing business of assessing outsourced and/or privatised government functions. The latter is a significant and growing proportion (although not yet the majority) of government activity. The examples draw on audits of:

- regulatory bodies;
- public sector financial operations in a global economy
- the private sector delivery of public services;
- the sale of public sector assets;
- contract management; and
- performance accountability.

The fourth section of the paper deals with some steps being taken to promote the development of corporate governance in the Australian public sector, with the concluding remarks canvassing some major pressures for continuing change. For SAIs, the challenge is to help legislatures and governments achieve an appropriate balance of public and private sector involvement in the provision of public services: there is no one size to fit all places at all times.

Constant accountability in a changing public sector

As in other democracies, Australian governments have endeavoured to make the public sector less costly and better tailored to public needs while providing higher quality services to citizens. A major impetus was the fundamental questioning, during the 1980s, of what government does, or should do. Citizens often perceived public services as being inefficient and ineffective. Commentators attributed this largely to government regulation or monopoly. Reformers advocated harnessing market discipline to provide public services more efficiently, effectively and with greater public satisfaction.

In practice, both the nature and the scale of government business with the private sector has changed. It has changed in nature by: adapting, or adopting, private sector methods and techniques; and by direct private sector provision of public services, even those (such as policy advice and determination of entitlements) traditionally regarded as 'core' government functions. It has changed in scale by: opening up to competition areas previously reserved to government, such as telecommunications; by public sector entities contracting private sector suppliers of goods and services in areas such as employment services and information technology; and by transferring some

\$A70 billion in Commonwealth assets or business to private sector owners. In aggregate, these changes are often described as the privatisation or commercialisation of the public sector.

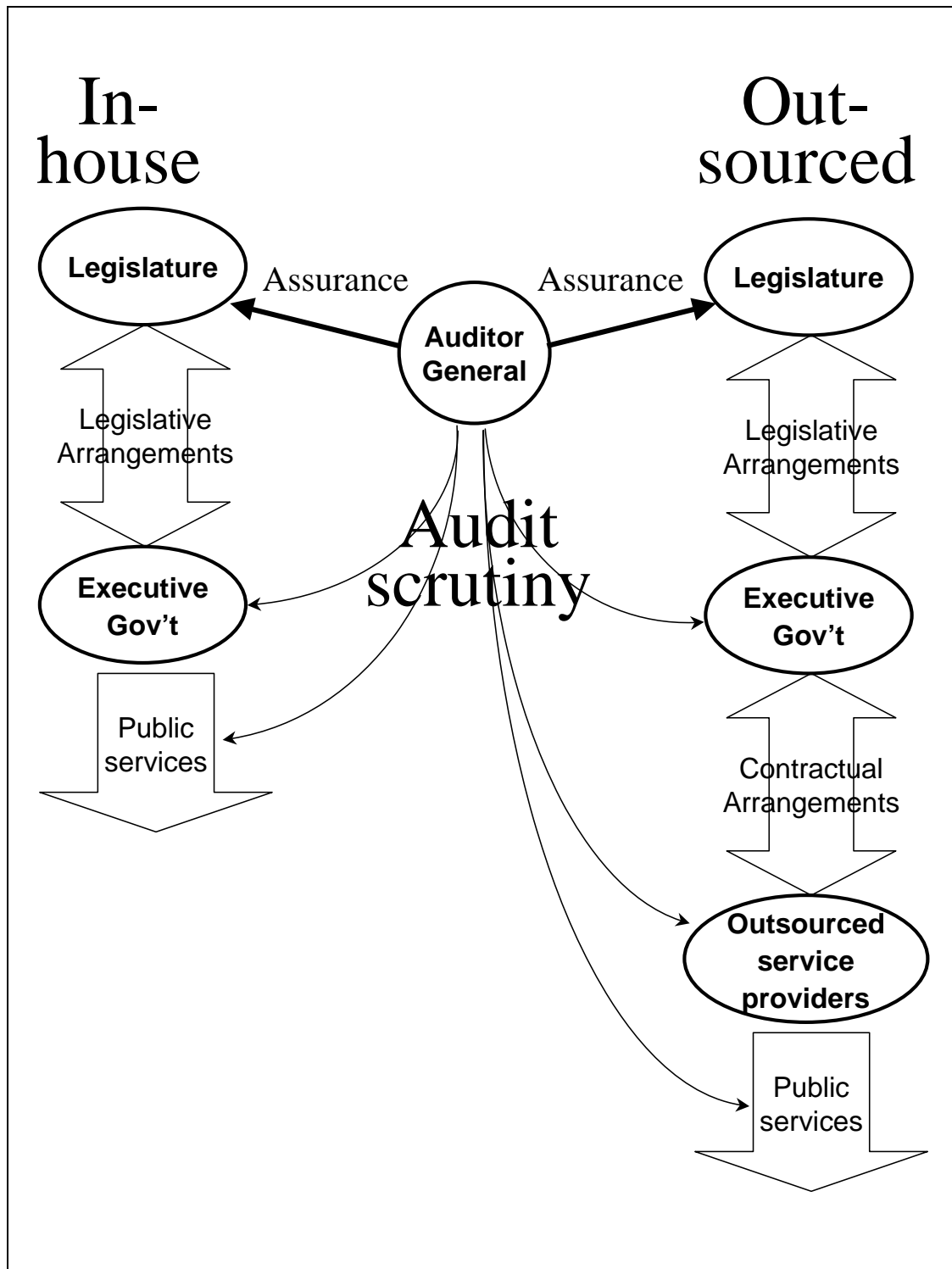
While commercialisation and privatisation have changed the face of governments' business, accountability¹ remains essentially constant. In the Australian context, accountability relies on the separation of the powers of each arm of government, with the Auditor-General accounting to parliament rather than the judiciary or to executive government. Indeed, Auditors-General or their equivalents in democratic systems of government have essentially the same role (allowing for variations in mandate, focus and operating arrangements). They provide the elected representatives of the community (the Parliament) with an independent, apolitical and objective assessment of the way the government of the day is administering their electoral mandate and using resources approved by democratic processes, albeit in differing governance frameworks. In this context, it has been said that:

*'...independent bodies with a watchdog role, such as the Office of the Auditor-General, are so important in underpinning accountability. The Auditor-General works for the Parliament, and has a specific responsibility to report on the way in which the executive (the Government) uses public resources, particularly money. Auditors-General report on the veracity of financial statements (their traditional role) and they also undertake performance audits, which address economy, efficiency and effectiveness. It is a wide remit, and intentionally so. Without information, the Parliament cannot do its job properly. While governments are keen to give us the good news, they are more reticent when it comes to their more questionable or controversial undertakings.'*²

The more business-like approach of the public sector has been generally welcomed, though it has raised practical questions of accountability. Unlike purely commercial entities, public service providers are required to simultaneously account for (among other things) client satisfaction, the public interest, fair play, honesty, justice and equity as well as striving to maximise 'value for money'. The additional requirements derive, ultimately, from the political judgement passed (at intervals, through the electoral process) on democratically elected governments' stewardship of public resources. The range and relative importance of these additional requirements vary. However, they remain the distinguishing feature of public sector accountability compared to private sector accountability.

Figure 1 reflects the essential roles of Auditors-General (scrutiny and assurance) as they apply to in-house as well as commercialised or privatised public services.³ As the public sector changes, as public sector managers assume more responsibility than at any time in the past, as they become more directly accountable to executive government and subject to judicial review, so too grows the importance of the role of Auditors-General.

Figure 1: Auditing in-house and out-sourced public services



For senior managers, the commercialisation and privatisation of public services poses risks and challenges different in nature and degree than in the past. The new challenges include market-testing, competitive tendering and contracting out. The new risks arise from (for instance) separating responsibility for service delivery from responsibility for policy advice, less direct control over the delivery of services, and finding and retaining skilled managers of new sorts of contractual arrangements in a public sector environment.⁴ Top managers in the public sector strive for an appropriate balance, attempting to derive the benefits of commercialisation and privatisation while properly accounting for the use of public assets, for public resources and for the quality of public services. In particular:

‘Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out because the main increases in efficiency come from the greater freedom allowed to contracting providers. Accountability is also likely to be reduced through the reduced availability of citizen redress... At the same time, accountability may on occasion be increased through improved departmental and Ministerial control following from greater clarification of objectives and specification of standards. Providers may also become more responsive to public needs through the forces of market competition. Potential losses (and gains) in accountability need to be balanced against potential efficiency gains in each case.’⁵

In short, commercialisation and privatisation can strain the thread of accountability between executive government and the elected representatives of the people in parliament. The more closely the public and private sectors interact, the more evident their similarities (for instance, management issues and responses) and the more stark their differences (mainly the nature and extent of accountability). Public servants, at least, must understand the pervasive and often decisive influence on public policy and on administration of ‘politics’ as distinct from the imperatives of ‘markets’.⁶

How then are public sector managers and private sector providers of public services to account for their business within a public sector which operates first and foremost in a political climate in which values and public interest are central?⁷ The acid test is the satisfaction of ‘public interest’. While always difficult to define or measure in any generally agreed fashion, it is very real to the Parliament, to public servants and to the ordinary citizen. In particular, everyone seems to know when public interest is not satisfied.

Ultimately, government and parliament decide on trade-offs between public sector accountability and private sector cost efficiency. They do so on the basis of information and advice from both the public and private sectors. It is proper that public servants, and SAIs in particular, ensure such advice is not, by omission or default, left solely to the private sector where the public interest may not be recognised or fully understood.

II. THE GOVERNANCE ENVIRONMENT

Audits have focussed increasingly on governance in the public sector. Applying the market discipline induced by competition for the delivery of public services does not obviate or limit the need for accountability. To the contrary, devolving responsibility in pursuit of improvements in service necessarily entails careful management, informed by reliable information and, ultimately, an accounting to the community.

Accountability in a more business-like public sector

Commonwealth public servants in Australia work within a legislative and administrative framework that still requires full accounting for the public interest while allowing sufficient flexibility to engage directly with the private sector. Where before public sector accountability operated under fairly strict separation from private sector endeavour, Australian public servants are now required, for example:

- to take a much broader view of policy and administrative issues and possible solutions (*Public Service Act 1999*);⁸
- to work more flexibly with more attention to the efficient and effective use of human resources (*Workplace Relations Act 1996*);
- to assume greater responsibility and accountability for public resources (*Financial Management Act 1997*);
- to focus on outcomes through the accrual budgeting framework; and
- to emphasise strategies, such as customer charters, which help balance complex political, social and economic objectives.

The intention is to allow managers increased flexibility and eliminate unnecessary processes so that they can respond better to their environment and improve the performance of their organisations. Greater flexibility in management and corresponding increases in personal accountability are the hallmarks of the ongoing reform of public sector, such that the emphasis is now very much on personal responsibility starting at the level of the Chief Executive Officers (CEO).⁹

The new arrangements pose opportunities and risks. Ideally, the identification, assessment, prioritisation, monitoring/review and treatment of risks will become an integral part of an effective, operational and strategic management approach at all levels of a public sector organisation. From the SAI's perspective, there are obvious steps to be taken to manage the risks. With greater responsibility and flexibility in decision-making comes greater accountability, to ensure that decisions are appropriately made and that those people making decisions can be properly called to account should the question arise. To provide such assurance, public sector entities need to have robust corporate governance arrangements including sound financial management and other suitable control structures in place as well as providing meaningful performance information.

Improving corporate governance in individual agencies has been driven, in part, by the simultaneous devolution of authority to agencies and their CEOs and the diminution of explicit central controls and direction. Organisations are now responsible to the minister and the parliament for their own oversight and need to develop and implement

appropriate accountability and performance structures to assist them measure and report their achievement against strategic objectives. Any coordination of activities or sharing of experiences are matters for individual agencies to arrange between themselves. Further diminishing central oversight and coordination is problematic as agencies recognise that, for instance, 'shared outcomes' indicate the need for broader corporate governance arrangements across agencies. Realistically, these will take some time to accomplish.

From the Australian National Audit Office's (ANAO) perspective, reduced central oversight has broadened the approach to auditing. Where once the ANAO focussed largely on compliance and conformance, it has become more actively involved in the scrutiny of governance within agencies and entities so as to add real value to public administration. Central agencies' vacation of the traditional monitoring review and oversighting roles has led to gaps in the information available to managers and, while not replacing centralised monitoring, the ANAO's across-the-service perspective enables it to fill at least some of those gaps and contribute to improving public administration through, for example, conducting cross-agency audits of particular issues and the promulgation of better practices.

The ANAO has moved from the 'gotcha' mentality of audit practice to seeking to assist organisations to better manage their functions and improve performance. The role of providing assurances to parliament and the community is now increasingly interpreted as including advice on how practices can be improved and accountability ensured. That is, the ANAO seeks WIN-WIN outcomes. For example, ANAO *better practice guides* are designed to assist organisations test their own systems and where applicable, improve their practice and performance in line with recognised principles of better practice.

Regulation and globalisation

Over the past three decades, there has been rapid progress towards creating a single world market. This 'globalisation', in which many large corporations operate across national boundaries, has been accompanied by dramatic government reforms aimed at improving the international competitiveness of the private sector. These include the deregulation of financial sectors, floating of exchange rates, pursuit of free trade, and reform of tax systems, all embraced by Australia along with public sector reforms which have helped reduce costs to business.¹⁰ Improvements in communications technology and innovative networks now allow the rapid transfer of large volumes of all types of information. These changes have, for instance, virtually overcome the problems posed by the geographical separation of the buyers and sellers of many services, especially financial services.

Globalisation poses regulatory challenges to governments. With new opportunities from wider markets and greater capital flows comes the risk of weakening the power of the state to manage its domestic affairs: it is simply much harder for states to control the flow of information, money and goods. This is due both to the changing nature of international business and its scale, a recent editorial in *The Economist* noting that:

‘the ten biggest industrial multinationals each has annual sales larger than their [Australian] government’s tax revenue.’¹¹

For the past 50 years, multinational companies have been an important part of the Australian economy, investing heavily in capital and technology and providing valuable experience¹² and generally increasing employment and wages.¹³ They are integral to Australia’s economic health. Globalisation now means that the Australian government (and many others) faces the challenges of doing business with multinational corporations operating on a similar, or even larger, scale. The following reflect such challenges:

- The failure of a large corporation is likely to have a significant impact on markets and government through, say, a ‘bail-out’ on the failure to deliver a public good.
- It may be difficult to capture legitimate taxes from electronic business and avoiding loss of government revenue and capacity to fund programs.
- Profit shifting may promote “a ‘race to the bottom’ in which governments slash taxes and services to lure global business”.¹⁴
- Government jurisdiction may not extend to the locale of corporate executives, shareholders or operations.

Multinational corporations are not beyond regulation, especially when coordinated between nations. Some 85 per cent of multinationals are based in OECD countries and many employ most of their workforce there.¹⁵ They may be pursued through their home governments’ legal systems. In this vein, the United States (US) Government has, in the last 6 years, amended its transfer pricing regulations twice to counter the concern that foreign multinationals are not contributing to domestic tax revenues. These changes give US tax authorities additional powers to change tax assessments, similar to powers conferred on the Australian Tax Commissioner to adjust the taxable income of a taxpayer engaged in international dealings on the basis of the consideration that might reasonably be expected to have passed between independent parties dealing at arm’s length.¹⁶

This is a prime example of governments regulating in order to influence or modify the behaviour of individuals or business in ways which are consistent with national and (and international) social or economic policy goals. Regulatory intervention by government usually deals with apparent ‘market failure’. The term suggests that government action may improve upon market outcomes in the public interest, though regulation is not usually justified unless it will largely overcome market failure and improve the community’s welfare.

The benefits of regulation need to be weighed against the costs which might arise from subsequent litigation and administrative redress and, for this and other reasons, considerable attention has been given over the last few years to the need for regulatory review and reform in Australia. We have been moving further away from a traditional ‘protective’ regulatory regime toward greater reliance on ‘self-regulation’ and consumer empowerment. The emerging less regulated environment has been characterised by governments’ efforts to ‘deregulate’, simplify, streamline and reinforce the essential ‘contract’ between consumers (or clients) and the providers of goods and services, whether in the private or public sector.

This evolving environment is sustainable only if consumers are well informed and supported by prudential and supervisory safeguards which are seen to promptly detect and remedy defects in the information available to consumers or defects in the operations of the providers of good and services. Performance, especially the avoidance of significant failures, therefore becomes the essential criteria of public confidence (and 'public interest') in a deregulated environment. In this context, recent market failures have raised questions about the efficacy of the new regulatory arrangements, as well as, in some instances, significant calls on taxpayer's funds and/or underwriting of risk by taxpayers.

III. AUDITING IN AN EVOLVING PUBLIC/PRIVATE SECTOR ENVIRONMENT

Scrutiny of regulation

The costs of deregulation must, as always, be weighed against the likely benefits. For instance, successive reforms of the Australian financial sector have shown that reducing prescriptive regulation can encourage significant improvements in competition and in the range of services available to consumers, although deregulation may also have contributed to the collapse of a number of financial institutions during the late 1980s.

In Australia's case, the reforms included the establishment of government regulators of competition, prudential supervision and disclosure to oversee financial operations, including those of banks and other deposit-taking institutions, insurers and superannuation funds (responsible for privately funded retirement benefits).¹⁷ Correspondingly, the ANAO has commenced a program of audits of prudential regulation (with the audit focusing on deposit-taking institutions completed last year, and superannuation commenced in June 2002) to assess the efficiency and effectiveness of the arrangements. In respect of banks and other deposit-taking institutions, the ANAO concluded that the relatively new prudential regulator has taken the useful step of adopting a risk-based supervisory methodology and promulgating harmonised prudential standards for all deposit-taking institutions. The ANAO also concluded that regulation would benefit by the more comprehensive adoption of the international best practice standards for effective banking supervision. Such changes would better reflect Australia's rapid integration into world markets and consumer's growing expectations of sophisticated and reliable banking services.

The ANAO's focus on financial regulation has proved timely, given the issues raised by the March 2001 collapse of the HIH Insurance Group, one of Australia's largest insurers. Now the focus of a Royal Commission, the collapse left liabilities estimated at up to \$A5 billion and has prompted public and Parliamentary questioning of the effectiveness and quality of the regulation and supervision of the Australian insurance industry. While it is unlikely that the benefits of market discipline can be achieved with total assurance of consumer safety or without the 'moral hazard' risk of public funds being required to correct market failures, the public clearly demands a balanced approach and wishes regulators to play a significant role in averting the worst effects of deficient corporate governance. The matter is especially sensitive when the

financial effects are long term and affect, for example, consumer housing or retirement incomes.

The avoidance of further failures is also crucial to continuing public confidence in the new regulatory regime and a prime example that privatisation and deregulation do not necessarily diminish the public interest inherent in the operation of certain businesses. Accordingly, governments may see that the regulation of privatised companies or of industries in which privatised companies compete is in the public interest. In this case, Auditors-General can perform an important function by examining and reporting on the public sector's performance in regulating privatised businesses and/or administering government contracts with these businesses. The regulators themselves have to be accountable as well as being reasonably independent – a suitable balance is often difficult to achieve.

Auditors-General are well placed to recognise and address the risk of regulatory capture. In general terms, if regulators do not, for whatever reason, put in place cost-effective surveillance and enforcement programs, inequities between non-complying and complying businesses will arise. The risks of regulatory capture are exacerbated if regulators do not account for the full impact of the shift of ownership of a business from the public sector to the private sector, with the potential to impair the regulator's independence, objectivity and capacity to act fairly.

Public sector financial operations in a global economy

Governments are often involved in international trading activities through the need to procure goods and services such as Defence equipment; provide or receive aid; and operate diplomatic posts in other nations. These activities give rise to significant financial risk exposures, including variations in exchange rates. Exchange rates are highly volatile and, accordingly, a government's international financial flows need to be prudently managed.

In 2000, the ANAO examined the management of foreign exchange risk by Australian Public Service agencies and found that foreign exchange risk was not effectively managed by the audited agencies in an environment of devolved authority reinforced by the *Financial Management and Accountability Act 1997*. Specifically, questions arose as to their systems and policies for identifying risk exposures, analysing the extent of these exposures and their impact, as well as their effective and cost-effective management of the resultant risks.

The ANAO's findings highlight the challenges faced by public sector managers in an evolving administrative environment. The findings reflected the real risks inherent in agencies' recognising (or not recognising) their responsibility for managing foreign exchange risks under a devolved governance framework. Accordingly, ANAO recommended better practice to ensure prudent management of foreign exchange exposures, with the object of increasing the Commonwealth's purchasing power and improving the long run risk-adjusted returns to the Commonwealth of funds exposed to exchange rate fluctuations. The key recommendation was to promulgate an overarching Commonwealth position on foreign exchange risk management, coupled with agency responsibility for a proper assessment of individual foreign exchange risk and its management¹⁸. In support of a more sophisticated risk management, ANAO

struck a prudent balance between necessary central oversight and enabling agencies themselves to responsibly manage risks.

The Australian Financial Markets Association has noted that large corporations are increasingly employing sophisticated risk management systems to record their financial risk exposures and the transactions that hedge these exposures.¹⁹ As ANAO found, it is as important for Commonwealth agencies to identify their financial risk exposures and explicitly evaluate potential options for the efficient management of exchange rate risk as part of their overall risk management strategy. In this respect, the Australian Society of Certified Practising Accountants has commented that:

*'Financial risks associated with exposure to interest rates, foreign currencies, commodity and share prices can impact on the results of an entity's core business, whether or not they are actively managed. Given the increasingly global nature of business and recent volatility in interest and currency rates, financial exposures have the potential to undo the results of even the best managed businesses. The main objective in managing these risks is to reduce or eliminate uncertainty in the business, in terms of the future costs of external inputs to its operations. The entity will then be better placed to plan and control operations and to concentrate on its core business. In essence the role of treasury is to ensure that the entity's profitability or effectiveness is the result of its own decisions and actions, rather than the result of factors beyond management's control.'*²⁰

An important step in any risk management program is goal specification. Many commercial organisations aim to reduce the volatility of cash flows, earnings and/or market value through management, or hedging, of foreign exchange exposures.²¹ Consequently, the key objectives of hedging are to avoid taking speculative positions and eliminate foreign exchange transactional risk while minimising hedge costs²² and taking advantage of the structure of spot and forward markets to increase returns or reduce costs.

Hedging is the process of managing risk by eliminating, or at least reducing, the underlying exposure. This is often achieved by using financial derivatives. Recently, the legal authority of Australian statutory authorities and companies, including government business enterprises, to enter derivative financial contracts has been questioned.²³ Consequently, a call has been made for greater legal certainty about such organisations' power to enter into such contracts. A key risk for many of the commercial statutory authorities is exposure to the impact of changes in interest and exchange rates on cash flows and net worth. The deregulation and globalisation that have occurred in financial markets in recent decades has led to the accelerated development and use of a range of financial derivatives. Financial derivatives, such as swaps, options and forward rate agreements, enable government bodies to manage (or hedge) their financial risks, particularly in the area of sovereign debt and major procurement contracts.

While originally developed as a risk management tool, derivatives also involve risks that need to be managed. For example, in recent years a number of entities have suffered significant financial losses associated with derivatives.²⁴ Subsequent reviews

have attributed the losses, in part, to flawed corporate governance systems that did not establish effective risk management and internal controls to ensure approved policies and risk limits were applied and were effective. There is also a risk that derivatives may be used to speculate on financial market movements, thereby creating new risks rather than managing existing risks.

Derivatives also raise important issues for auditors of statutory authorities. Unless the enabling legislation shows a legislative intention to create a corporation with a wider capacity, corporations established by statute have no legal capacity beyond that necessary for the purpose for which they were established.²⁵ Significant losses have been experienced by derivatives users and dealers when derivatives contracts were found to be unenforceable as counterparties did not have the necessary legal power and authority to engage in derivatives transactions,²⁶ or because particular terms of the contract were not legally sound. Even where there is reasonable legal certainty, as in the case of Commonwealth companies subject to the Corporations Law, there is a stated concern that:

'... these organisations can legally use derivatives for speculation, possibly exposing the Commonwealth to greater risks. Imposing restrictions in the use of derivatives in the memorandum or articles would send the appropriate signal to officers of these organisations that derivatives are to be used only for hedging purposes'.²⁷

The use of derivatives by Government agencies and bodies has been the subject of inquiry and debate in the Australian Senate (the Upper House of Parliament) indicating clear Parliamentary concern with such use even in the more market oriented environment being experienced by the public sector.²⁸ Central among these concerns has been the leverage that such products offer with the possibility of significant financial gains and losses for a small initial outlay.

Of note is the Australian Government Treasury Department's extensive use of interest rate and cross-currency swaps with over 300 swaps transacted since May 1988 with a notional principal value of more than \$A38 billion²⁹. This swap program is aimed at changing the debt portfolio to fixed and floating interest rates as well as seeking to obtain foreign currency exposures which may reduce debt costs. While legislation removes any doubts about the Treasury's legal authority to enter into these transactions, Parliamentarians have questioned the Treasury about the purpose of this swap program and the extent of the Commonwealth's associated financial and risk exposures. Treasury assured the Parliament that the program is soundly based with substantive processes that appropriately protect the Commonwealth's exposure.³⁰ The ANAO's 1999 audit of Commonwealth Debt Management and the control and governance framework for the swaps program was an important element of the audit scope. Many of the audit recommendations were aimed at strengthening the control framework in order to manage the significant legal, operational and market risks that are inherent in the use of financial derivatives.³¹

In its recent review of this Audit Report, the Joint Committee of Public Accounts commented³² that it remains unconvinced of acceptability of the risk in relation to the Commonwealth's foreign currency exposures and recommended that all audit recommendations be implemented. Of particular concern was the effect of the

depreciation of the Australian dollar such that significant cash flow losses would be borne in future years. Indeed, losses of more than \$A2.2 billion were realised between 1999-2000 and 2000-01, which gave rise to adverse media commentary on the merits of the swap program.

This issue highlights the importance of auditors having a sound understanding of the business environment of the agencies they audit. Because of their complex nature and the significant risks involved, the public sector auditor needs to be satisfied that financial derivatives are being used in a prudent and considered manner; that appropriate governance arrangements³³ are developed and adhered to; and that government is aware of the nature and extent of the activities involved. However, it is also important that the auditor be satisfied that the agency has the power to enter into derivative contracts.

The use of financial derivatives by public sector agencies has a further implication for public sector auditors of these organisations. As part of the audit planning process, regard needs to be had to the control framework and a careful risk assessment undertaken. Where reliance is placed on controls (for a financial statement audit) or the performance audit scope includes coverage of the use of derivatives, it is important that the auditors have a sound understanding of these financial instruments and that audit examination be undertaken by appropriately qualified and independent staff.

Private sector delivery of public services

Outsourcing has been a key feature of the changing Australian public sector environment and has raised important questions of accountability. The lessons learned from the outsourcing of information technology (IT) will illustrate the challenges facing public sector managers charged with outsourcing functions which, it was judged, the private sector could deliver more efficiently.

The outsourcing of IT in the Commonwealth sphere in Australia arose from a government decision known as the IT Initiative, which was to transfer around \$A4 billion of IT provision in Federal agencies to the private sector. The then Office of Asset Sales and Information Technology Outsourcing (OASITO) managed the Initiative centrally for the government through a series of tenders dealing with groupings of agencies (clusters). These clusters were determined without adequate consultation and involvement of the agencies concerned and were, in effect mandated, as opposed to agencies being allowed voluntary participation in groupings with accepted synergy and shared purpose. The scope of services to be included in each outsourcing tender was also mandated.

The arrangement posed significant problems of corporate governance for those agencies where the IT requirement was predominantly scientific or otherwise related to the core activities of a particular agency (for example, the payment of pensions). The approach taken by OASITO was designed to implement the Government's policy agenda under centralised direction (and control) despite the perceived reluctance (buy-in) of some agency Chief Executive Officers (CEOs) because they did not have the degree of control necessary to best manage transition risks though they remained ultimately responsible for the agency outputs and outcomes and the budgets involved.³⁴ There was no evidence to indicate that public servants were not endeavouring to

implement the Government's outsourcing policy. The question was more apparently to find the best way of meeting all the Government's requirements, including legislative imperatives.

A preliminary scoping study identified significant savings expected to accrue from implementing the Initiative. Indeed, these projected savings from the implementation of the IT Initiative were removed, upfront, from the respective agencies' future budgets. Significantly, the financial evaluation methodology applied in the tenders did not allow for two key factors that were material to the assessment of savings arising from outsourcing the services. The evaluations considered neither the service potential associated with agency assets expected to be on hand at the end of the evaluation period under the business-as-usual case, nor the costs arising from the Commonwealth's guarantee of the external service provider's (ESP) asset values under the outsourcing case. Consequently, the financial savings realised by the agencies from outsourcing, as quantified in the tender evaluations, were overstated.

The ANAO identified a range of issues on which agencies should place particular focus in the management of IT outsourcing arrangements as follows:

- identification and management of 'whole of contract' issues including the 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 when a number of agencies are grouped together under a single agreement;
- putting in place a management regime and strategy that encourages an effective long term working relationship with the 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 in the agreement so as to focus unambiguously on 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 in order to support effective contract management, as well as from both an agency performance and accountability point of view.

As a response to the audit, the Government commissioned a review of IT outsourcing conducted by Richard Humphry (Managing Director, Australian Stock Exchange). This independent review recognised the implicit management dilemma described above and recommended that, because CEOs of agencies had the statutory responsibility, they should be responsible for the outsourcing decisions. In particular, decisions that impacted upon the core business of the agency needed to be taken at agency level. Mr Humphry remarked:

*'Priority has been given to executing outsourced contracts without adequate regard to the highly sensitive risk and complex processes of transition and the ongoing management of the outsourced business arrangement.'*³⁵

The review pointed out that there were several risk management lessons to be learned as follows:

- the most significant risk factors were the unwillingness to change and the failure to buy-in the appropriate expertise;
- there was a lack of focus on the operational aspects of implementation;
- there was insufficient attention paid to the necessary process of understanding the agencies' business; and
- there was insufficient consultation with key stakeholders.³⁶

The review drew heavily on the Standards Australia publication HB 240:2000, *Guidelines for Managing Risk in Outsourcing*.

The Government agreed with the ten recommendations made by the review, some with qualification.³⁷ This agreement included that responsibility for implementation of the IT Initiative be devolved to Commonwealth agencies in accordance with the culture of performance and accountability incorporated in the relevant financial management legislation. Agencies are required to obtain value for money (including savings) and maximise Australian industry development outcomes. Agency heads will be held directly accountable for achieving these objectives within a reasonable timeframe, as well as grouping with other agencies at their discretion, wherever possible, to establish the economies of scale required to maximise outcomes.

Agencies will also be responsible for addressing implementation risks. A separate body will be established within the Department of Finance and Administration (Finance) to advise agencies, at their request and on a fee for service basis, on managing their transition. Audit experience indicates that the agency emphasis has to be on developing a robust analysis of business requirements at the initial stage, which would be the basis of a strong business case for whatever IT strategy is developed. Without OASITO's involvement, the industry can now deal directly, from the outset, with the people responsible for the function and related outputs and outcomes, as well as with those who will be managing the contract. The inability to have this relationship was the subject of criticism by the industry under the previous arrangements managed by OASITO. This is a significant lesson for all future outsourcing arrangements.

Following the tabling of the Audit Report³⁸, the Senate Finance and Public Administration References Committee announced an inquiry into the IT Initiative. The Committee's August 2001 report found that the sheer size of the implementation task was ambitious and that the Initiative introduced substantial risks in its own right. The Committee noted that its deliberations had been greatly assisted by the analyses and recommendations set out in the Audit Report. Acknowledging that the Government has taken heed of the majority of the recommendations emanating from the Humphrey Review, the Committee made further recommendations designed to strengthen accountability and increase transparency in contractual dealings.³⁹ The Committee noted that its report highlighted failures in achieving projected cost savings, difficulties experienced in transition to total outsourcing, and other matters, particularly those related to documentation of results. More positively, the Committee also found agencies that have succeeded in building genuine partnerships with their providers and have consequently set standards to which both agencies and business should work.⁴⁰

Advocates of outsourcing 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.⁴¹ However, outsourcing also brings risks to an organisation which cannot be ignored. The experience of the ANAO has been that a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and considerable public concern.⁴²

The main message from this experience is that savings and other benefits do not flow automatically from outsourcing. Indeed, like any other element of the business function, outsourcing must be well managed and analysed within an overall business case including an assessment of its effect on other elements of the business. The latter can be positive or negative. For instance, in the case of the Department of Finance and Administration's outsourcing of all its human resource management functions, it was assessed as positive for its core business and that arrangement subsequently won a worldwide outsourcing achievement award.⁴³

Outsourcing represents a fundamental change to an agency's operating environment. It brings with it new opportunities as well as risks, requiring managers to develop new 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 skills across the public sector and will be a key accountability requirement of public sector managers. In particular, outsourcing places considerable focus and emphasis on project and contract management, including management of the underlying risks involved. The thrust of this change is reflected in the Australian Senate's Finance and Public Administration Committee's second report on Contracting Out of Government Services released in 1998:

*'Despite the volumes of advice on best practice which emphasise the need to approach contracting out cautiously, to invest heavily in all aspects of the process and to prepare carefully for the actual implementation, and the substantial body of comment in reports from the Auditor-General indicating that Commonwealth agencies have a very mixed record as project and contract managers, the prevailing ethos still seems to promote contracting out as a management option that will yield inevitable benefits. Resources must be made available to ensure that contract managers have the skills to carry out the task.'*⁴⁴

The effective and efficient management of the relationship with private sector investors/owners/operators by government agencies requires a solid foundation of commercial, project management and policy skills. There is a particular risk that the private sector service provider may have greater information and knowledge about the task than the Commonwealth agency. If they are not to be disadvantaged by this situation, public service contract managers will need a level of market knowledge and technical skills that are at the same level, or above, those prevailing amongst the private sector service providers. In this context, public sector managers and auditors

need to be cognisant of the potential risks which might arise from project management arrangements with private sector investors, such as:

- short term flexibility may be compromised by unforeseen 'downstream' costs or liabilities which erode or offset early gains;
- there may be a tendency for government to bear a disproportionate share of the risks, such as through the offer of guarantees or indemnities;
- the failure of private sector service providers may jeopardise the delivery of the project, with the result that the government may need to assume the costs of completion plus the costs of any legal action for any contractual breaches;
- drafting inadequacies in contracts or heads-of-agreement with partners could expose governments to unexpected risks or limit the discretion of future governments by imposing onerous penalty or default clauses;
- inadequacies in the modelling and projection of costs, risks and returns may, under some conditions, result in an obligation by governments to compensate private sector providers for actual losses or failure to achieve expected earnings;
- there may be some loss of transparency and accountability for disclosure as a result of private sector provider claiming commercial confidentiality with respect to the terms of their investment; and
- the level of private sector investment and the amount of risk private sector providers are willing to bear may be inversely proportionate to the conditions placed on them by governments to determine pricing, delivery of community service obligations, or transfer or sell interest in the project.

Selling public sector assets

One of the most prominent forms of the commercialisation of public services has been the outright sale (or privatisation) of government businesses to the private sector. In Australia, the last ten years has seen an increased focus on privatisation of government business entities, with approximately \$50 billion raised by the Commonwealth Government through such asset sales over this time.⁴⁵ In addition to raising significant cash proceeds, asset sales provide an opportunity to transfer risks to the private sector and has been argued to offer the potential for improved business efficiency.

Privatisation, whether by trade sale or public share offer, has always impacted on the financial statement business of Auditors-General through participation in the activities associated with the due diligence program, which ensures the accuracy and completeness of information provided to prospective purchasers. Information disclosed to potential purchasers typically includes financial performance data for a five year period as well as for the most recent audited financial statements. This emphasises the importance of comprehensive and sound financial statement auditing practices.

The underlying objective of a financial statement audit is to express an opinion on the fairness of the information reported in the financial statements. However, for the public sector auditor, audit coverage needs to extend beyond the minimum work necessary to substantiate financial statement disclosure. If the Auditor-General is to truly add value and provide appropriate assurance, it is important that the public sector audit coverage should recognise and report matters which, although not directly related to the financial statements or supporting systems, impact directly or indirectly on the

efficient, effective and ethical use of public resources.⁴⁶ In a similar vein, the role of financial statement auditors in the Australian private sector is also under scrutiny in this regard in the wake of recent large corporate collapses. A recently released report on audit independence in Australia,⁴⁷ which was prompted by recent overseas work and the failure of a number of listed Australian companies during the first half of 2001, examined the existing legislative and professional requirements and compared them with equivalent overseas requirements. The Government has welcomed the report.

Australia has an ongoing program of asset sales and the assurance provided by audits plays an important role in enhancing accountability for the stewardship of the sale process and whether post-sale performance is meeting the objectives set by government. The ANAO 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. Risk management has been a particular focus of the public service reforms in Australia, particularly in an era of devolved authority and commensurately less central control.⁴⁸

To ensure their effectiveness, ANAO privatisation audits (such as the recent audits of the Telstra Corporation – Australia’s major public sector communications supplier - share offers⁴⁹, the leasehold sales of Federal airports⁵⁰, the third tranche sale of the Commonwealth Bank⁵¹ and the the sale of Commonwealth Estate Property⁵²) are undertaken by a team of experienced officers who understand the commercial nature of the transactions and the overlaying public accountability issues. In addition, ANAO engages appropriately qualified professionals to provide specific technical, including commercial, advice for such audits.

A key issue in these performance audits has been the role of financial, legal and other private sector advisers to the sale process. In Australia, the privatisation process itself is now subject to extensive outsourcing under multi-million dollar advisory contracts. This places considerable emphasis on contract management and balancing commercial interests with the overlaying public accountability required of the public service. One of the key outcomes from our privatisation audits has been the identification of opportunities for significant improvement to the process of tendering and managing these advisory contracts, the adoption of which has led to improved overall value for money and project management quality in subsequent sales. In short, the emphasis is on better practice to add value to public administration as a major audit objective.

Asset sales in Australia are invariably conducted by way of public share offers or trade sales. Although there are similarities in some of the administrative processes associated with the management of public share offers and trade sales, there are also stark differences which need to be considered when planning and undertaking audits of such sales. Because of the time pressures and commerciality of these sales, ANAO audits have all been *ex-post*. Opportunities were available to undertake probity audits of the sales processes but potential conflicts of interest as well as resourcing issues inhibited ANAO’s participation.

By virtue of their scale and complexity, audits of public share offers are quite challenging undertakings. Furthermore, the scale of such offers particularly emphasises the importance of sound administrative practices because small deficiencies can have significant adverse financial implications. ANAO has examined

the three largest public share offers conducted in Australia, namely the first and second tranche sale of shares in Telstra and the third tranche sale of shares in the Commonwealth Bank. These three sales collectively raised proceeds of some A\$35 billion. The audit reports have 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. While fees need to be high enough to motivate them to sell shares, it is important that the entity oversighting the sale should take advantage of the competitive broking market by considering the level of fees sought by individual brokers when deciding on the composition of the selling syndicate for the offer. It is equally important that the division of fees and commissions between the fixed component shared among the selling syndicate and the 'competitive' component paid according to which broker secured the order for shares provide an incentive for all brokers to actively market and sell shares,⁵³ and that fees and commissions only be paid for services provided. For example, underwriting fees should only be paid on shares that are actually underwritten;
- the 'price discovery' process which is important to achieving value for money in initial public offers. In Australia, the final offer price is established by a 'bookbuilding process' whereby investors submit bids in advance of the pricing of the share offer and, on the basis of this information, shares are allocated to qualifying bidders. In secondary offers, a market price already exists for the shares being sold and this makes the process of establishing the issue price less complex. However, in an initial public offer, the bookbuild performs a more important price discovery role and it is important that the bookbuild allocation criteria, and any indicative price ranges specified by the vendor, encourage and reward bidders who indicate their price elasticity of demand for shares; and
- the logistics of the settlement process, if the vendor is to receive the full proceeds from the share sale in a timely manner. This requires comprehensive settlement procedures to be developed and advised to successful bidders, ongoing monitoring and reconciliation of relevant bank accounts, and the implementation of effective settlement default procedures.

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

A common objective of any privatisation is to obtain a fair value from the sale. ANAO audits of trade sales have adopted the Australian Accounting Standards'⁵⁴ definition of fair value, namely: the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. 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, ANAO 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 minimise the costs of potential buyers understanding the business in order to develop their bid;
- adopting structures such as tender evaluation committees to enhance transparency and accountability as well as structuring these committees so that relevant agencies are able to satisfy themselves that the evaluation is fully informed, properly conducted and identifies the best possible offer for each business;
- the development of appropriate priorities which set out the relative importance attaching to each evaluation criterion;
- carefully considering the nature of fees paid to commercial advisers to ensure advisers do not have a pecuniary interest in 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
- the merits of undertaking a credible assessment of the net financial benefits of all tenders in order to maximise financial returns from the sale.

It has been pleasing to observe that ANAO privatisation audits have had a real impact on the way sales are being conducted. For example, Federal airports in Australia have, to date, been sold in three major tranches with total proceeds of approximately \$8.3 billion. The first two major tranches have been audited, and the audit of the third major tranche commenced in September, shortly after the sale of Sydney Airport in June 2002 to a consortium led by Macquarie Bank. An aspect of ANAO'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. The ANAO found that all eleven recommendations in the 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.

The ANAO audit of the first sale of Telstra shares received serious attention during the planning and conduct of the second sale, which was completed late in 1999 and was audited by ANAO. The 1998 audit report on the first sale found that overall value for money in future sales could have been improved and the report included 11 recommendations aimed at improving the future management of Commonwealth public share offers, particularly financial management. Although the recommendations were not universally accepted by the relevant agencies, the Government required that the issues raised in the 1998 report be taken into account in the management of the Telstra 2 transaction. The subsequent audit of late 2000 confirmed substantial improvements in contract management and tendering, maximising the Commonwealth's bargaining position. However, the audit also found substantial opportunities to improve the transparency of accountability by ensuring adherence to

proper processes, ensuring timely advice from relevant specialists and providing an appropriate audit trail.⁵⁵

Achieving positive outcomes from such audit activity demonstrates the value of the latter in providing assurance to all stakeholders and in promoting improved performance by the public sector and their private sector advisers and contractors. This outcome reflects the value of recommendations aimed at assisting the achievement of better outputs and outcomes and concomitant commitment to their implementation – in other words, a win-win situation.

It would be remiss to imply that this is always achievable. ANAO's recent audit of the sale of Commonwealth Estate Property has highlighted the potential for conflict faced by Auditors-General. In this instance, the contested issue of accountability was whether or not the agency commissioned to sell almost \$1 billion of Commonwealth property was also bound to protect the Commonwealth's overall interest with respect to the retention or divestment of the properties. The ANAO view was that the Commonwealth's legislative framework for financial accountability continued to bind the agency and, accordingly, the audit found that sale of properties for which the Commonwealth had an ongoing interest in the form of long-term leases exposed the Commonwealth to future liabilities that, over time, effectively negated the sale proceeds. Importantly, both the agency and the responsible Minister took the contrary view, citing Executive Government's prerogative to make policy judgements as to the public interest and to require Departments of State to effect such policies, a role the responsible agency described as necessary to achieve the property sales rather than protecting the Commonwealth's interest.

The conflict goes to the heart of accountability in the Australian interpretation of the Westminster system of government, wherein Parliament is the paramount authority among the three arms of government. In such a system, it is inevitable that tensions will arise between Executive Government and Parliament involving, in this case, the Auditor-General's status as an Officer of the Parliament rather than of the Government. In some respects, the tension reflects the price of accountability in the Australian system of responsible government.

Partial privatisation

The partial privatisation, or phased approach to full privatisation, gives rise to a different set of audit risks than full privatisation in one tranche. Chief among these is the question of whether the audit of partially privatised entities should be part of the core business of Auditors-General. From the ANAO perspective, this is not core business, though the ANAO still carries the full audit risks, including accountability, to both non-government shareholders and to the Parliament including the Executive Government. The issue becomes how to handle the potential, if not likely, conflicts of interest.

Government activities that have been partially privatised have somewhat different imperatives and require other forms of control or oversight in terms of how they are to be held accountable. In this context, Auditors-General need to consider what is the appropriate manner for them to discharge their mandate responsibilities. However, of critical importance is that, whatever delivery method is used, the Auditor-General has,

and will continue to have, the ultimate responsibility for the conduct of financial statement audits.

It is important to recognise that the partial privatisation of a government business represents a marked change in the operating environment of an entity. Typically, the entities would not be part of the recognised core of public sector activity. It would often not be feasible, let alone practical, for the Auditor-General to maintain in-house the expertise needed to audit such entities, particularly where there is a strong identification and/or relationship with the private sector and where the Audit Office has little, or only limited, knowledge and experience. Perhaps more importantly, from an audit effectiveness viewpoint, it would be very difficult to obtain and maintain the necessary experience to conduct such audits well, with a full knowledge and understanding of the industry in which they operate. Private sector firms with the appropriate connections are often able to call on the necessary expertise and background knowledge nationally and internationally as well as being able to maintain that expertise because of their broader client base in particular areas.

This is one reason why private sector involvement in public audits can add value. Accordingly, for a number of years the ANAO has been using private sector firms as agents in conducting financial audits. This does not abrogate the Auditor-General's responsibility for the opinion given on those financial statements nor from the responsibility to be satisfied that the work of our agents is not just "adequate" but is based on demonstrated good professional practice and in accordance with audit standards set by the Auditor-General. Therefore, ANAO retains strong project management and oversight of such audits both for assurance and for understanding of the issues, including the professional development of ANAO staff.

Using the private sector in this way does, moreover, provide us with the opportunity to concentrate resources on core business. This is mainly entities wholly or mainly budget funded. Here we have specialist skills, knowledge, understanding and experience of public sector functions and activities. At the same time, we can provide a better service with private sector firms to the more specialised entities, often with limited or no additional budget funding, than could be provided solely from ANAO's resources. Such a strategic approach ensures the ability to provide the Federal Parliament with the required assurance about overall public service accountability and the necessary degree of involvement to do so credibly. The issue is basically about achieving the right balance of such involvement to be effective.

Contract management

The outsourcing of government services now encompasses not just the support service contracts (familiar to most organisations) but elements of agencies' 'traditional' core business. This trend is unlikely to reverse in the foreseeable future, if only because of the difficulty of recreating in house that infrastructure already outsourced. It is therefore incumbent on Australian Public Service managers to refine their skills and knowledge of their role as managers of outsourced (contractual) arrangements, as well as the developers of policy advice.

While the public and private sectors may be said to be converging or re-converging in historical terms, necessary differences remain: the nub of these is that taxpayers'

dollars are at stake. Thus, the awarding of contracts must of necessity follow a process that ensures open and effective competition and the realisation of value for money. The reasons for selecting a particular source need to be written up and be able to withstand scrutiny, including from the Parliament. Contracts have to be put in place which clearly specify performance standards and include appropriate arrangements for monitoring and reviewing contractors' performance.

To improve contract management in the Australian Public Service, the ANAO has issued a *Better Practice Guide on Contract Management* and has conducted a series of audits of recent contracting exercises, which found as follows:

- One agency selected a service provider and advanced funding of 80 per cent of the contract fee to a contractor without checking the financial viability of the contractor. When its financial backers later withdrew, the contractor abandoned the project before it was complete. As a result, the agency terminated the contract and has taken legal action in an endeavour to protect any remaining Commonwealth funds held by the contractor.⁵⁶
- Similarly, the audit of the \$5 billion project for six new submarines found that, although only two submarines had been provisionally accepted by the Navy, 95 per cent of the construction contract funds had been paid over. This was compounded by the finding that the contract only provides the Commonwealth modest recourse by way of financial guarantees and liquidated damages for late delivery and under-performance.⁵⁷
- In conducting the initial sale of Telstra shares, advisers were appointed without having regard to the fees quoted by the tenderers because the Commonwealth agency considered the expected outcome in sale proceeds to be more important than sale costs. The contract fees, amounting to some \$91 million, are the highest ever paid in a Commonwealth public share offer and were significantly above those indicated by other tenderers. Furthermore, the contractual arrangements required fees to be paid for services that were not provided and other fee payments departed from the terms of the relevant contract, which the agency said did not fully capture the commercial understanding of the parties as to the basis on which fees would be calculated and paid.⁵⁸
- In 1997, the sale of the supplier of passenger and commercial vehicles to the majority of Commonwealth bodies (known as the DASFLEET) was finalised for a price of \$408 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.
- An important part of the 1994 sale of the former Commonwealth Serum Laboratories (now CSL Ltd) was the execution of a ten year contract for A\$1 billion between the Commonwealth Government and the soon to be privatised company for the supply of blood plasma products. The audit of the sale process found that systems had not been established to manage the risk of overpayments under this contract. A follow-up audit, focusing on the

administration of the long-term contract by the relevant public sector agency, was recently completed. The audit found that the management of the long-term supply contract was deficient in relation to the planning and conduct of commercial negotiations over price adjustments and that there were inadequate financial controls over the payment of more than \$400 million in public funds for blood products. The audit also highlighted the need for corporate governance structures that ensure appropriate action is taken to address issues that are raised by internal and external audits.⁵⁹

A common theme of these audit reports has been the deficiencies in the project management skills of agency decision makers, allied with the fact that some of these projects involve substantial resources and complexity. As well, the audits have flagged the need for care in assessing value for money and negotiating, preparing, administering and amending major contracts. The Parliament and the media have also paid particular attention to these issues during recent years with several agencies receiving significant adverse comments and publicity.

This situation has to be addressed as a matter of urgency, to reverse these concerns and win back the confidence of all stakeholders. Presently, contracting can be a high risk and costly exercise for both parties. For the private sector, the risks arise from understanding the services to be provided, the attendant obligations and the immediate expense of developing a tender with few guarantees of success. Contractors face the challenge of working in a public sector environment and public servants the challenge of dealing with all aspects of commercial financial viability.

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

The significance of agencies clearly understanding the legal imperatives associated with contracting was highlighted in a recent seminar in Australia⁶⁰ at which was raised the convergence of legal and commercial risks and the need for planning and sound systems for contract management, particularly over the whole life of the contract. Recent judicial decisions have also emphasised the importance of having a legally defensible tender process as an integral part of contracting out. It has always been important for the tender process to be commercially defensible. However, recent rulings have demonstrated that commercial interests are also served by meeting legal requirements.

Performance accountability

Although the public sector may contract out service delivery, this does not extend to contracting out the responsibility for the delivery of the service or program. It is the responsibility of the agency and agency management to ensure that the government's objectives are delivered in a cost-effective manner. The agency must therefore specify

in the contract the necessary level of service delivery and required quantitative and qualitative service standards and measures.

There is no doubt that the more ‘market-oriented’ environment being created is inherently more risky from both performance and accountability viewpoints. Good managers have an opportunity to perform better, particularly when the focus is more on outcomes and results and less on administrative processes and the inevitable frustration that comes from a narrow pre-occupation with the latter. However, the Public Service is just as accountable to the Parliament for the processes it uses as for the outcomes it produces. That is inevitable and proper, although the ANAO’s experience suggests that some agencies, faced with the prospect of adverse audit findings about the transparency and accountability of their risk management or other processes, have argued for a greater emphasis on the outcomes than on the process. The ANAO tends to the view of the then Chairman of the Australian Senate’s Standing Committee on Finance and Public Administration, that:

‘[Risk management] does not mean that managers can expect to be judged only on the efficiency and effectiveness of their results and be able to claim that the mix of inputs chosen, how they are applied and the selection of who is to supply them is outside the reviewer’s area of concern. The fundamental principles of accountability have not changed: information still needs to be readily available to allow reviewers to make their own assessments about the legal and proper use of inputs and the ethical behaviour of the people involved in the processes. Managers cannot simply claim that the ends justify the means.’⁶¹

Sound contract management, and accountability for performance, are dependent on adequate and timely information. It is simply good business for agencies to consider the level and nature of information to be supplied under the contract and access to contractors records they require to monitor adequately the performance of the contractor. However, the more detailed the performance standards, the specific requirements for rigorous reporting and monitoring and the need for frequent renegotiation and renewal, the closer the contractual arrangements come to the degree of control and accountability exercised in the public sector.⁶² It is a matter of balancing any trade-offs in efficiency and/or accountability if optimal outcomes are to be secured, although the benefits of good management information are accepted almost without question.⁶³

In the interest of securing access to premises and records, the ANAO has been encouraging the inclusion of model access clauses which agencies can include in contracts. These clauses give the agency and the Auditor-General access to contractors’ premises and the right to inspect and copy documentation and records directly related to the contract. While the need for the external auditor to have access to the premises of third party service providers is likely, in practice, to be required in very few situations, where necessary it would contribute to an audit being undertaken in an efficient and cooperative manner. As well, such access is important for both management performance and accountability and any access required for an external auditor is unlikely to exceed that required for sound management: audit and management’s interests in access are likely to coincide. 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.

Nonetheless, the ANAO found that agencies have not fully embraced these opportunities. An examination of 35 contracts for business support processes across eight agencies⁶⁴ found only two contracts referring to possible access by the Auditor-General. None of the contracts reviewed, which had been entered into since the ANAO provided advice on standard access clauses, included the recommended provisions. Furthermore, the level of consideration given to the inclusion of such access provisions in those contracts by agencies was not apparent. This is unlikely to foster optimum performance or contribute to appropriate accountability.

The matter is complicated by the commercial confidentiality of certain contractual information, the subject of considerable parliamentary concern and comment in many constituencies. While commercial agencies may have legitimate concerns as to the final disposition of information gathered during an audit, Section 37 of the *Auditor-General Act 1997* precludes the ANAO from publishing information which, among other things, might unfairly prejudice the commercial interests of any body or person.⁶⁵ More germane is the concern expressed by then Auditor-General of the State of New South Wales, that:

*'... it appears to me that governments just don't want to be accountable and are using private sector participation and so are reducing the amount of information that's available.'*⁶⁶

At the heart of this debate is the on-going problem of clearly defining the 'public interest'. The public interest is, of course, fundamental to democratic governance and is an issue with which public officials, including auditors, continue to grapple. It was explicitly addressed by the Senate Finance and Public Administration References Committee during its inquiry into the IT Outsourcing Initiative, as follows:

'... during the inquiry, the Committee was frequently frustrated in its attempts to access key information required to closely examine and evaluate the Initiative. It became apparent to the Committee that the lack of transparency it encountered surrounding the outsourcing contracts was the result of two main areas of confusion:

- *inconsistency and uncertainty as to what information, relating to managing the Initiative as a whole and government contracts, should remain confidential; and*
- *a lack of knowledge of parliamentary accountability obligations, in particular, the powers of parliamentary committees.'*⁶⁷

There is concern that contracting out to the private sector may restrict the flow of information available to assess performance and satisfy accountability. In this context, ANAO recently completed a performance audit of the use of confidential provisions in contract with commercial providers.⁶⁸ The ANAO worked cooperatively with several agencies to distil their experience into a sound framework for wider application across

the Australian public/private sector interface. The ANAO reported several weaknesses in agencies handling of confidentiality provisions in contracts:

- a lack of rigorous consideration during the development of contracts of which information should be confidential;
- the failure of the confidentiality provisions in contracts to specify which information in the contract is confidential; and
- uncertainty among officers working with contracts as to which information should properly be classified as confidential.⁶⁹

The ANAO made three recommendations to redress these shortcomings and developed criteria for use in determining whether contractual provisions should be treated as confidential.⁷⁰ These criteria are designed to assist agencies to make a decision on the inherent quality of the information before the information is accepted or handed over – rather than focusing on the circumstances surrounding the provision of the information. The audit also gave examples of what would not be considered confidential⁷¹ and examples of what would be considered confidential.⁷²

The Senate Finance and Public Administration References Committee in a recent report on Commonwealth contracts⁷³ 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 a 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 order⁷⁴.

Adequate information and records are essential to maintaining the thread of accountability, not least because they provide a clear trail of evidence for managers and other stakeholders. Sound information management reduces the risk of unnecessary speculation, confrontation and conflict, particularly when parties assert opposing views or perceptions. Unfortunately, deficiencies in information and records may not become apparent until an issue is contested.

As a matter of principle, it is worth noting that it is Parliament's prerogative to decide the balance of public and private interest in any disclosure it may make, reserving the position that information should be disclosed unless there is a good reason otherwise. That is, in this case the onus of proof is reversed and parties arguing for non-disclosure must show good cause.⁷⁵ Nevertheless, it appears prudent for SAIs to be sensitive to the need to respect the confidentiality of genuinely sensitive commercial information. The ANAO has found that, almost without exception, audit reports can explore the relevant issues without disclosing commercially sensitive information. In this way, the Parliament can be confident it is informed of the substance of issues which impact on public administration without impinging on Parliament's discretion to require additional information for its own purposes.

The message here is that external scrutiny (whether by Parliamentary Committees or Auditors-General) is an essential element in ensuring that public accountability is not eroded, by default, through contracting out. Just as it is incumbent upon public sector agencies to ensure they have a sound understanding of the commercial nature of any contract, private sector entities need to recognise that public accountability may require

actions on their part not usually required in commercial dealings. Handled properly, this need not deter private sector participation.

Virtually all accountability relies on the availability of reliable and timely information. Indeed, it has been said that '*information is the lifeblood of accountability*'.⁷⁶ 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, especially where performance data is held exclusively by the private sector or where access is restricted on the basis of commercial confidentiality. 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.

IV. PROMOTING AND IMPROVING CORPORATE GOVERNANCE

The key elements of corporate governance in both the private and public sectors are business planning, risk management, performance monitoring and accountability. To work, they require the clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources to deliver required outcomes. Add to these the additional requirements of accountability in the complex operating environment of the Australian Public Service and one has a significant management challenge. The political environment of public service, its checks and balances, ethics and codes of conduct, its diversity of functions, all result in a broad range of approaches to governance by agencies and entities in the public sector, with many sharing similar features to those of private sector governance.

Corporate governance provides the integrated strategic management framework necessary to achieve the outputs and outcomes required to fulfil organisational goals and objectives. Realistically, clearly defined roles and responsibilities are good business practice and are essential for the measurement of and accountability for performance. The ANAO takes an active role in promoting the development of corporate governance in the public sector and to commercial groups whose interests may intersect with the public sector. In particular, it advocates sound risk management and robust accountability to encourage better performance as, simply, good business sense.⁷⁷

In recognition of the need for good corporate governance in the public sector, the ANAO released a discussion paper entitled '*Principles for Core Public Sector Corporate Governance: Applying Principles and Practice of Corporate Governance in Budget Funded Agencies*'.⁷⁸ This paper was designed to fill the gap in core public sector awareness of the opportunities provided for improved management performance and accountability through better integration of the various elements of the corporate governance framework within agencies. As well, the paper included a checklist designed to assist CEOs to assess the strengths and weaknesses of their agencies' current governance framework. Although the discussion paper was not meant to provide a comprehensive model for each agency, CEOs should be able to identify those elements of a governance strategy most applicable and useful to their particular

agency. The paper identified the following key operating principles that should underpin a sound corporate governance framework in the public sector:

- **openness** is about providing stakeholders with confidence regarding the decision-making processes and actions of public sector agencies in the management of their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information leads to effective and timely action and lends itself to necessary scrutiny;
- **integrity** is based on honesty, objectivity as well as high standards of propriety and probity in the stewardship of public funds and the management of an agency's affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the agency. Integrity is reflected in the agency's decision-making procedures and in the quality of its performance reporting;
- **accountability** is the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities and roles are clearly defined through a robust organisational structure; and
- **leadership** involves clearly setting out the values and standards of the agency. It includes defining the culture of the organisation and the behaviour of everyone in it.⁷⁹

These principles should be reflected in organisational structures and processes, external reporting, internal controls and standards of behaviour of the organisation. Control structures, incorporating sound risk management, are a particularly relevant element of an effective governance framework because of their importance in promoting effective performance and ensuring proper accountability. Another ANAO publication '*Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control*'⁸⁰ defines control as:

*'... a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency's objectives.'*⁸¹

The control structures within a corporate governance framework provide assurance to clients and the Parliament that an agency is operating in the public interest and has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. In contrast, weak internal controls may indicate less than optimal business practices as well as the opportunity to commit fraud.⁸²

Accordingly, an effective corporate governance framework assists an organisation to identify and manage risks in a more systematic and effective manner. A corporate governance framework, incorporating sound values, cost structures and risk management processes can provide a solid foundation on which we can build a highly performing, cost effective, transparent and accountable public sector.

*'Corporate governance is the organisation's strategic response to risk.'*⁸³

The ANAO fosters the view that risk management is an essential element of corporate governance underlying many of the reforms that are currently taking place in the public sector. It is not a separate activity within management but an integral part of good management process, particularly as an adjunct to the control environment, when we have limited resources and competing priorities. Risk management is primarily the responsibility of the CEO and/or board.⁸⁴ To be effective, the risk management process needs to be rigorous and systematic.⁸⁵ If organisations do not take a comprehensive approach to risk management then directors and managers may not adequately identify or analyse risks, actions may not mitigate the actual risks and administrative controls may be ineffective or irrelevant. To guard against this, recent ANAO audits have highlighted the need for: a strategic direction in setting the risk management focus and practices; transparency in the process; and effective management information systems.

Management of risk in the public sector involves making decisions that accord with statutory requirements and are consistent with public service values and ethics. This means that more, rather than less, attention should be devoted to making the 'right rather than quick decisions'. Coming full circle, effective control structures link the agency's strategic objectives to the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the organisation's objectives and which adds value by focusing control efforts on the 'big picture'. Public sector organisations will need to concentrate on the potential of an effective control framework to enhance their operations in the context of the more contestable environment that is being created as part of government reform policy.

Against the background of the proliferating service delivery arrangements; greater involvement of the private sector in the provision of public services; and a more contestable/competitive environment, risk management can only become more critical to satisfactory public sector performance.

Where services are outsourced and separated from an agency's core operations, good corporate governance becomes critical to performance and accountability. While public sector managers may not always be responsible for delivering public services but will, inevitably, be held accountable for results. For instance, in an ideal world there would be perfect alignment between the values, objectives and processes of the public service and its outsourced contractors. However:

*'Pieces of paper are one thing, real belief systems quite another. It is very hard to export the public service ethic into the private contractor hinterland. Commercial contracts are not susceptible to a foolproof, public service ethical override.'*⁸⁶

In practice, transparency and accountability are the watchwords of good governance in an outsourced environment. The public sector must act in the public interest and, in common with the private sector, avoid apparent personal conflicts of interest to the maximum extent possible while being prepared to openly explain decisions – that is, accept responsibility for decisions. In short, accountability provides a way of

measuring performance in a practical operational manner that makes sense to those involved.⁸⁷

However, the public sector operates without absolute clarity as to the extent of a public sector employee's, officer's, CEO's, and board member's accountability for implicit or explicit action that can affect the citizen. While reforms are raising public sector awareness of, say, legal accountability (just as in the private sector) the innate complexities of public accountability preclude absolute clarity. For instance, One of the most important components of robust accountability is to ensure that there is a clear understanding and appreciation of the roles and responsibilities of the relevant participants in the governance framework, importantly, of the responsible Minister(s), Board and CEO. Furthermore, the absence of clearly designated roles weakens accountability and threatens the achievement of organisational objectives.

In the private sector, there are clearly defined relationships between the board of directors, including the chairperson of the board, and the CEO responsible for the ongoing management of the agency.⁸⁸ However, this model is not readily transferable to the public sector, even with GBEs, because of the different roles and relationships between the responsible Minister(s), the CEO and (possibly) the Board. As well, Australian citizens (stakeholders) have no choice as to their investment. Organisations need to tailor their governance practices to take account of such differences.

Another apparent difference between the public and private sectors is reflected in a public sector organisation's relationship to its stakeholders. The private sector approach focuses on the shareholder as the fundamental stakeholder⁸⁹ and the fundamental responsibility of a board of directors to its shareholders.⁹⁰ While boards may recognise that being 'good corporate citizens' is integral to the long-term viability of an organisation and, therefore, in the interests of shareholders, this is still far removed from the relationship between citizens and the CEOs of public agencies. In the public sector, citizens bear some similarities to shareholders or the beneficiaries of a trust. In practical terms boards, CEOs and management should be very aware of their responsibilities to the government (as owners or custodians and regulators), to the Parliament (as representatives of citizens and legislators) and to citizens (as ultimate owners as well as in their particular client roles as citizens).

An ANAO discussion paper entitled '*Corporate Governance in Commonwealth Authorities and Companies*'⁹¹ suggests that there may be opportunities to formalise relationships between the Board, the CEO, including management, and responsible Minister(s), perhaps through the development of a Board Charter. Alternatively, written agreement or memorandum of understanding could be prepared outlining roles and responsibilities as is done, say, in New Zealand.

In Commonwealth authorities and companies, even though the Board is responsible for directing and controlling the organisation on behalf of the stakeholders and is ultimately accountable for its own performance as well as that of the organisation, it is important to note that, to maximise performance within an organisation, requires an effective 'partnership' between the Board and management in guiding organisation strategy and performance. Similarly, CEOs of government departments and agencies will need to ensure effective partnerships with senior management if they are to effectively govern their organisations.

Thus, the threshold requirement of sound governance must be agreement between the key parties, whether this is the board and management (including the CEO) or the CEO and management, on the broader corporate objectives. These parties should jointly develop the corporate objectives which the CEO is personally responsible for achieving. This puts greater pressure on performance management with its focus on integration as part of organisation planning, and its alignment with: required outputs and outcomes; the legislative framework; and public service values and codes of conduct. In these respects, observations on performance assessment by a forum of Secretaries and agency heads coming together in the Management Advisory Committee (MAC) under the *Public Service Act 1999* is instructive:

*'This is an area where there are no right answers or simple solutions. Neither organisational nor individual performance can be measured by itself. It will always be a composite of measurables and judgements. There also needs to be a credible performance management system in place that is based on ethical behaviour and trust.'*⁹²

V. CONCLUDING REMARKS

The outsourcing and privatisation of government services is one of the most significant issues in contemporary public sector administration. There is a new emphasis on the contestability of services, the outsourcing of functions that the private sector can undertake more efficiently and on ensuring a greater public service orientation towards outcomes rather than just on processes. There is an accent on continuous improvement to achieve better performance. In effect, we are witnessing a degree of convergence between the public and private sectors.

Convergence represents a major challenge for public service managers. They must establish an appropriate balance between achieving cost effective outcomes and accounting for the manner in which public sector resources are used. While the public sector reforms demand a greater focus on achieving efficient and effective outcomes for citizens, we also need to recognise that such outcomes also depend importantly on robust and credible administrative and management processes. In short, good processes should ensure good outcomes. They are complements not alternatives. In addition, managers at all levels require greater commercial skills and experience, in particular in the areas of contract negotiation and management.

Experience has shown that savings and other benefits do not flow automatically from privatisation and commercialisation. Accordingly, the convergence of the public and private sectors raises a number of important questions for public sector managers, their private sector partners and accountability institutions such as Auditors-General. Significantly, in a democratic system of government, the privatisation of the public sector does not obviate the need for proper accountability for the stewardship of public resources. Furthermore, transparency and accountability can contribute to improved performance in terms of value for money: they can represent good business practice.

Integrated, coherent and effective corporate governance frameworks offer the prospect of public accountability and protection of the public interest. The public sector does have something to learn from the private sector in this respect while recognising the complexity of public interest factor and its associated wide-ranging requirement for

accountability. On the other hand, if privatisation of public services is to work effectively, private sector providers have to recognise the rights of citizens not just as customers or clients, and the associated accountability that goes with that recognition.

Nevertheless, the convergence raises issues about whether there should be a change in the nature of accountability. Private sector providers clearly feel under pressure from the openness and transparency required by public sector accountability to Parliament and the community. Public sector purchasers are under pressure to recognise the commercial ‘realities’ of operating in the marketplace. As Professor Richard Mulgan of the Australian National University has observed:

‘... as long as management in the public sector continues to be assessed by private sector standards, and as long as the private sector continues to be increasingly entrusted with public purposes, both political and social as well as economic, we can expect further pressure on the distinction between the two sectors in matters of accountability.’⁹³

There is a need for at least some movement towards striking a balance on the appropriate nature and level of accountability and the need to achieve cost-effective outcomes by: emphasising project and contract management skills in public sector managers; basing commercial relationships on sound tendering and administrative processes and an enforceable contract; and ensuring that public accountability is not eroded, by default, through contracting-out that reduces external scrutiny by Parliament and/or Auditors-General.

Auditors-General need full access to information as well as to government assets, including on private sector premises as necessary. We need to be able to assure Parliaments and Executive Governments about legal compliance, probity, security, privacy and ethical behaviour as well as providing an opinion on financial reporting and the systems and controls on which such reporting is based. We also need to be able to put in place a sound basis on which to assess the performance of private sector providers as well as of the ‘purchasing’ agencies. In most respects we should not need any more information and/or evidence than the accountable public servants would require to discharge their management obligations. Such accountability cannot be outsourced to the private sector. Nor can auditors fail to contribute to the development of a suitable accountability framework for the changing environment of the public sector with its greater focus on the market and the involvement of the private sector in recent years. At the same time we need to recognise an important reality, that:

‘The private sector has no real equivalent to political accountability, for which precise measures are never likely to be found.’⁹⁴

Does this necessarily block the consideration of a different kind of public accountability? While essentially an issue for governments and Parliaments to resolve, the public sector and Auditors-General must meanwhile account to stakeholders and seek the cooperation of private sector providers in doing so. Hopefully, this will more resemble a partnership in which parties understand and act both on public interest and commercial imperatives that need to be met by public sector purchasers and private sector providers respectively. The notion of partnership should also extend to agency and entity cooperation and coordination,

particularly when setting strategic directions and sharing better practice. This is evident in what appears to be a move towards greater networking rather than simply growing market-based bureaucracies. Nevertheless, the two approaches may be mutually reinforcing rather than mutually exclusive.

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

Good corporate governance should result in good performance. Whatever framework is put in place by organisations, it is important to ensure that it will facilitate the achievement of desired outputs and outcomes. Good processes are required to achieve good results. They are not alternatives. And they do not occur by accident. A well governed organisation will provide to its Chief Executive Officer, its Board, its responsible Minister(s) and other stakeholders reliable and well founded assurances that it is meeting its performance targets. Above all, a well governed organisation can achieve better performance and it will have a robustness, the internal cohesion and direction essential to successfully drive the organisation forward and to respond quickly and coherently to external conditions.

In summary, public sector reform requires public servants to be more responsive and meet changing client needs; to be more efficient, effective and ethical; to be more flexible in responding to internal and external change; and to support national economic and other imperatives. These reforms are now well under way in many countries. They bring with them new challenges such as market-testing and competitive tendering and contracting out, all of which may be considered to present opportunities for, as well as risks to, public services that have traditionally said to be risk averse. These new elements are central to improved business performance and accountability in current reforms to the public sector. The process, like any other similar arrangement, must satisfy a sound business case and be well managed.

Above all, public sector managers will still be held accountable for the outcomes and/or results achieved. In a more contestable and performance oriented environment, increasingly involving the private sector, a major issue for those managers is just what being accountable actually means in practice. There will most likely be continuing guidance from the Parliament and/or the Government in this respect. In Australia's case, a key Senate Committee has served notice that it will:

'... continue to question, in estimates and in annual report or other agency operating processes, such matters as the delivery of services when contractors go to the wall, legal costs, the immediate and longer-term

*costs and benefits of the use of contractors, the probity of tender processes, et cetera.*⁹⁵

At the very least, SAIs will need to be in a position to respond in a timely and effective manner to such questions as part of our accountability to Parliament. As with other public sector organisations, we will need to focus more attention on our performance management as part of a sound corporate governance framework.

NOTES AND REFERENCES

- ¹ In this paper, accountability is taken to mean the direct relationship of authority by which one party accounts to a person or body for the performance of tasks or functions conferred, or able to be conferred, by that person or body.
- ² Stewart, Dr Jenny, 2001, '*Hands off the Auditor!*', in *The Public Sector Informer*, Canberra, October (page 6).
- ³ The responsibilities of the Auditor-General for the Commonwealth of Australia 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) ensure, by statute, independence 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 ANAO mandate is generally to undertake audits of:
- **financial statements**, which provide an essential independent attestation of the financial statements of public sector entities and, in so doing, provide an independent and objective assurance to all parties on the financial stewardship of the public sector and on the financial systems which support it; and
 - **performance**, evaluating the economy, efficiency and effectiveness of the management of public sector entities by, for example, examining and assessing the use of resources, information systems, performance measures, monitoring systems and legal compliance.
- ⁴ Barrett, P, 1999, '*Accountability for Risk in a Contestable Environment*', Presentation to 1999 Department of Employment, Training and Industrial Relations Biennial Risk Management Conference, Brisbane, 27-29 July.
- ⁵ Mulgan, Richard, 1997, '*Contracting Out and Accountability*', Discussion Paper 51, Graduate Public Policy Program, Australian National University, Abstract.
- ⁶ The Chartered Institute of Public Finance and Accountability, 1995. '*Corporate Governance: A Framework for Public Service Bodies*', July (page 7).
- ⁷ *Ethical behaviour is one of the principal means by which accountability is maintained in the public sector. Indeed, political and administrative accountability depend on the observance of ethical standards and ethical relations between individuals or between institutions.* O'Faircheallaigh Ciaran, Wanna John, Weller Patrick, 1999. '*Public Sector Management in Australia – New Challenges, New Directions*'. Centre for Australian Public Sector Management, Brisbane (page 225).
- ⁸ See Section 10 for the general requirement, Section 13 for the consequent code of conduct and Section 15 for penalties applying to breaches. The core values of the Australian Public Service are that:
- it is apolitical, performing its functions in an impartial and professional manner;
 - it has the highest ethical standards;
 - it is accountable for its actions, within the framework of Ministerial responsibility, to the Government, the Parliament and the Australian public;
 - it delivers services fairly, effectively, impartially and courteously to the Australian public; and
 - it focuses on achieving results and managing performance.
- ⁹ Barrett, P, 1998. '*Corporate Governance*'. Address to the Defence Audit and Program Evaluation Committee (DAPEC), Canberra, 28 July (page 4).
- ¹⁰ Catley, B, 1996, '*Globalising Australian Capitalism*', Cambridge University Press, (pages 107 to 108).
- ¹¹ Ibid.
- ¹² Fagan, R, & Webber, M, 1994, '*Global Restructuring – The Australian Experience*', Oxford University Press, (pages 63 to 64).
- ¹³ The Economist, 2000, '*The world's view of multinationals*', 29 January (page 19).

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- 14 Ibid.
- 15 Ibid.
- 16 Australian Taxation Office, 1998, *'New Transfer Pricing Documentation Guidelines'*, Media Release – Nat 98/33, Canberra, 24 June. Against such concerted measures by industrialised nations governments must take into account the possibility of multinational corporations responding by emphasising domestic over international trade, to the detriment of many developing countries.
- 17 Financial System Inquiry, 1997, *Financial System Inquiry Final Report*, AGPS (pages 31-73).
- 18 On 28 May 2002, the Department of Finance and Administration issued *Finance Circular 2002/01: Foreign Exchange (FOREX) Risk Management*, reiterating the responsibility of entities within the General Government Sector for managing their own foreign exchange risks. The Circular notifies agencies that, from 1 July 2002, agencies are no longer permitted to hedge (except in special circumstances) though Budget supplementation may be available to agencies with significant foreign exchange exposures, which are able to demonstrate proper risk management.
- 19 Australian Financial Markets Association, 1997. *'AFMAdata – Essential New Tool for Financial Risk Management'*, AFMA Minutes & Issues, No.5, <http://www.afma.com.au>
- 20 Australian Society of Certified Practising Accountants, Treasury and Audit Centres of Excellence, 1996, *'Understanding and Auditing the Treasury Function'* (page 14).
- 21 Smithson Charles W, 1996, *'Implementing a Risk Management Program'*, CIBC World Markets, School of Financial Products in *Managing Financial Risk – A Guide to Derivative Products, Financial Engineering, and Value Maximisation*.
- 22 Greenwich Treasury Advisors LLC 1999, *'The Group of 31 Report: Core Principles for Managing Multinational FX Risk'*, July, (page 4).
- 23 Oliver, Barry R, 1999, *'The Legality of Derivative Contracts Entered Into by Commonwealth Organisations'*, Accounting, Accountability and Performance, Vol.5, No.1, April (pages 43 to 46).
- 24 For example, in February 1995 the Barings investment bank failed as a result of over \$1 billion in futures and options trading losses incurred by one of its employees. Similarly, in December 1994, Orange County in California filed for bankruptcy after losing an estimated \$1.7 billion on the county Treasurer's large and highly leveraged investments. Another example involved a major OTC derivatives dealer which, according to the Federal Reserve Bank of New York, failed to adjust its internal controls in response to a riskier new line of business, namely marketing and sales of leveraged derivatives. Source: United States General Accounting Office, 1996, *'Financial Derivatives - Actions Taken or Proposed Since May 1994'*, Washington, November (Chapter 2:1).
- 25 Ford, H and Austin, R, 1995, *'Principles of Corporation Law'*, 7th edition.
- 26 For example, the January 1991 decision of the United Kingdom House of Lords in the *Hammersmith and Fulham* case voided derivatives contracts between more than 130 local councils and over 75 of the world's largest banks. The House of Lords ruled that the London Borough of Hammersmith and Fulham, a local government authority that had been an active participant in the market for sterling interest rate derivatives, lacked the capacity to enter into those transactions.
- 27 Oliver, Barry R, 1999 op. cit. (page 52).
- 28 Parliamentary Joint Committee on Corporations and Securities 1995, *'Report on Derivatives'*, Canberra.
- 29 The swaps continue and the estimates cited of the number and value are still the best available.
- 30 Economics Legislation Committee, 1994. *'Consideration of Additional Estimates'*, Department of the Treasury, Sub-program 1.3 Debt Management. Hansard, Commonwealth of Australia, 29 November.
- 31 ANAO Report No. 14 1999-2000, *'Commonwealth Debt Management'*, Canberra, 12 October.
- 32 Joint Committee of Public Accounts and Audit, *Review of Auditor-General's Reports 1999-2000 Second Quarter*, Canberra, October 2000.
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- transportation and freight business that had entered into financing arrangements based on future gold prices and movements in the Japanese Yen currency. The report concluded that governance arrangements for such enterprises needed to be strengthened in order to manage the risk that activities not directly related to business purposes were properly considered and authorised and reduce the risk of future calls on the government budget. Source: Audit Report No. 2 1997-98, *'Government Business Enterprise Monitoring Practices'*, Canberra, September, (pages 43 to 45).
- 34 Humphry, Richard, 2000, *Review of the Whole of Government Information Technology Initiative*, Canberra (pages. 10, 13, 30, 31 and 32).
- 35 Ibid., (page 10).
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- 39 Senate Finance and Public Administration References Committee, 2001 *'Re-booting the IT agenda in the Australian Public Service'*, Final Report on the Government's Information Technology Outsourcing Initiative, Parliament of the Commonwealth of Australia, August (page xv).
- 40 Ibid., (page xvi).
- 41 Industry Commission, 1996, *'Competitive Tendering and Contracting by Public Sector Agencies'*. Report No.48, Melbourne, 24 January.
- 42 For example, in October 1998 the Auditor-General tabled Audit Report No. 10 1998-99, *'Sale of One-third of Telstra'*. The audit concluded that, as an essential element of the outsourcing of project management for future Commonwealth public share offers, overall value for money could be improved by giving greater emphasis to financial issues when tendering for advisers; encouraging more competitive pressure on selling commissions and fees; paying fees only for services actually provided; and instituting a more effective and commercial approach to administering payment for shares by investors.
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- 44 Senate Finance and Public Administration References Committee 1998. *'Contracting Out of Government Services'*. Second Report. The Parliament of the Commonwealth of Australia, Canberra, May.
- 45 ANAO Report No. 47 1997-98, *'Management of Commonwealth Guarantees, Indemnities and Letters of Comfort'*, Canberra, 23 June, page 17, Exhibit 2.3; ANAO Report No. 20 2000-2001, *'Second Tranche Sale Telstra Shares'*, Canberra, 30 November; and ANAO Report No. 48 1998-99, *'Phase 2 of the Sales of the Federal Airports'*, Canberra 21 June.
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- 47 Ramsay, Ian, 2001, *'Independence of Australian Company Auditors – Review of Current Australian Requirements and Proposals for Reform'*, October.
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- 50 ANAO Report No. 38 1997-98, *'Sale of Brisbane, Melbourne and Perth Airports'*, Canberra, 24 March and ANAO Report No. 48 1998-99, *'Phase 2 of the Sales of the Federal Airports'*, Canberra, 21 June.

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- 57 ANAO Report No. 34 1997-98, *New Submarine Project*, Canberra, 24 March.
- 58 ANAO Report No. 10 *Sale of One-Third of Telstra*, op. cit.
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- 62 Mulgan, Richard 1997, *The Processes of Public Accountability*, in Australian Journal of Public Administration, Vol. 56, no. 1, March, (page 8.)
- 63 For instance '... the quality of service improved by 38 per cent when a performance monitoring system was implemented'. Public Accounts and Estimates Committee 2000. 34th Report op. cit. (page 22).
- 64 ANAO Report No.12 1999-2000, *Management of Contracted Business Support Processes*, Canberra. 14 October.
- 65 Section 37(2) of the *Auditor-General Act 1997* sets out the following reasons for non disclosure of information in the public interest:
- (a) *it would prejudice the security, defence or international relations of the Commonwealth;*
 - (b) *it would involve the disclosure of deliberations or decisions of the Cabinet or of a Committee of the Cabinet;*
 - (c) *it would prejudice relations between the Commonwealth and a State;*
 - (d) *it would divulge any information or matter that was communicated in confidence by the Commonwealth to a State, or by a State to the Commonwealth;*
 - (e) *it would unfairly prejudice the commercial interests of any body or person;*
 - (f) *any other reason that could form the basis for a claim by the Crown in right of the Commonwealth in a judicial proceeding that the information should not be disclosed.'*
- 66 Harris, Tony, 1998, *Shrinking Democracy*, 2RN Radio broadcast interview, 1 November.
- 67 Senate Finance and Public Administration References Committee, *Re-booting the IT Agenda in the Australian Public Services*, op. cit., (page 157).
- 68 The audit sought to: assess the extent of guidance on the use of confidentiality clauses in the context of contracts at a government wide level or within selected agencies; develop criteria that could be used to determine whether information in (or in relation to) a contract is confidential, and what limits should apply; assess the appropriateness of agencies' use of confidentiality clauses in the context of contracts to cover information relating to contracted provisions of goods and

services, and the implications of existing practices of applying the criteria that have been developed; and assess the effectiveness of the existing accountability and disclosure arrangements for the transparency of contracts entered into by the Commonwealth, and whether agencies are complying with the arrangements. ANAO Report No 38 2000-2001. *The Use of Confidentiality Provisions in Commonwealth Contracts*. Canberra, 24 May (page 13).

⁶⁹ Ibid., (page 15).

⁷⁰ Ibid., (pages 55-60).

⁷¹ Ibid., (page 64). The following types of information in, or in relation to, contracts would generally not be considered to be confidential:

- performance and financial guarantees;
- indemnities;
- the price of an individual item, or groups of items of goods or services;
- rebate, liquidated damages and service credit clauses;
- clauses which describe how intellectual property rights are to be dealt with; and
- payment arrangements.

⁷² Ibid., (page 65). The following types of information may meet the criteria of being protected as confidential information:

- trade secrets;
- proprietary information of contractors (this could be information about how a particular technical or business solution is to be provided);
- a contractor's internal costing information or information about its profit margins;
- pricing structures (where this information would reveal whether a contractor was making a profit or loss on the supply of a particular good or service); and
- intellectual property matters where these relate to a contractor's competitive position.

⁷³ Senate Finance and Public Administration References Committee 2001. *Commonwealth Contracts: A New Framework for Accountability*. Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts. Parliament of the Commonwealth of Australia, Canberra. September (See Appendix A).

⁷⁴ Ibid. (see Appendix C).

⁷⁵ This view was also recently endorsed by the Public Accounts and Estimates Committee of the State of Victoria in Public Accounts and Estimates Committee, 2000, *'Inquiry into Commercial in Confidence Material and the Public Interest'*. 35th Report to Parliament, op.cit., (page xxxii).

⁷⁶ Stewart, Dr Jenny 2001, *'Hands off the Auditor!'*, op. cit., (page 6).

⁷⁷ Barrett, P, 1997. *'Corporate Governance and Accountability for Performance'*, for A Joint Seminar Conducted by IPAA and the ASCPA on 'Governance and the Role of the Senior Public Executive', Canberra, August.

⁷⁸ Australian National Audit Office 1997, *'Principles for Core Public Sector Corporate Governance'*, Discussion Paper, Canberra, June.

⁷⁹ Ibid., (pages 9 and 10).

⁸⁰ Australian National Audit Office 1997, *'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control'*, Canberra, December.

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