

**Public private partnerships –  
Are there gaps in public sector accountability?**

**Pat Barrett, AM  
Auditor-General for Australia**

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## I. INTRODUCTION

All public sector organisations are required to be transparent, responsive and accountable for their activities. Citizens are entitled to know whether public resources are being properly used and what is being achieved with them. This paper considers the question of public sector accountability<sup>1</sup> in the context of public-private partnerships (PPPs) for the delivery of public sector outcomes. The central theme is the challenges facing audit institutions and Parliaments in protecting the public interest and maintaining accountability for the expenditure of public funds in an environment where, more than ever before, significant aspects of the delivery of public sector outcomes involve complex, long-term arrangements with the private sector.

A key question is whether PPPs, by their very nature, present the possibility of gaps in public sector accountability arising, or whether, as is the case with traditional funding and procurement models, it is more the approach taken to questions of accountability by the public and private sector entities involved that will largely determine the extent to which suitable accountability is maintained. It may be that the greatest challenge to audit institutions and Parliaments in maintaining appropriate accountability in an environment of increasing private sector involvement is the extent to which, and the manner in which, existing legislative and other requirements will need to be exercised and/or changed.

I thought it would be useful to first canvass the rationale, nature and forms of PPPs as a lead-in to the following discussion of risk management and corporate governance in the context of PPPs. The third section of the paper identifies a number of specific audit examples, from Australian and international experience, exploring important aspects of complex procurement and service delivery arrangements involving the private sector which raise significant issues for the maintenance of accountability, including transparency and openness. The examples draw on audits of:

- 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 emerging challenges to the maintenance of accountability to the Parliament for the efficient and effective achievement of public sector outputs and outcomes, with the concluding remarks canvassing some major pressures for continuing change in this important area of public administration.

### **Public outcomes / private delivery**

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. This has been reflected in a growing trend toward a range of organisations bringing their specialist skills to bear in order to achieve a common public sector goal in the most effective manner. In

regard to the Australian Public Service, the Prime Minister has commented that:

*Another challenge is the capacity of departments to successfully interact with each other in pursuit of whole of government goals and more broadly, for the entire Service to work in partnership with other bureaucracies, with business and with community groups as resources and responsibility are devolved closer to where problems or opportunities exist.<sup>2</sup>*

The Prime Minister further commented that: ‘Whole of government approaches, collectively owned, by several Ministers, will increasingly become a common response.’<sup>3</sup> A recent paper by the Management Advisory Committee noted this trend in regard to Australian Government use of information and communication technology, commenting:

*In a devolved management system where the cost of enablers like [information and communications technology] is increasing, a ‘federated’ governance approach is desirable. A federated governance system is one in which independent agencies work together to achieve an optimal outcome for each other and government as a whole.<sup>4</sup>*

More broadly, there has also been a fundamental questioning of what government should do, and whether there is scope for the private sector to perform roles traditionally regarded as the province of the public sector. Many reformers have advocated using market-type disciplines to provide public services more efficiently, effectively and with greater public satisfaction. Governments have stressed the need for more responsive public services. As the British Prime Minister, Tony Blair, has observed in relation to the current environment:

*Distinctions between services delivered by the public and private sectors are breaking down in many areas, opening the way to new ideas, partnerships and opportunities for devising and delivering what the public wants.*

and

*People want effective government.<sup>5</sup>*

In practice, both the nature and the scale of government business with the private sector have changed, and continue to change. The nature has changed 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, for example, 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.

PPPs represent a further step along this continuum of procurement options, with governments increasingly turning to the private sector as a source of financing, project management and/or operational skills for major public sector infrastructure projects and the delivery of ancillary services. Professor Mervyn Lewis of the University of South Australia has defined PPPs as:

*...agreements where public sector bodies enter into long-term contractual agreements with private sector entities for the construction or management of public infrastructure facilities by the private sector entity, or the provision of services (using infrastructure facilities) by the private sector entity to the community on behalf of a public sector entity.<sup>6</sup>*

Public-private involvement in public infrastructure can take a variety of forms, including:

- *Traditional Design and Construction (TDC)*: Private sector contractors tender to design and construct the project in accordance with a brief set out by the Government;
- *Operation and Maintenance Contract (O&M)*: Involve the private sector operating a publicly-owned facility under contract;
- *Lease-Develop-Operate (LDO)*: Involve a private developer being given an long-term lease to operate and expand an existing facility. The private developer agrees to invest in facility improvements and can recover the investment plus a reasonable return over the term of the lease;
- *Build-Own-Maintain (BOM)*: Involve the private sector developer building, owning, and maintaining a facility. The Government leases the facility and operates it using public sector staff;
- *Build-Own-Operate-Transfer (BOOT)*: Involve a private developer financing, building, owning and operating a facility for a specified period. At the expiration of the specified period, the facility is transferred to the Government; and
- *Build-Own-Operate (BOO)*: Operate similarly to a BOOT project, except that the private sector operates the facility in perpetuity. The developer may be subject to regulatory constraints on operations and, in some cases, pricing. The long term right to operate the facility provides the developer with significant financial incentive for the capital investment in the facility.<sup>7</sup>

The main users of PPPs for public infrastructure in Australia have been the State governments. For example, as at November 2001, New South Wales had contracted the private sector to build, own, operate and transfer over \$5.5 billion of capital infrastructure, covering over 20 projects. The majority of this expenditure, \$3.4 billion, has been associated with transport projects, although the new NSW policy and guidelines for privately financed projects (PFPs) extend potential use to a wider range of social infrastructure.<sup>8</sup> Prominent examples of PPPs in the States include the Sydney Harbour Tunnel and M2 Motorway<sup>9</sup>, the City Link project in Melbourne<sup>10</sup> and the introduction of privately owned and operated prisons.<sup>11</sup>

At the national level, the 1996 National Commission of Audit observed that the private sector has a significant capacity for a greater role in infrastructure services. The Commission concluded that the role for government could be reduced and suggested that the identification of good opportunities for private sector investment in infrastructure could assist the goal of increased national saving.<sup>12</sup> Accordingly, there has been increasing interest in private financing initiatives in Australia at the federal level, although to date there has been limited actual adoption. In particular, the Commonwealth is yet to undertake a private financing arrangement, although a number of agencies have been preparing for the possible use of private financing, including the Department of Defence and the Department of Transport and Regional Services.

While private sector financing is an important element of PPPs, it is not the only aspect that needs to be considered. For example, it has been said that:

*The very essence of a PPP is that the public sector does not primarily buy an asset; it is purchasing a service under specified terms and conditions. This feature provides the key to the viability (or not) of the transaction.*<sup>13</sup>

A successful partnership allows the participants to work together to achieve their objectives for their mutual benefit; the public sector receives a service that represents value for money; and the contractor delivers that service for a reasonable financial return.<sup>14</sup> However, it has also been recognised that the use of PPPs raises challenges for the maintenance of transparency and accountability.<sup>15</sup> At a conceptual level, in many ways PPPs are not substantially different to other procurement methods, involving significant private sector involvement and long-term contracting, such as outsourcing or contracting out. As a result, the consequences of PPPs for the public sector are, in many ways, similar to those resulting from contracting out.<sup>16</sup> However, their scope and complexity do give rise to unique issues and risks for government, particularly where they involve private sector financing and ownership of public assets and very long-term service delivery contracts.

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, security 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 at points in time and over time, not least because of changing public perceptions and expectations. However, they remain the distinguishing feature of public sector accountability compared to demands made of the private sector.

Commercialisation and privatisation can strain the thread of accountability between executive government and the elected representatives of the people in parliament. This is an issue that I will expand on later in the paper. 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). While there is an expectation that agencies cannot outsource accountability, the

nature of some PPPs at least raises the question as to how that expectation can be practically met, particularly in any absolute sense.

## **II. RISK MANAGEMENT AND CORPORATE GOVERNANCE**

### **Risk allocation and the value for money assessment**

The policies on the use of private sector financing and PPPs issued by various Australian jurisdictions have in common the core principal that, in order to be successful, a proposed PPP arrangement must be in the public interest and must offer better value for money, or net benefit, when compared with the best public sector delivery model. In respect to the financing decision for a particular project, it is argued that, as it is difficult for the private sector to borrow as cheaply as governments can, the extent to which a PPP offers greater value for money than other forms of procurement will depend upon the terms of the overall deal, including risk transfer (allocation more precisely), innovation and project and contract management skills. Consequently, accountability gaps can occur both in relation to the initial decision and to its successful achievement.

For example, the Guiding Principles for Private Sector Participation in Public Infrastructure Provision issued by the Tasmanian Department of Treasury and Finance state that:

*Whilst there can be little argument that the Government can achieve a lower borrowing cost than the private sector, the overall long term cost of entering into a contract with the private sector to design, build, own and/or operate infrastructure (with the possibility of leasing back or transferring the infrastructure to the Government at the expiration of the contract), must be cost effective relative to the public sector benchmark.<sup>17</sup>*

The Commonwealth Policy Principles for the use of Private Financing (the Commonwealth Principles) identify the analysis (and treatment) of risk as being critical to the value for money determination, and note that it is likely to be the deciding factor in many private financing proposals.<sup>18</sup> The Commonwealth Principles state that:

*The Government recognises that the appropriate use of private financing can provide significant benefits to the public sector, such as access to specialist expertise and innovation, and the opportunity to transfer risk to those better able to manage it. However, it is generally more expensive for the private sector to raise capital through private capital markets, than for the Commonwealth to do so directly. The critical test when assessing a private financing proposal, therefore, is whether the overall features of the private financing proposal provide the Commonwealth with a net benefit when compared with traditional procurement methods.<sup>19</sup>*

The NSW Public Accounts Committee has reported that a key lesson learned in various overseas jurisdictions is that:

*...at the government level and for the community as a whole, PPPs can be expensive. Governments as a collective unit have more financing options. They can borrow or increase taxes to finance projects. Further, they are better credit risks than private sector companies and can borrow at cheaper rates than the financiers in a PPP.<sup>20</sup>*

The view has been put that the cost of raising tax revenues should be included in the funding cost-equation, if comparisons with the private sector borrowing rates are to be valid.<sup>21</sup> A recent paper on this topic produced by the Department of the Parliamentary Library similarly noted that:

*Critics of PPPs claim that public sector finance is cheaper than private sector finance and so the latter should not be used. But critics of this argument claim that the government's ability to borrow cheaply is a function of its capacity to levy taxes. They say that what determines the real cost of finance for a project is its risks. The private sector explicitly prices these risks into the cost of finance. When the public sector finances a project, taxpayers bear the risks and implicitly subsidise the cost of the project because the risks are not factored into the government borrowing rate.<sup>22</sup>*

It should be noted that the determination of the value of proceeding with a project based on the social opportunity cost or, alternatively, social time/cost view is a separate decision from the consideration of how to finance the project.

Another interesting aspect, relevant to this discussion, is the consideration of the potential effects on taxation revenues arising from a PPP arrangement. Access to tax deductions, such as for depreciation, can contribute to lower financing costs for the private sector provider, which may, on the face of it, contribute to a favourable comparison with the projected cost of providing the infrastructure through the public sector. However, when tax revenue effects are taken into account, the overall public cost benefit may be largely neutral. Such tax revenue effects occur mainly at the Commonwealth level, while the use of private sector financing for infrastructure has to date occurred more often at the State level. In that circumstance, there is the potential for tension to arise between the value for money arising from a PPP from a State perspective, and the overall value for money from a whole-of-government perspective if the tax revenue implications of a PPP proposal are considered. The Commonwealth Policy Principles for the use of private financing note that:

*There is potential for the Commonwealth to face hidden costs through revenue foregone resulting from the use by the private sector of tax effective arrangements, and this should be accounted for in the final calculation of relative value for money at a whole-of-government level.<sup>23</sup>*

This issue is likely to become of increased relevance with the introduction of proposed changes to Section 51AD and Division 16D of the Commonwealth *Income Tax Assessment Act 1936*. In certain circumstances, these sections



deny to the private sector owner of an asset certain asset-related tax deductions (predominantly depreciation) where the asset is leased to, or effectively controlled by, a tax-exempt public authority. These provisions have been criticised as unnecessary impediments to private provision of public infrastructure.<sup>24</sup> The Government has announced that it expects legislation to be introduced in the Autumn 2003 sittings of the Commonwealth Parliament to replace those sections.<sup>25</sup>

However, regardless of the disparate views in this area, there is general consensus that, in order for a private financing deal to represent value for money, it needs to provide for the appropriate allocation of risk to the private sector and for the establishment of strong incentives for the private sector entity to achieve time and cost project goals and provide long-term delivery of reliable public services. An important question is whether there are appropriate arrangements in place to ensure that the private sector can be made fully responsible and accountable for these results. Experience to date in Australia and overseas at least suggests a qualified 'no'.

Unless an appropriate level of risk is allocated to the private sector, on the basis that such risk is best managed by that sector, private financing may achieve little other than to provide the private sector with the benefit of a very secure income stream, similar to a government debt security, but with the private sector able to earn returns above those available from investing in government debt securities. In this regard, the Commonwealth Principles explicitly state that:

*Arrangements which involve little or no transfer of risk (for example finance leases and quasi-finance leases) are unlikely to provide government with value for money given the relative costs of capital.*<sup>26</sup>

The Tasmanian government's policy statement on private sector participation in public infrastructure provision goes further in this respect. It includes an explicit requirement that, where the project involves the use of a capital asset under a lease arrangement, any underlying finance transaction must be structured as an operating lease in accordance with relevant Australian Accounting Standards, with agencies prohibited from entering into finance lease arrangements.<sup>27</sup> Agencies are required to obtain the Tasmanian Auditor-General's opinion on the lease's status prior to the signing of any leases. The guiding principles accompanying the policy statement further explain that finance leases are incompatible with the Government's desire to reduce debt levels, and would also not generally reflect the preferred risk allocation basis the Government is aiming to achieve through involving private sector participation in public infrastructure.<sup>28</sup>

### ***Achieving optimal risk allocation***

It is now generally accepted that the transfer of risk to the private sector is only really cost-effective where the private sector is better able to manage and price these risks. Seeking to transfer inappropriate forms of risk onto the private entity merely adds unnecessary cost to a PPP agreement and will also undermine the value for money obtained from the deal. This is because attempting to transfer to the private sector a risk that it cannot control and

.manage will result in the private sector entities trying to price that risk into the payments they seek or they simply fail. A good example was the United Kingdom Royal Armouries private financing deal, where the armouries had to take back certain risks previously allocated to the private sector supplier in a revised deal in July 1999.<sup>29</sup> This arrangement also illustrated that it is not always desirable to transfer demand risk since the level of usage required of an asset or service under private financing deals is usually not within the private sector's control.

Optimal risk allocation seeks to minimise both project costs and the risks to the project by allocating particular risks to the party in the best position to control them. This is based on the proposition that the party with the necessary skills and experience with respect to a particular risk is best able to reduce, and/or take advantage of, the identified risk(s) *and* to manage the consequences. Allocating the risk in line with those opportunities creates an incentive for the controlling party to use its influence to prevent, mitigate or take advantage of the risk and to use its capacity to do so in the overall interests of the project.<sup>30</sup>

Identifying the most appropriate risk allocation between the parties to a PPP while maximising value for money to the public sector is not, however, at all straightforward. A NSW Treasury official commented to the NSW Public Accounts Committee that:

*So although people talk about risk transfer and the ability to optimise it, it is not an easy topic. The easy ones are the ones that fall out first. The difficult ones are the ones that get caught up in a lot of complex legal frameworks whereby you are trying to allocate blame, accountability and risk transfer, where it is a difficult area. ...There is a point at which you are going to get optimal risk transfer, and that is what we are trying to achieve.<sup>31</sup>*

The conceptual framework used in the guidance material on PPPs recently released by the Victorian Government is that, because government is a service recipient providing full payment only on satisfactory delivery of the required services, all project risk is *initially* allocated to the private party. It is then a matter for government to determine, on a value for money basis and having regard to the cooperative framework of the partnership, what risks it should 'take back' to achieve an optimal risk position.<sup>32</sup> Taking back means a deliberate decision by government to assume or share a risk that would otherwise lie at the door of the private party.<sup>33</sup>

As usual, the devil is in the detail, but experience is indicating some useful means of deciding on an appropriate allocation of such risks and assessing the true value for money offered by a PPP arrangement. For example:

- In an audit of a major private financing deal that had to be restructured when the private sector parties' initial revenue forecasts proved overly optimistic<sup>34</sup>, the UK National Audit Office (NAO) identified a number of important lessons to be borne in mind for future PPPs as follows:

- revenue forecasts for start up businesses are subject to great uncertainty;
  - make sure that bidders for a deal are not encouraged to be over-optimistic;
  - the equity capital to be invested in a project should reflect the risks of that project;
  - government guarantees of project debts are unlikely to be costless;
  - substantial risks arise if public sector assets are transferred in advance of external finance raising;
  - monitor retained risks from the start of the project;
  - reallocate risks if necessary;
  - if a project requires public funding, give careful consideration to the most cost-effective route; and
  - if a deal goes wrong, private sector partners should bear their share of the risk.<sup>35</sup>
- The previous New South Wales Auditor-General consistently commented that, although private sector owners had been given long-term rights over important road networks, there had not been a proper comparison of the cost-effectiveness of private sector involvement and the traditional public sector approach. Accordingly, the Auditor-General was unable to conclude that the projects that have been undertaken were in the State's best interests from a financial viewpoint.<sup>36</sup> In particular, the opportunistic and ad hoc use of private finance was criticised as it was considered unlikely to improve the overall efficient use of the road network and reduce the total costs of road maintenance and management.<sup>37</sup>
  - The Melbourne City Link project is one of the largest infrastructure projects ever undertaken in Australia with an estimated total cost of around \$2 billion. It involves around 22 kilometres of road, tunnel and bridge works linking three of Melbourne's most important freeways. A report by the State Auditor-General at the time found that, while the users of the City Link via toll payments would, in substance, be the financiers of the project, the private sector has accepted substantial obligations associated with the delivery and operation of the City Link, including traffic and revenue risks. However, the auditors also found that the decision to establish the City Link as a toll road was not supported by a financial model which compared project costings on the basis of private sector financing versus government borrowings.<sup>38</sup>
  - More positively, the NAO has found that the private financing deal for the redevelopment of the Ministry of Defence's (MOD) principal London office building, and the provision of subsequent maintenance and facilities management services, has the appropriate features of a private financing deal.<sup>39</sup> NAO found that the deal

provides incentives to the private consortium to complete this major project on time, without varying the cost to MOD, and then to provide the specified standards of service, and that the contract provides MOD flexibility on reducing the space it occupies.<sup>40</sup> NAO concluded that a major benefit of the private financing initiative as a form of procurement is that it has enabled MOD to achieve an appropriate allocation of risk between itself and its private sector contractor.<sup>41</sup>

At the Commonwealth level, the importance of ensuring rigour in costing and evaluating the risk allocation aspects of tender proposals was highlighted in the sale of the supplier (known as DASFLEET) of passenger and commercial vehicles to the majority of Commonwealth bodies. The sale was finalised in July 1997 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. A number of commercial disputes which started to arise out of the 1997 sale very soon after the sale process was completed were the subject of substantial negotiation between the parties and an independent arbitration process. Audits undertaken by ANAO of both the 1997 sale process and subsequent management of the tied contract indicate that, at the time of executing the relevant contracts, there was not adequate and shared understanding between the parties of the nature of the agreement, particularly in regard to the transfer of financial risk. Key audit findings made included that the following issues related to the accountability for performance:

- The Commonwealth considered that, in disposing of DASFLEET, it had engaged in a trade sale of the DASFLEET business together with a five year tied contract for the provision of vehicles leasing and fleet management services to agencies. The alternative of externally refinancing the fleet had been specifically explored and rejected. However, during the arbitration process for the DASFLEET sale agreement and tied contract disputes, it became clear that, contrary to the Commonwealth's view, the winning bidder had bid for DASFLEET on the basis that some \$15 million of the total price tendered was for the purchase of the business and the remaining \$392.9 million related to the sale and lease-back of the vehicle fleet. The operation of the tied contract was an external refinancing of the Commonwealth's fleet, resulting in estimated additional costs over four years of some \$6.9 million compared to the cost of the Commonwealth funding the refinancing of the vehicle fleet itself. Through the residual risk management mechanism, the Commonwealth effectively bore all the risk for the vehicles leased.<sup>42</sup>
- The tied contract was a finance lease at the whole of Government level, and an operating lease at agency level. ANAO found that the financial implications of the tied contract were such that the Commonwealth was 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.<sup>43</sup>

## **Accounting for PPPs**

A related issue in the assessment of value for money is the consideration of how PPP arrangements should be accounted for and disclosed in public sector financial statements and budgets. Any deficiencies or inadequacies in this respect have obvious transparency limitations. The only jurisdiction we know of that has developed detailed guidance on how to account for the complex risk allocations that arise under PPP arrangements is the UK, which has made extensive use of such arrangements for the provision of public infrastructure and services. *Application Note F to UK Accounting Standard Financial Reporting Standard FRS5 “Reporting the Substance of Transaction: Private Financing Initiative and Similar Contracts”* was issued in response to a range of concerns about the report of private finance initiative arrangements.

There is not currently an Australian accounting standard that deals specifically with risk allocation issues associated with PPPs. The Australian Accounting Standards Board (AASB) has been examining the issue of accounting by public sector entities for the provision of public infrastructure by other entities. The previous Public Sector Accounting Standards Board (PSASB) originally commenced the project in response to concerns expressed by several government authorities and commentators about the financial report of BOO, BOOT and other similar arrangements for the provision of public infrastructure by private sector entities.<sup>44</sup> In December 1999, the AASB issued an exposure draft, Exposure Draft ED 100 “Arrangements for the Provision of Public Infrastructure by Other Entities – Disclosure Requirements”.

In December 2000, the AASB having reviewed the submissions received on ED 100 made a number of decisions, including that a revised ED should be developed on the basis of ED 100 and that a new Project Advisory Panel be established with both public sector and private sector members, to assist the AASB in developing this project. Shortly thereafter, the Heads of Treasury Accounting and Reporting Advisory Committee (HOTARAC) established a subcommittee to work through accounting and reporting issues (including recognition and measurements issues) relevant to private sector involvement in public infrastructure provision. The AASB gave its tacit endorsement to this work and at its June 2002 board meeting was briefed on progress made by the HOTARAC subcommittee.<sup>45</sup>

More recently, in September 2002, the International Accounting Standards Board (IASB) invited the AASB to join a research team, comprising national standard setters and others from Australia, France, Spain and the United Kingdom, to look into a potential IASB project “Accounting for Service Concession Arrangements”. It has been agreed that there be a meeting of the jurisdictions involved in the project on 18 December 2002 to further the project. At its December 2002 meeting the AASB was briefed on progress made by various groups working on accounting and reporting issues relating to infrastructure projects. The AASB agreed that the scope of the potential IASB project should be comprehensive and deal with accounting for service concession arrangements by all participants.<sup>46</sup>

Currently, because transactions involving the delivery of infrastructure can have the characteristics of a lease agreement, governments have utilised Australian Accounting Standard 17 *Accounting for Leases* (AAS17) in

accounting for PPP-type transactions. AAS17 requires that leasing-type arrangements be classified as either operating or finance leases, with the degree to which ownership risk is transferred between the lessor and lessee being the critical variable. Finance leases are required to be reflected in the balance sheet of the lessee, whereas operating leases are not. In this regard, it has been said that:

*Critics of PPPs claim that governments can use PPPs to understate debt by not recording in the balance sheet the total value of payments payable to the private sector providers, that is, PPP obligations are 'off balance sheet'.<sup>47</sup>*

An alternative view is that the underlying rationale for PPPs is not the achievement of off-balance sheet borrowing, but rather that they offer value for money. For example, the NSW Treasury has said in respect to the recently released NSW and Victorian policies on PPPs:

*...the policies require that privately financed options demonstrate superior value-for-money to the Government and community compared to conventional, publicly funded approaches to infrastructure provision. This is the sole reason for considering private financing and delivery – with both States having low debt levels, off-balance sheet borrowing is not an attraction in its own right.<sup>48</sup>*

The South Australian guidelines on PPPs notes that, while the accounting standards attempt to create a clear distinction between operating and finance leases, for evaluation purposes most service contracts with the private sector under consideration by agencies will fall somewhere between the strict definitions of operating and finance leases. In this regard, the guidelines advise that:

*Agencies should keep in mind that there is a fundamental tension between meeting the requirements of [Australian Accounting Standard 17 Accounting for Leases (AAS17)] for operating leases and achieving value for money. The fundamental objective of the partnerships procurement process is to achieve an efficient allocation of risk, not simply to transfer as much risk as possible in order to achieve an operating lease classification.<sup>49</sup>*

As discussed earlier, attempting to transfer inappropriate risk to the private sector will add unnecessary cost to a PPP agreement, thereby undermining value for money. The difficulties associated with these issues were demonstrated in the context of the Department of Defence's tender process for the procurement of patrol boats for the Royal Australian Navy. In announcing the tender in July 2001, the then Minister for Defence stated that the Government was keen to pursue the project under private financing arrangements, but that the Government must be satisfied it is receiving the best outcome for the investment of taxpayer dollars.<sup>50</sup> However, in announcing the shortlist for the tender in June 2002, the current Minister for Defence stated that:

*After evaluating two possible procurement options, the Government has decided to directly purchase the boats. The use of private financing to deliver the boats and associated through-life support was also considered. However, advice provided to the Government indicated that there was uncertainty about whether the requisite capability could be provided on a value for money basis while also ensuring that the transaction would be classified as an operating lease for accounting purposes.<sup>51</sup>*

### **Accountability in a sound corporate governance framework**

It has been increasingly recognised, in both the private and public sectors, that appropriate corporate governance arrangements are a major factor in corporate success. A key element of corporate governance in both the private and public sectors is risk management. An effective corporate governance framework assists an organization 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 cost effective, transparent and accountable public sector. As one expert opinion puts it:

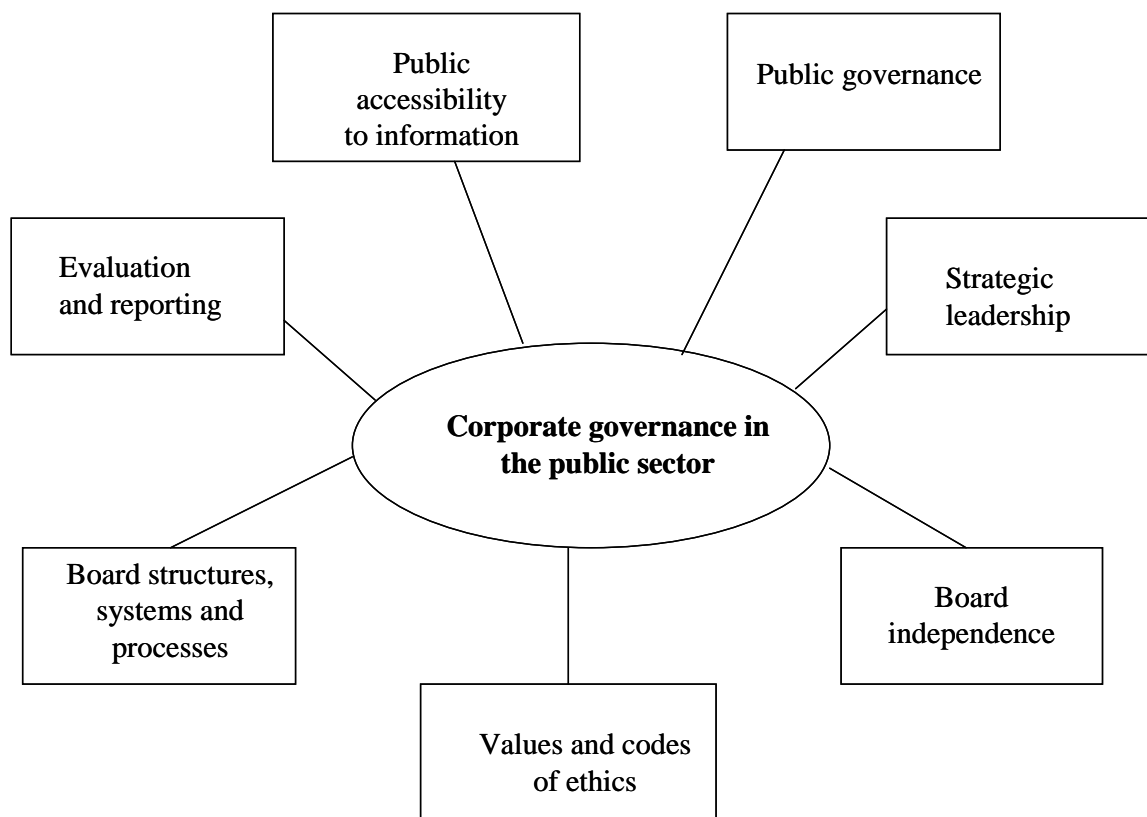
*...corporate governance is the organisation's strategic response to risk.<sup>52</sup>*

PPPs have given rise to additional challenges and demands in this respect for the public sector because the parameters of risk are far different from those involved in traditional approaches to the provision of public infrastructure and services. Indeed, the potential liabilities accruing to governments may be significant. The governance arrangements that will facilitate the effect transfer of risk and operational control to a private sector entity while reserving the capacity for the public sector entity to protect the public interest and enforce government policy objectives need to be clearly established at the outset.

Indeed, the policies issued by various jurisdictions on the use of private financing and PPPs require a test of transparency and accountability to be satisfied in order for the proposal to be successful.<sup>53</sup> At the federal level, it is useful to reiterate that the Commonwealth Principles for the use of private financing identify transparency and accountability, together with value for money, as the three core principles for assessing whether private financing should be the preferred procurement method used.

As has been observed by the Chartered Institute of Public Finance and Accountancy in the United Kingdom, no system of corporate governance can provide total protection against management failure or fraudulent behaviour.<sup>54</sup> However, sound corporate governance arrangements do form the basis of a robust, credible and responsive framework necessary to deliver the required accountability and bottom line performance consistent with an organization's objectives. Figure 1 provides one model of the various components of corporate governance in the public sector.

**Figure 1 Components of public sector governance**



Source: Victoria

n Public Accounts and Estimates Committee 2002, Issues Paper: *Inquiry into Corporate Governance in the Victorian Public Sector*, Melbourne, April, p. 8.

The increasing involvement of the private sector in the delivery of public services is challenging traditional notions of accountability, an issue that is central to good governance.<sup>55</sup> As the Commonwealth Principles state:

*The potential for private financing to alter traditional risk allocation also requires close attention to how existing accountability arrangements impact on the relationship between agencies and contractors.*<sup>56</sup>

Corporatisation, privatisation and partnership arrangements commonly involve the transfer of direct control of an organisation responsible for delivering public services to a board of directors. As the Victorian Public Accounts and Estimates Committee has recently observed, accountability for Government spending can be at risk if arrangements involve parties who are not directly accountable to a Minister and not subject to parliamentary scrutiny.<sup>57</sup> The Committee further observed that the standards and practices of good corporate governance are important elements for not only ensuring these boards operate as expected but also in preventing fraud and corruption.<sup>58</sup>

In this increasingly complex environment, 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 namely, the organisation's stakeholders and those who are entrusted to manage resources and deliver



required outcomes. The absence of clearly designated roles weakens accountability and threatens the achievement of organisational objectives. Any uncertainty experienced by private and/or public participants in this respect can create confusion both as to who is accountable for what and the various relationships with stakeholders.

### ***Sustainability of the private sector entity***

An important aspect of the assessment of value for money is consideration of the sustainability of the private sector entity's bid, having regard for the risks it is willing to accept for the bid price offered. Even where the risk has been transferred, there can remain a residual risk that the public sector may have to step-in in the event the private sector contractor experiences difficulties in meeting its obligations. This is because, where the provision of public services or goods is involved, private financing does not equate to contracting out ultimate responsibility for their delivery. In this respect, the NSW Auditor-General has commented:

*...I think quite often the risk assessment that takes place may assume that the private sector entity continues to operate and can continue to honour its obligations under the arrangement for risks that arise. Whether or not there is a contractual obligation for the private sector party to continue to meet obligations is one thing, but in reality, many of these projects become perceived by the public as a public sector project, as a government project. If the private sector entity were, for example, to become bankrupt, go into receivership or otherwise default, the risk will quite often fall for public policy reasons or revert to the Government.<sup>59</sup>*

Whether it is regarded as a gap in accountability or not, there does not appear to be sufficient attention given to minimising, or at least ameliorating the initial, and sometimes ongoing, impact of a bankruptcy or other cessation of service by a private sector provider or the immediate clients and/or the general public. This should preferably be decided when the initial outsourcing/partnership arrangements are being determined and/or, at the latest, at the time of the contract negotiations, so that both parties can address the issue and be aware of what action would be taken and who is responsible and accountable.

The NSW Public Accounts Committee has similarly reported that:

*Governments sometimes also use PPPs to divest themselves of risk and instead transfer it to the private sector. But often the private partners in these cases run into trouble. Governments, being sensitive to community expectations, renegotiate these deals at considerable expense and re-assume the risk. In these cases they would have been better off not to enter into a PPP in the first place.<sup>60</sup>*

An example of such a circumstance arose in Victoria in regard to the Latrobe Regional Hospital, for which a private sector consortium had been awarded a contract utilising the build, own and operate (BOO) model of private sector involvement. The new hospital commenced operations in September 1998. Under the terms of the agreement, the consortium was required to provide

services to specified quality standards. In return for services delivered, the State paid the consortium a service charge comprising a service component and an allocated facilities component.<sup>61</sup> The Victorian Auditor-General's Office, which had examined this PPP, reported that the overall arrangements as structured, effectively transferred a significant proportion of the financial risk to the private sector.<sup>62</sup>

Within a year of commencing the operations, the consortium began making representations to the relevant Department that the hospital had been incurring substantial operating losses.<sup>63</sup> The Auditor-General reported that, by July 2000, the Department had concluded that, as a result of financial problems stemming from the low original bid (which was materially below the public sector comparator established for the tender process) and the inability of the private sector consortium to make the efficiency gains upon which the bid price was predicated, it was only a matter of time before the State would need to consider either the renegotiation of the contract or manage the collapse of the arrangement.<sup>64</sup> Ultimately, the step-in provisions set out in the agreement were exercised and the hospital's operations were transferred to the public sector, with the private sector consortium required to pay the State around \$2 million, representing net assets and liabilities assumed from the consortium.<sup>65</sup> The Auditor-General concluded that:

*Although the contractual arrangements for the privatisation of the Latrobe Regional Hospital were successful in transferring financial risk to the private sector, the social responsibilities of the State meant that any threat to public health and safety or hospital service provision could not be allowed to occur. In this case, the State stepped in when it appeared that a risk to the provision of on-going hospital services was developing. The final outcome was that [the private sector consortium] was able to avoid the full financial risk obligations embodied under the contractual arrangements.<sup>66</sup>*

The recent research paper on PPPs by the Department of the Parliamentary Library noted another example in which the State found the need to exercise step-in rights:

*In practice, the allocation of risk has not always been appropriate, and the government has had to assume risks that were initially transferred to the private party. An example is the Sydney airport rail link, which the NSW Government took over after the company that built and operated the link failed to meet scheduled payments to creditors.<sup>67</sup>*

The implications for accountability arising from such circumstances highlight the need for public sector entities to ensure that a PPP arrangement includes a) adequate step-in provisions and b) appropriate governance arrangements that give the public sector entity sufficient capacity to monitor the private entity's ongoing financial viability and plan for orderly take-over to ensure continued service to the public. Lessons in this regard have been similarly noted by the NAO in respect to the use the UK Private Financing Initiative (PFI).

For example, the private financing deal for the construction of the Channel Tunnel Rail Link and operation of the UK arm of the Eurostar international train service had to be restructured after it became clear that overly optimistic forecasts for the operating performance of Eurostar UK had scuppered the private sector partner's efforts to raise all the money it needed from private investors to build the Link.<sup>68</sup> In an audit of that PPP, the NAO found that, under the original deal, the responsible Department decided not to demand all of the information it was entitled to under the contract with the private sector partner.<sup>69</sup> This decision hampered the Department's ability to monitor progress and at the same time denied the external financiers, at the early stages of the project, the opportunity to bring private sector financial disciplines to the deal. NAO found that, in the restructured deal, the Department now has considerable influence on the way the whole project is being managed and is actively monitoring the performance of the private sector partner and the other parties to the project.<sup>70</sup>

There is no doubt that risk transfer has been seen as a major driver for the UK PFI.<sup>71</sup> More broadly, the PFI was introduced to harness private sector management and expertise in the delivery of public services.<sup>72</sup> For example, in 1997, National Air Traffic Services Ltd (NATS), the company owned by the Civil Aviation Authority which was responsible for air traffic control in the UK, estimated that it required some £100 million of further capital investment every year for the next decade to increase air traffic control capacity to meet future traffic growth. But NATS could not be sure of getting this money: it competed with the rest of the public sector for finance. The UK Department of Transport had concerns over whether NATS could manage such a large investment programme efficiently. The Department and the UK Treasury concluded that the solution to this problem was to adopt a PPP for NATS which provided:

- above all, for standards of safety and national security to be at least maintained, in particular by separating service provision from safety regulation;
- an injection of private sector money and improved project management skills;
- for NATS to benefit from greater freedom to invest and to improve its services free of public sector constraints; and
- that, in achieving these prime objectives, the interests of the taxpayer should be safeguarded.<sup>73</sup>

In a recent report, the NAO highlighted that the corporate governance arrangements put in place for the NATS PPP, in order to provide for ongoing protection of the public interest, appeared to be working.

The PPP involved transferring part ownership of the company responsible for air traffic control from the regulator, the Civil Aviation Authority, to a consortium of airlines, which was given operational control and a 46 percent share of the company.<sup>74</sup> In designing the PPP, the UK Department of Transport had to incorporate controls over the business to protect safety, national security and the public interest, without taking operational control of the business away from the Strategic Partner. The Department and its advisers

addressed these needs mainly through arrangements for corporate governance of the Company, laid down in a Strategic Partnership Agreement, and through the provisions of the Company's licence to provide air traffic services. A key feature of the PPP is the role of three 'Partnership Directors' nominated by government. Their function is:

- to exercise their independent commercial judgement on issues of strategy, performance, resources and standards of conduct; and
- to seek to ensure that the Board, as the principal decision-making forum in the Company, functions effectively and transparently.<sup>75</sup>

In particular, their duty is to protect the taxpayer's financial interest in the company, and to ensure that the company retains its capability to operate without undue reliance on the consortium.<sup>76</sup>

In practice, achieving transparency and accountability is a major challenge for good governance in an outsourced environment, not least in the nature and extent of risks involved. 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 overall responsibility for decisions. In short, such a focus on accountability encourages measurement of performance in a practical operational manner that makes sense to those involved.<sup>77</sup> That does not occur by accident or default. It requires sound leadership and direction.

It has to be admitted that the public sector often does not operate with complete clarity as to the extent of a public sector employee's, officer's, CEO's, and/or board member's accountability for implicit or explicit action that may 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 do not lend themselves to easily providing complete clarity of requirements. Indeed, ongoing reforms promote individual discretion, judgement and initiative. Nevertheless, there is a public expectation of personal responsibility and accountability that has to be met.

The UK PFI has also demonstrated the governance complexities that can arise as governments move further into the PPP experience. Initially, a Treasury Taskforce provided UK public sector entities with specialist skills and experience to assist in developing PPP projects. That role has now been taken up by Partnerships UK.

Partnerships UK is not an adviser. It acts as a PPP developer, working in partnership with public bodies. Public bodies which previously would have used the Treasury Taskforce may now enter into a development partnership agreement with Partnerships UK. The latter works with the Government in the development of PPP policy and contract standardisation; helps with project evaluation and implementation; and supports PPPs in difficulty. Partnership UK's financial targets are set to fulfil its public sector mission while permitting a fair return on capital. Its returns are linked to the success of the PPP. It helps to fund the costs of development and procurement, and intends to provide finance for PPPs where this will achieve better value for money for the private sector.

As a private sector company, with the Government holding a substantial minority stake, Partnerships UK is itself a PPP, having completed a capital raising exercise in March 2001. It is a joint venture with the public sector owning a minority interest and the private sector owning a majority. A majority of board members come from the private sector. The public sector is represented by two non-executive directors appointed by HM Treasury. The wider public interest is represented through an Advisory Council made up of the principal public sector stakeholders. In a real sense, it is another player in the accountability drain with dual responsibilities and accountabilities which is not conducive to Parliamentary confidence about just who is to be held accountable for what and on what basis.

### ***Umbrella governance arrangements***

The increasing involvement of the private sector has been accompanied by a general trend toward diminished central oversight and coordination. This 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 operationally to the satisfaction of all parties and induce stakeholder confidence that there is a realistic framework for shared accountability, except where there is a lead agency that assumes overall accountability for the result.

An example of the need for cross-agency governance arrangements was highlighted in the ANAO’s recent audit of the management of the administration of the Federation Fund Programme.<sup>78</sup> That audit found that no Commonwealth department had the responsibility for monitoring the collective performance of Federation Fund projects against the programme’s objectives. Consequently, up to the time of the audit, very little performance information on the achievement of the programme’s overall objectives had been collected or reported to the Parliament.<sup>79</sup> The audit noted that, where more than one portfolio is responsible for delivering the Government’s programme objectives, the concept of whole of government performance reporting through the identification of a ‘lead agency’ is an area of potential improvement in Commonwealth reporting and accountability.<sup>80</sup>

The trend toward ‘networked’ or cross agency approaches is one that is likely to continue as agencies take advantage of the opportunities offered by more responsive service delivery. Equally, in the context of PPPs, responsibility for the achievement of government outcomes is shared across public and private sector entities. Further, governments may choose to contract with separate contractors for various parts of the overall project, thereby imposing an ‘interface risk’ on themselves arising from construction complexities and possibilities of construction cost and time overruns. In that environment, governance issues need to be given greater prominence and consideration. It may for example, be appropriate for governance arrangements to be set out in Cabinet submissions and subsequently approved by the executive. These issues need to be addressed sooner rather than later if gaps in accountability are to be prevented, or, at least, minimised.

### III. AUDITING IN AN EVOLVING PUBLIC/PRIVATE SECTOR ENVIRONMENT

Auditors-General are an essential element of the accountability process by providing that unique blend of independence, objectivity and professionalism to the work they do. Corresponding with the public sector changes over time, the role of Auditors-General and the place of auditing in democratic government have also changed. As the public and private sectors converge; as the management environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them.

A particular risk for auditors in this new environment is the considerably increased complexity involved in arrangements such as PPPs. It is important that audit offices ensure they are in a position to fully understand the transactions being undertaken by agencies in order to be able to both review the value-for-money assessment, as well as the appropriateness of the accounting for the transaction. This raises issues of ensuring commonality of views across audit functions. These risks and implications for the public sector auditing process will continue to gain in prominence as we continue along the procurement continuum.

To ensure their effectiveness, ANAO privatisation audits 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.

That said, however, the essential management principles that underpin efficient and effective management are a constant. In any procurement project, important aspects of accountability relate to the capacity to demonstrate that the approach selected represents superior value for money when compared with other possible approaches and/or providers, and that the projected benefits and outcomes are achieved over the term of the project. This remains the case with the introduction of the concept of PPPs. In this regard, Professor Mervyn Lewis has said:

*In structuring the most appropriate approach, the focus should be on the output specifications, the public interest, the capabilities of both government and the private sector, the optimal risk allocation environment and commercial viability. The objective remains one of achieving effective and efficient value for money outlay.<sup>81</sup>*

In recent years, ANAO has undertaken performance audits of a range major Commonwealth asset sales and procurement activities. In addition to raising significant cash proceeds, asset sales provide an opportunity to transfer risks to the private sector and have been argued to offer the potential for improved business efficiency. In a number of instances, a common theme of these audit reports has been the deficiencies in the project management skills of agency decision makers. This is of concern given that some of these projects involve substantial resources and complexity. As well, reports have flagged a need for

care in assessing value for money and negotiating, preparing, administering and amending major projects. These issues have significance for accountability to stakeholders and their confidence in the arrangements, not least the Parliament itself.

As noted earlier, in Australia, most of the activity in private financing initiatives has occurred at the State Government level. However, ANAO has observed lessons learnt from the increasing involvement at the federal level of the private sector in services traditionally delivered by the public sector which can be expected to also have considerable relevance in the implementation of PPPs, as identified in the following sections.

### **The use of private sector advisers**

Executing a PPP deal is a major project in itself, typically involving substantial use of financial, legal and other private sector advisers. This is similar to the experience with the privatisation process in Australia, which 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. The use of such advisers needs to be effectively managed by agencies in order to ensure there is appropriate accountability for their selection, performance and payment.

One of the key outcomes from ANAO's 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.

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, including 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,<sup>82</sup> 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.

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.<sup>83</sup>

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.

### **Tendering process**

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'<sup>84</sup> 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.<sup>85</sup>

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 the latter is always achievable. ANAO's recent audit of the sale of Commonwealth Estate Property<sup>86</sup> 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 audit found that the 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. The ANAO view was that, in implementing the Government's property sales policy, the Commonwealth's

legislative framework for financial accountability continued to bind the agency. This would require that it undertake an assessment of whether proceeding with a sale and leaseback represented the best overall value for money outcome for the Commonwealth, and provide such advice to Government. Importantly, the agency took the contrary view, arguing that its role was to implement the Executive Government's decision to divest property, and that it was not charged with the role of protecting the "overall" interest of the Commonwealth, which it argued had been considered in the development of the relevant policy.<sup>87</sup> The responsible Minister suggested that the ANAO's view represented a view that the policy should be questioned.<sup>88</sup>

A key point for the audit was the efficiency and effectiveness of advice provided by the agency as its 'output', which was considered to be wrongly based. More broadly, in a Westminster system of government, it is inevitable that tensions will arise between the prerogative of Executive Government to formulate and implement policy, and the right of the Parliament to be informed about the value for money obtained in the use of public money. Such tensions can, as in this case, involve 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.

### **Lessons from audits of outsourcing arrangements**

Outsourcing has been a key feature of the changing Australian public sector environment and has raised important questions of accountability. The concepts underlying the outsourcing of infrastructure such as information technology (IT) are conceptually similar to PPPs in that, under a PPP contract, the emphasis is similarly on the purchase of services rather than the procurement of an asset. Consequently, lessons learnt from outsourcing initiatives raise important issues to consider in the context of PPPs, particularly in relation to accountability for results achieved, or not achieved as the case may be.

The outsourcing of IT infrastructure 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.<sup>89</sup> 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, and their accountability for agency performance.

A performance audit of the IT Initiative undertaken by ANAO identified that 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 (which had similarities to the public sector comparator in a PPP evaluation), nor the costs arising from the Commonwealth's guarantee of the external service provider's (ESP) asset values under the outsourcing case. ANAO also found that the competitive neutrality adjustments applied to agencies' business-as-usual cost baselines did not appropriately reflect the lower business risk faced by private sector tenderers under the finance leasing arrangements offered, and the commensurately lower equipment lease pricing included in their bids.<sup>90</sup> Consequently, the financial savings realised by the agencies from outsourcing, as quantified in the tender evaluations, were overstated.<sup>91</sup>

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.<sup>92</sup>*

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.<sup>93</sup>

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.<sup>94</sup> 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 ANAO audit report, 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 had 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.<sup>95</sup> 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.<sup>96</sup>

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.<sup>97</sup> Similar benefits are often cited from the use of PPP-type arrangements. However, all such arrangements also bring 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.<sup>98</sup> An important issue is whether there is sufficient transparency in the arrangements to satisfy Parliament's concerns about accountability both for the use of public resources and the results being achieved.

### **Governance in alliancing**

A relatively new method of public sector contracting is project alliancing. A project alliance is an agreement between two or more parties, the project owner and the contractor/s, who undertake work cooperatively, on the basis of sharing the risks and rewards of the project. This approach shares similarities to PPPs in that successful project alliancing depends importantly on skillful management of the particular risks involved.

Although project alliancing is a business relationship, the aim is to achieve agreed commercial outcomes based on the principles of good faith and trust. As such it offers potential benefits over traditional contracting but also raises new and different risks that have to be managed – in particular, determining the appropriate balance between maintaining real cooperation and achieving the results required and protecting the Commonwealth's financial interests. Some see this conundrum as a real threat to accountability, sometimes put rather colourfully as public servants 'doing deals'. Nevertheless, the accent is on transparency. Nevertheless, project alliancing is a contracting methodology worth consideration by agencies involved in major construction projects – particularly high profile, prestige Commonwealth projects.<sup>99</sup>

The first use of such arrangements by the Commonwealth was for the construction of the National Museum of Australia and the Australian Institute of Aboriginal and Torres Strait Islander Studies. ANAO examined aspects of that project in an audit undertaken in 1999-2000<sup>100</sup>, which was completed

prior to completion of the construction phase of the project. ANAO concluded that, with respect to that project, appropriate financial incentives were in place to encourage 'best for project' behaviour from the relevant agency and the commercial alliance partners to achieve the cost, time and quality requirements of the project.<sup>101</sup> However, ANAO also noted aspects of project alliancing that agencies undertaking such projects would need to consider in relation to effective risk management and accountability.

While such projects are based on the parties working cooperatively to achieve agreed outcomes, the underlying goals of both parties remain as they do in any construction contract. The client wants a building that at least meets stated cost, time and quality parameters. Construction organisations want to meet, or exceed, their normal project expectations commensurate with the nature and extent of their involvement. What happens if the alliance's goals and the goals of the alliance members become difficult to reconcile due to, say, a significant cost overrun trend? This was the very problem encountered on the museum project. Although the Department had no legal obligation to do so, it varied the cost gainshare provisions to the benefit of the commercial alliance partners. The Department justified its decision, in part, by saying that the great pressure on the need to achieve savings was deflecting the Alliance from striving towards an outstanding result, thus acting to the detriment of the project. Underwriting part of the final cost overrun would help to drive the right behaviours for achieving overall outstanding results.

This issue illustrates the difficulty, as I indicated earlier, within the Alliance Agreement of determining the appropriate balance between maintaining the collaborative imperatives of the Alliance and protecting the Commonwealth's financial interests. Careful management and judgement on the part of those responsible for managing the Commonwealth's interests are required. Whatever decisions are made in this regard, the decision and its reasons should be open, transparent and documented and be subject to Parliamentary or independent scrutiny if necessary – as was the case with the Museum project. This example also highlights the need for careful consideration to be given to the potential for any variations to the contractual arrangements to alter the original value for money determination. This is central to the accountability expectation of the Parliament.

### **Contract management and performance accountability**

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 contractual 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, it 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 Senate 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.*<sup>102</sup>

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.

The competent management of the contract is the public sector entity's key means of control over its outputs and their contribution to outcomes. In this context, public sector managers and auditors need to be cognisant of the potential risks that 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 (this point is discussed further in the next section); 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.<sup>103</sup>

There are also legal risks in terms of determining who is liable for service level deficiencies – these questions bear on the strength and completeness of the contract arrangements. Because outcomes can be difficult to specify (and

indeed may even be the combined product of more than one agency) it can be difficult to specify the circumstances in which ‘non-performance’ has occurred, in order to press for successful contractor performance, given these complex linkages and, moreover, to specify enforceable responses.

That is why it is essential that agencies ensure their staff have the capability and capacities to manage contracts effectively if they are to achieve the results required. It is not just skills in relation to contracting that are important. There is still a high premium on knowledge and understanding of the functions/business that are being managed. Put simply, agencies have to be in a position to know what it is actually getting under a contract and whether it is meeting the set objectives. If they do not, the success of the agency and its very reason for being is put at risk.

Crucial to meeting the challenge is the contract itself and how it is subsequently managed. The prime purpose of a contract with the private sector is to make a legally enforceable agreement. Our audits have clearly illustrated the value of written contracts that reflect the understanding of all parties to the contract, and which constitute the entire agreement between the parties. Otherwise, the documentary trail supporting the authority for the payment of public money and contractual performance requirements, incentives and sanctions may not be clear. Not surprisingly, this is a matter of concern to the federal Parliament, which has been very supportive of initiatives being taken to improve records management.

The contract must clearly specify the service required; the relationship between the parties needs to be clearly defined, including identification of respective responsibilities; and mechanisms for monitoring performance, including penalties and incentives, set in place. However, it should never be forgotten that such relationships are founded on a business relationship in which the parties do not necessarily have common objectives. There should not be any equivocation about required performance nor about the obligations of both parties. Contract management is as much about achieving the desired outcome as it is about meeting particular accountability requirements. Both require sound, systematic and informed risk management which recognises that:

*...managing contract risk is more than a matter of matching risk-reducing mechanisms to identified contract risks; it involves an assessment of the outsourcing situation.<sup>104</sup>*

On the issue of contract preparation and management, the (then) Industry Commission (now the Productivity Commission) suggested that public sector agencies tend to transfer as much risk as possible to the agent, thus increasing the risk of contract failure. Conversely, if too little risk is left with the agent, this can lead to poor service delivery and resulting political problems for the government.<sup>105</sup> Such political problems reflect the rights of service recipients as citizens who are not party to the principal-agent relationship. This can create other problems as indicated by the following observation:

*Probably the greatest accountability weakness, from the standpoint of service recipients and other third parties affected by the actions of a contractor, is the limitation of*



*private contract law in dealing with the interests of parties not covered by the privity of contract between the government agency and the contractor.*<sup>106</sup>

It is recognised that contractual performance is maximised by a cooperative, trusting relationship between the parties. To get the most from a contract, the contract manager and contractor alike need to nurture a relationship supporting not only the objectives of both parties but also one which recognises their functional and business imperatives. It is a question of achieving a suitable balance between ensuring strict contract compliance and working with providers in a partnership context to achieve the required result. According to the OECD:

*A good contract is one that strikes, at a level which will be robust over time, a balance between specification and trust which is appropriate to the risks of non-performance but does not impose unnecessary transaction costs or inhibit the capacity or motivation of the agency to contribute anonymously and creatively to the enterprise in question.*<sup>107</sup>

ANAO has conducted a series of audits of recent contracting exercises, with some interesting findings, 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.<sup>108</sup>
- 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.<sup>109</sup>
- 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, 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. As well, 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.<sup>110</sup>

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, similar 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 still 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.

The experience in the UK has been that, while authorities have high expectations at the outset of PFI projects for their success in delivering value for money in public services, the achievement of that value for money is not guaranteed. A 2001 report by the NAO highlighted this issue, noting that:

*Authorities need to ensure that the value for money anticipated at the time of contract letting is delivered in practice. To do so requires careful project management and a close attention to managing the relationship with contractors. Authorities also need to consult with users about their level of satisfaction with the services being provided.<sup>111</sup>*

Particularly with large and complex projects there should be provision for contract milestone reviews in the progress of the project, with tests wherever appropriate that prove the progress, and provisions for relief in the event of default.<sup>112</sup> However, it has also been suggested that ‘*contracts should be framed for performance rather than detailing how to achieve this performance.*’<sup>113</sup>

This is an area to which agencies entering into significant contracts with the private sector need to pay particular attention. Even where performance information requirements are set down in the contract, there is a risk that the private sector entity will not fulfil those requirements. In the context of complex, high-cost and high-profile contracts, agencies may not have the leverage needed to obtain timely compliance by the contractor with those obligations. For example, ANAO audits have observed examples of this, as follows:

- In the case of the sale of DASFLEET, the tied contract with the winning bidder for the provision of leased vehicles and fleet management services to the Commonwealth required the contractor to provide regular reports and information to enable the responsible agency to monitor performance by the contractor of its obligations under the tied contract. In lodging its dispute in relation to the tied contract, the agency was of the view that the contractor had not provided reports or information that were sufficient or accurate enough for the agency to monitor the contractor’s performance. In addition,

there was evidence that many of the invoices provided were also inaccurate. An audit commissioned by the agency concluded that there were serious deficiencies in the information and reports provided by the contractor. The agency advised the contractor that its inability to provide accurate, reliable and complete reports and information was a serious failure to perform fundamental obligations under the tied contract. This issue, together with multiple other disputes between the parties, was ultimately considered in a whole of dispute settlement.<sup>114</sup>

- The formalised performance reporting generally required of external service providers is an important tool for the effective management of the contract by agencies. However, ANAO's performance audit of the Commonwealth government's IT Initiative identified that, while in each of the three contracts examined by ANAO there had been extended delays in the provision by the contractor of accurate and adequately substantiated performance information.<sup>115</sup> The audit found that the provision by the contractor of accurate and appropriately substantiated and detailed invoices had also proven to be an area of difficulty.<sup>116</sup> This was despite each of the successful tenderers representing in the tender process that they would be able to satisfy these contractual requirements.

To improve contract management in the Australian Public Service, the ANAO issued a *Better Practice Guide on Contract Management*, which has received international recognition and is being used by a number of audit offices overseas. The guide emphasises the importance of dealing with risk in contracts. It also emphasises the need to develop and maintain a relationship with the contractor that supports the objectives of both parties and focuses on the agreed results to be achieved, while not ignoring the requirements for parliamentary accountability. For accountability measures to be effective, it is critical that agencies closely examine the nature and level of information to be supplied under the contract and the authority to access contractors' records and premises as necessary to monitor adequately the performance of the contract.

An interesting corollary to the need to ensure that the performance of private sector entities involved in the delivery of government services under PPP arrangements is effectively monitored is the need to ensure the effort involved in achieving that doesn't divert resources from adequate monitoring of, and accountability for, continued public sector service delivery of similar or related services. For example, in 1999, the then Victorian Auditor-General found that due mainly to a need to direct scarce resources to the monitoring of three private-operated prisons opened following the introduction in 1994 of amendments to the Corrections Act 1986, the Commissioner's Office had undertaken very limited monitoring of the State's 10 public prisons in recent years.<sup>117</sup>

### **Privacy**

Another important aspect of performance accountability in the delivery of public services by the private sector is the question of privacy. All Commonwealth agencies are subject to the *Privacy Act 1998*, which contains a number of Information Privacy Principles (IPPs) that provide for the

security and storage of personal information. The IPPs state that if a record is to be given to a service provider, the recordkeeper (ie the agency) must do everything reasonably within its power to prevent unauthorised use or disclosure of information contained in the record.

In the past, the obligations that apply to Commonwealth agencies under the Privacy Act have not applied to private sector organisations. However, the *Privacy Amendment (Private Sector) Act 2000* was introduced in December 2000 to provide privacy protection for personal records across the private sector, including those organisations providing outsourced services to the public sector. A key provision of the Act is the inclusion of ten 'National Privacy Principles for the Fair Handling of Personal Information'. This legislation is likely to have a marked impact on the private sector's involvement in the delivery of public services.<sup>118</sup>

The Act enables a contract between a Commonwealth agency and the private sector supplier to be the primary source of the contractor's privacy obligations regarding personal records. The contractual clauses must be consistent with the IPPs that apply to the agency itself, and details of these privacy clauses must be released on request. Section 95B of the Act requires agencies to consider their own obligations when entering into Commonwealth contracts and obliges them to take contractual measures to ensure that a contracted service provider does not do an act, or engage in a practice, that would breach an Information Privacy Principle if done by the agency. The obligation on the agency extends to ensuring that such an act or practice is not authorised by a subcontract. Under the Privacy Act as currently constituted, privacy monitoring of outsourcing arrangements falls into two stages:

- assessing the privacy control environment, particularly by ensuring that outsourcing arrangements are governed by contracts that contain appropriate privacy clauses; and
- monitoring the actual implementation of the controls, particularly by monitoring compliance with the contractual clauses.<sup>119</sup>

In practice, to date, feedback from outsourcing agencies and contractors suggests that few, if any, complaints have arisen in relation to privacy breaches associated with outsourcing contracts.<sup>120</sup> However, as the private sector becomes more and more involved in the delivery of public services, it is important that there is clear accountability for the protection of personal information contained in records gathered by either the public or private party in the delivery of those services. The expectation that agencies cannot outsource accountability suggests that public sector agencies should remain responsible and accountable for ensuring the private sector parties adhere to any contractual obligations relating to the requirements of the Privacy Act. Indeed, the ANAO's audit of the Commonwealth Government's IT outsourcing initiative recommended that, in implementing IT outsourcing arrangements, agencies develop a specific strategy for monitoring external service providers' compliance with contractual privacy obligations.<sup>121</sup> Both the whole-of-government response to the audit and the Privacy Commissioner agreed with that recommendation, with the Privacy Commissioner commenting:

*If contractual clauses are to deliver effective privacy protection there needs to be a mechanism in place to ensure that both parties meet their privacy obligations.*<sup>122</sup>

### **Access to information**

The current trend towards increased contracting with the private sector for the provision of government services provides a challenge, not only for agencies' accountability, but also for auditors' actual ability to access the relevant records. Concern on audit access to contractors records and premises were reflected in a recent report of the Joint Committee of Public Accounts and Audit (JCPAA).<sup>123</sup>

In the interest of securing access to premises and records, the ANAO has been encouraging the inclusion in contracts of model access clauses. 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.

The inclusion of access provisions within agency contracts to enable performance and financial auditing is particularly important in maintaining the thread of accountability with government agencies' growing reliance on partnering with the private sector and on contractors' quality assurance systems. In some cases, such accountability is necessary in relation to government assets, including records, located on private sector premises.

Nonetheless, the ANAO found that agencies have not fully embraced these opportunities. An examination of 35 contracts for business support processes across eight agencies<sup>124</sup> 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.

Regardless of the access powers that may be available to auditors, however, the appropriate satisfaction of accountability relies, self-evidently, on the relevant information being retained in an appropriate form in the first instance. As highlighted by an audit conducted by ANAO into the effectiveness and probity of policy development processes and implementation related to Magnetic Resonance Imaging (MRI) Services,<sup>125</sup> properly documenting all aspects of the decision-making process is a key element of sound administration and accountability. Failure to do so can result in considerable damage to the reputation of, as well as a loss of confidence in, the agency, minister and government.

However, the increasing trend towards electronic communication and record keeping techniques poses significant challenges in terms of auditors' traditional evidentiary standards. ANAO is also ready confronting situations in which traditional forms of documentary evidence are not available. For example, in a recent performance audit of the Health Group IT outsourcing tender process, ANAO's capacity to examine the management of the probity aspects of that tender was limited by deficiencies in the contemporaneous records made.<sup>126</sup> In a number of areas, the recollection of individuals was the only means of establishing important elements of the sequence of events.<sup>127</sup>

As electronic communications between agencies and outsourced service providers increase, it becomes more important to ensure that the standards of accountability expected for the performance of government functions are understood and complied with by the relevant private sector partners. In close partnership with National Archives, ANAO recently undertook what we then called an Assurance and Control Assessment audit focusing on agencies' record keeping, which made a number of recommendations directed at assisting agencies to improve their ability to appropriately capture, control and preserve official records.<sup>128</sup>

### **Ability to report information**

Reflecting the increasing involvement of private sector entities in public sector activities, performance audits undertaken by ANAO have increasingly involved the commercial and reputation interests of a number of private sector parties, as well as individuals. This has increased the complexity of undertaking such audits. Three main interrelated concerns are access to information, including transparent explanations; requirements of public accountability, particularly with the use of commercial-in-confidence arguments; and the possible consequence's for a firm's reputation and market situation of any adverse comments on public sector management and administration practices, particularly where there is overseas ownership.

Issues that have arisen in recent audits having included: procedural fairness and natural justice issues, and copyright claims on comments provided on draft audit reports which sought to restrict the capacity of the ANAO to reflect those comments in the final audit report. The legal issue of defamation has also arisen on a number of occasions, which can result in the use of language that may be counter to straight-forward and simple explanations.

One important element supporting the Auditor-General's ability to report without fear or favour, is the application of Parliamentary privilege to performance and financial statement audit reports tabled in the Parliament. This privilege can operate to protect the Auditor-General and ANAO staff from being held liable for statements contained in audit reports. This in turn allows the Auditor-General to report freely, openly and responsibly on matters examined in the course of audits. Recently, however, there has been some concern as to whether draft reports and working papers leading to official public reports are similarly covered by Parliamentary privilege. The JCPAA examined this issue in the course of its recent review of the *Auditor-General Act 1997*. The Committee recognised that:

*The provision of Parliamentary privilege is an essential element in protecting the office of the Auditor-General so that it may provide a fearless account of the activities of executive government.*<sup>129</sup>

Legal advice to the ANAO suggests that, until a court decides to the contrary, it is proper for the Auditor-General to proceed on the basis that Parliamentary privilege does apply to draft reports and working papers. The JCPAA accepted this approach. However, the JCPAA considered that the Privileges Committees of both the Senate and the House of Representatives should examine this complex issue to provide greater clarity.

While the ANAO is sensitive to private sector concerns about commercial reputations, the Parliament expects full public accountability, particularly on issues of fair and ethical conduct and protection of the public interest. Conflicts of private and public interest are not new but their resolution in performance audit reports is a challenge for all parties without a genuine shared understanding of what constitutes public accountability.

#### **IV. ACCOUNTABILITY TO THE PARLIAMENT AND THE PUBLIC**

Public access to reliable information is necessary for government accountability. Such access is supported in each Australian jurisdiction by *Freedom of Information* (FOI) legislation. A separate, but related issue, is the accountability of governments and agencies to the Parliament. In all circumstances, agencies remain responsible for ensuring that the government's objectives are delivered in a cost-effective manner. Agencies are not able to transfer accountability to a private sector entity, irrespective of the procurement method used.<sup>130</sup> The essential characteristic of accountability is access to information - virtually all accountability relies on the availability of reliable and timely information. Indeed, it has been said that '*information is the lifeblood of accountability*'.<sup>131</sup>

However, as a result of increased private sector involvement, through contractual arrangements, in activities traditionally undertaken by the public sector, it is arguable that the flow of information available to assess performance and satisfy accountability requirements has, on the whole, been reduced. This situation has arisen where performance data is held exclusively by the private sector or through claims of commercial confidentiality that seek to limit or exclude data in agency hands from wider public or parliamentary scrutiny. A statement of Principles for Commercial Confidentiality and the Public Interest put out by the Australasian Council of Auditors-General in 1997 found that:

*Recent experiences in Australia would indicate that Government agencies are tending to use the pretext of commercial confidentiality as a shield against the disclosure of information which is commercially embarrassing to the Government or which raises issues of probity.*<sup>132</sup>

Thus accountability can be impaired where the involvement of private sector parties in the delivery of public sector outcomes reduces openness and

transparency in public administration. Most confidentiality claims regarding contracts are claims about the commercial sensitivity of the material. As PPPs are, essentially, long-term contractual arrangements, this issue is of considerable significance to the maintenance of accountability to the Parliament under such arrangements. In this respect, a Senate Committee has said:

*Partnerships with government need to open, well documented and conducted with integrity – not only because the public has a right to know how public funds are spent, but because anything less may expose the Commonwealth to litigation, is costly and undermines public confidence.*<sup>133</sup>

### **Commercial-in-confidence issues**

The issue of commercial-in-confidence has been the subject of considerable parliamentary concern and comment in many constituencies. With the greater involvement of the private sector, concerns have been expressed about commercial considerations, particularly in maintaining competitive advantage. Freedom of information legislation, such as the *Freedom of Information Act 1982*, provides for documents to be exempt from disclosure where they would reveal, inter alia, trade secrets and other information having a commercial value that would be, or could reasonably be expected to be, destroyed or diminished if the information would be disclosed.<sup>134</sup>

Equally, however, concerns have also been expressed about the extent to which commercial interests have been protected at the expense of eroding transparency and accountability. As one commentator noted:

*While [Commercial-in-Confidence] may be good for business, it is inimical to the fragile processes of participatory democracy.*<sup>135</sup>

With the increased convergence of the public and private sectors, demonstrating transparency, accountability and the ethical use of resources has the potential to become clouded unless governments take a proactive and consistent stance to the scrutiny of contracts involving public funds.<sup>136</sup> A diminution or loss of accountability need not be a function, per se, of the chosen procurement method, whether it involves PPPs or some other method involving private sector commercial interests. To a large extent, it may be a function of the approach taken by agencies, and governments, to fulfilling their accountability obligations, whether by omission, commission or due to a lack of understanding of those obligations.

This issue was raised by the Senate Finance and Public Administration References Committee during its inquiry into the Commonwealth Government's IT outsourcing initiative, as follows:

*Placing limitations on the free flow of information has the effect of bypassing parliament; reducing public scrutiny of important government decisions or programs; denying citizens access to information about programs affecting them; and restricting citizens' access to remedies in the event of poor service delivery.*<sup>137</sup>



An alternative view was put in the Government Senators' minority report on that inquiry, which argued that there were legitimate reasons for not handing over these various documents including commercial-in-confidence grounds, a risk of litigation and public interest immunity.<sup>138</sup> The minority Senators expressed the view that:

*Companies considering entering into a partnership with the Government, or who have entered into a partnership with the Government should be able to provide commercially sensitive information to the Government with the confidence that it will not be made publicly available....*<sup>139</sup>

One of the difficulties in addressing commercial confidentiality issues is that of precisely defining just what is being covered. While there is a broad understanding of the kinds of information contractors might regard as commercially confidential, the question is how to ensure adequate accountability for the use of public funds while ameliorating any justifiable 'confidentiality' concerns. One of the Principles put out by the Australasian Council of Auditors-General concludes that:

*Some private and public sector bodies are instinctively apprehensive and protective about the disclosure of any commercial information. But such views often overstate the implied risks to an entity that might be occasioned by the release of commercial data. After-the-event commercial information has significantly less value than commercial information concerning events that have yet to occur. But even where commercial information might have commercial value to others, there are often overriding obligations that require it to be released. This is so for commercial information held in the private sector and, a fortiori, it applies to the public sector.*<sup>140</sup>

In May 2001, ANAO completed a performance audit of the use of confidential provisions in contract with commercial providers.<sup>141</sup> 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.<sup>142</sup>

The ANAO developed criteria for use in determining whether contractual provisions should be treated as confidential.<sup>143</sup> 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 confidential<sup>144</sup> and

examples of what would be considered confidential.<sup>145</sup> The Senate Finance and Public Administration References Committee in a recent report on Commonwealth contracts<sup>146</sup> strongly supported agencies' immediate use of the set of criteria developed by the ANAO for determining whether a sound basis exists for deeming information in contracts confidential. The ANAO audit report also made three recommendations directed at increasing the level of openness of government contracts

At the Commonwealth level, in June 2001 the Senate made an Order that required Ministers to table letters of advice that all agencies, which they administered, had placed on the Internet lists of contracts of \$100,000 or more by the tenth day of the Spring and Autumn sittings of Parliament. The list was to indicate, among other things, whether the contracts contained any confidentiality provisions and a statement of the reasons for the confidentiality. The Government subsequently agreed that agencies would comply with the spirit of the Senate Order. The Government advised that information regarding individual contracts would not be provided where disclosure would be contrary to the public interest, legislative requirements or undertakings given.<sup>147</sup> Subsequent amendments to the Senate Order were aimed at strengthening and clarifying the Order.

The Senate Order requested the Auditor-General to undertake twice-yearly examinations of agency contracts required to be listed on the Internet and report as to whether there had been any inappropriate use of confidentiality provisions. I agreed to that request and, to date, two audit reports have been tabled.<sup>148</sup> Both audits found that a high percentage of the contracts examined had been inappropriately classified as confidential when considered using the criteria endorsed by the Senate committee. ANAO noted that this was not unexpected, given that the majority of contracts were entered into by agencies before they had started to make the changes necessary to put into place the new accountability framework and without guidance to determine if information in a contract should be protected as confidential. In most cases, agencies agreed with the ANAO's assessment.<sup>149</sup> The second of these audits found that guidance provided by agencies for officers to determine confidentiality provisions and the reasons for confidentiality should be more comprehensive to enable greater consistency in agency assessments, and noted that the Department of Finance and Administration was in the process developing guidance in this regard, which it expected to issue to agencies in late 2002.<sup>150</sup>

In placing the onus on those who wish to keep the information confidential to argue that the confidentiality is warranted, the Senate Order sought to invoke the reverse onus principle, which has been described as follows:

*In order for the court to be persuaded to protect a government secret, the government must establish that it is in the public interest that the information not be disclosed. Further, the courts have been sceptical of governments wishing to keep matters secret so that the onus on the government is a heavy one.*<sup>151</sup>

The Senate Finance and Public Administration References Committee recently reported<sup>152</sup> in fulfilment of the requirement of part (7) of the Order to

consider and report on the first year of the operation of the Order, that is, from 1 July 2001 to 30 June 2002. The Committee has closely monitored the Order over its relatively short history and, soon after it became operational, recommended changes to the Order that were accepted by the Senate and implemented as of 27 September 2001 (referred to earlier). The Committee concedes that the establishment of the Order has been a catalyst for action on the part of government agencies to ensure greater accountability and transparency in relation to government contracting.<sup>153</sup> It noted that the new requirements regarding accountability that were included in the revised Commonwealth Procurement Guidelines of October 2001 were in response to the Order. The Committee made seventeen recommendations and an extensive range of conclusions on specific issues.<sup>154</sup>

The approach taken to this issue in other Australian jurisdictions has varied. For example, the policy statement on private sector participation in public infrastructure provision released by the Tasmanian government in July 2000 requires that a contract summary including key elements of the contract be prepared within 90 days of finalising the contract, which the Treasurer, in consultation with the Responsible Minister, may decide to make public in the interests of public accountability. The policy statement further provides that, in the event the contract summary is made public, any matters which, if disclosed would substantially disadvantage the contracting firm commercially with its competitors, will be deleted from the summary.<sup>155</sup>

Some other jurisdictions have taken their response to this issue even further, with some taking the approach of introducing policy or legislative requirements for the public disclosure of contracts based on the reverse onus principle. Measures taken by State governments include the following<sup>156</sup>:

- In response to the findings of an independent Audit Review of Government Contracts commissioned by the government in January 2000, the Victorian policy places the burden of proof to disclose government contracts on government agencies.<sup>157</sup> If there is a compelling reason, information need not be disclosed but such non-disclosure extends for only a limited time. Details of all departmental contracts worth more than \$100 000 are accessible on the internet and contracts over \$10 million are published in full on the internet. If a clause has been removed from a contract, a statement is required to explain the reason for and scope of the exclusion.
- In Western Australia (WA) the details of contracts over \$10 000 are to be published on the internet after the contract is signed. All government contracts must include disclosure clauses which advise that contractual documents may be disclosed if required by law, under the WA *Freedom of Information Act 1988*, by tabling the documents in State parliament or under a court order.
- *Principles and Guidelines for the Treatment of Commercial Information Held by ACT Government Agencies* outlines how information in a contract can be determined as confidential at the time a contract is being negotiated. The *Public Access to Government Contracts Act 2000 (ACT)* requires that agencies prepare a public text of a contract within 21 days of making the contract. The public text

only excludes clauses deemed genuinely confidential according to provisions of the Act. The ACT Auditor-General maintains a register of contracts containing confidentiality clauses.

- The policy for privately financed projects released by the New South Wales government in November 2001 states that the Government will require the publication of a contract summary for privately financed projects, with the summary audited by the Auditor-General and tabled in Parliament.<sup>158</sup>

It has been noted that these legislative and policy responses:

*...still respect the need for genuinely confidential material to remain undisclosed. Each system makes clear that governments are accountable for agreeing to non-disclosure and must be prepared to justify their decisions.*<sup>159</sup>

Ultimately, the successful maintenance of transparency and accountability for the expenditure of public funds in an environment of increased public sector involvement is likely to continue to rely upon the approach taken to the issue by governments and agencies. As the Audit Office of NSW has observed, a contract can be written to maintain or even enhance accountability and access, or can be written to diminish both.<sup>160</sup> The Senate Finance and Public Administration References Committee has similarly noted:

*Unfortunately, in the context of government contracts the reverse onus principle is in a precarious position because, as it stands, the reverse onus principle may be bypassed by contractual provisions.*<sup>161</sup>

The Senate Committee has reported that, in order that open government is not deliberately or unwittingly compromised in the context of Commonwealth contracting, it favours reinforcement of the reverse onus principle by legislation requiring all government contracts to be publicly available unless particular exemptions apply.<sup>162</sup>

### **Accountability to Parliament**

Quite separate from the issue of accountability to the public through freedom of information and similar obligations is the obligation of parties to a government contract to be accountable to the parliament.<sup>163</sup> However, concerns about a diminution in that accountability with the increased involvement of the private sector have also arisen in respect to parliaments. These concerns have stemmed in part from difficulties parliaments have experienced in gaining access to contract documents, including those relating to PPP arrangements. For example, in relation to the M2 Motorway project in New South Wales, the NSW Parliament was denied access to the contract deed between the public sector roads authority and the private sector counterpart.<sup>164</sup>

The powers of parliamentary committees in respect of government contracts are not affected by contractual confidentiality provisions.<sup>165</sup> Parliamentary Committees possess significant powers to invite, and if necessary, require the attendance of a person or the production of a document and to hear evidence either in public or in private.<sup>166</sup> Two celebrated court cases in New South

Wales have recently confirmed the right of the Parliament to call for documents from the executive.<sup>167</sup> At the Commonwealth level, the power of the Senate and its committees to compel the attendance of witnesses, the giving of evidence and the production of documents is virtually unlimited, subject to two qualifications.<sup>168</sup> However, the power to issue a summons for a witness to appear or make an order to produce documents are rarely used. As Odgers' Australian Senate Practice notes:

*...the extent of the power has been frequently restated in recent years although the power itself has been seldom used.*<sup>169</sup>

Even where the Senate or a committee has issued an order for the production of documents, it may choose not to exercise the full extent of its powers in the face of non-compliance with that order. An example of this situation arose in the course of the Senate Finance and Public Administration References Committee's recent inquiry into the governments IT outsourcing initiative. During the inquiry, the Minister for Finance and Administration used public interest immunity as a ground to deny access to the evaluation reports of a tender process. In that case, the Committee reported that it believed that it had not had adequate access to key documents and had not received clear, full and accurate information during its hearings that would enable it to make an informed decision on numerous important issues about the tendering process.<sup>170</sup> The Committee reported that:

*If a committee is faced with a refusal by a witness to attend or produce documents it has a range of options. The first is to report the refusal to the Senate where an outcome may be pursued with the full force of the Senate. Alternatively, it is open to committees not to exercise their powers and to agree to act in accordance with a witness's wishes. However, if the issue is of serious concern, the committee may identify an alternative avenue to resolve the matter, as was done after the Minister for Finance and Administration refused to provide documents relating to the unauthorised disclosure that occurred during the tendering of the Health Group's IT. In the case of this inquiry, the Auditor-General was requested to consider conducting an audit of the Health tender process.*<sup>171</sup>

At the heart of this debate is the on-going problem of clearly defining the 'public interest'. It is generally acknowledged that there is some information held by government that ought not to be disclosed. Such immunity from disclosure is now usually known as public interest immunity. The public interest is, of course, fundamental to democratic governance and is an issue with which public officials, including auditors, and parliaments continue to grapple. This is certainly the case in regard to the extent to which commercial information should be protected by that immunity.

Public interest immunity claims are only claims, and the Senate does not accept them automatically.<sup>172</sup> Odgers' Australian Senate Practice has reported that a common thread emerging from the deliberations of Senate committees regarding claims for public interest immunity is that the question is a political, and not a procedural one. Odger's further notes:

*There appears to be a consensus that the struggle between the two principles involved, the executive's claim for confidentiality and the Parliament's right to know, must be resolved politically. In practice this means that whether, in any particular case, a government will release information which it would rather keep confidential depends on its political judgement as to whether disclosure of the information will be politically more damaging than not disclosing it, the latter course perhaps involving difficulty in the Senate or public disapprobation.<sup>173</sup>*

In general, the roles and responsibilities of both public and private sector partners in relation to commercial-in-confidence issues have required clarification. All parties involved in service delivery must clearly understand their accountability requirements and their ultimate responsibility to the Parliament. This was highlighted during the IT outsourcing inquiry, with the Senate Finance and Public Administration References Committee noting that:

*...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.<sup>174</sup>*

Balancing commercial-in-confidence concerns against the public interest involve questions of judgement based on the merits of individual cases. Something that the IT outsourcing inquiry demonstrated is that Ministers and agencies have a choice about how they approach these types of issues. In that case, the Committee reported that in its opinion, the responsible agency:

*...resorted, far too often and without grounds, to claims of commercial confidentiality to withhold or delay providing information.<sup>175</sup>*

The Committee further reported that:

*Throughout this inquiry, the Committee relied on the good offices of agencies involved in this tendering process to ensure that it was fully and properly informed and that the principles of accountability and fairness were upheld. The Committee believes that it has been ill-served by [the responsible agencies] and by the responsible minister.<sup>176</sup>*

In light of its experience during the IT outsourcing inquiry, the Committee concluded that:

*There is confusion in both the private and public sectors regarding parliamentary committees' right of access to*

*information and their powers that adversely affects public and parliamentary accountability. A greater understanding of committee powers would significantly improve the effectiveness of parliamentary scrutiny and ensure that it proceeds more smoothly than has occurred during this inquiry.*<sup>177</sup>

In this respect, the Australasian Council of Auditors-General has noted that:

*The private sector must expect that, when it deals with the State, the disclosure requirements cannot merely be those that pertain to commercial transactions between two private sector entities. If the accountability arrangements are the same, insufficient weight will have been given to the need for the State to be accountable to the citizen.*<sup>178</sup>

Updated *Commonwealth Procurement Guidelines* released subsequent to the Senate Order stipulated that agencies should include provisions in tender documentation and contracts that alert prospective providers to the public accountability requirements of the Commonwealth, including disclosure to Parliament and its Committees; and consider, on a case-by-case basis, what might be commercial-in-confidence when designing any contract.<sup>179</sup>

The recently released Commonwealth policy principles for the use of private financing place particular emphasis on the need for agencies to ensure that appropriate mechanisms are in place to meet established reporting requirements, such as disclosure of information to Parliamentary Committees. The policy principals require that private financing arrangements comply with financial reporting standards, the Senate Order on the reporting of contracts, and the Auditor-General's authority to access documents, information and premises under the *Auditor-General Act 1997*.<sup>180</sup> The policy principals also provide that agencies should refer to criteria relation to confidential information identified in the ANAO audit in respect to the inclusion of commercial-in-confidence provisions in any successful private financing proposals.<sup>181</sup>

### **Auditors-General and commercial-in-confidence**

As has been noted by the Australasian Council of Auditors-General, where confidentiality clauses do exist, they do not override legislative provisions that require information to be included, and they do not themselves limit the capacity of the Auditor-General to report to Parliament, where that capacity is protected by legislation.<sup>182</sup> Further, it is the duty of Auditors-General to advise Parliament on those matters that have been identified in the audit process about which Parliament should know that. That duty, more than any other, distinguishes the public sector audit from its private sector equivalent.<sup>183</sup>

However, as is the case with parliaments, despite the legislative access and reporting powers that may exist, it appears prudent for audit institutions to be sensitive to the need to respect the confidentiality of genuinely sensitive commercial information. In March 2000, the Victorian Public Accounts and Estimates Committee concluded an inquiry into commercial-in-confidence material and the public interest.<sup>184</sup> That inquiry arose because the Victorian Auditor-General had brought to the attention of the Parliament that commercial confidentiality had become an issue of some contention between

government agencies and his office. Agencies claimed that some information the Auditor-General wished to include in his reports to the Parliament was commercial-in-confidence and therefore could not be published. This issue had arisen, for example, in the context of a May 1999 performance audit on Victoria's prison system, including the introduction of privately-operated prisons. The Committee reported that:

*This presented a number of difficulties for the Auditor-General because he then had to decide whether these claims were legitimate and, more importantly, whether or not disclosure of such material was in the public interest.*<sup>185</sup>

Legislation precludes publication by the Commonwealth Auditor-General of information that, if disclosed, would, among other things, be contrary to the public interest for reasons including unfair prejudicing of commercial interests of any body or person. Those reasons are more fully described in section 37 of the *Auditor-General Act 1997*.<sup>186</sup> 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. It is then up to the Parliament to decide the extent to which it requires 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 the increased involvement of the private sector through arrangements such as PPPs. 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.

The Senate Finance and Public Administration References Committee has reported that it believes that public accountability should be seen as a condition of doing business with government, observing that:

*If this is applied consistently, all contractors will face the same demands for openness, that is, there will be a level playing field.*<sup>187</sup>

## **V. CONCLUDING REMARKS**

The use of alternative means for funding and procuring government services is one of the most significant issues in contemporary public sector administration. In effect, we are witnessing a degree of convergence between the public and private sectors as a means of improving the delivery of required services to the Australian public.

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 also represent good business practice.



Ultimately, government and parliament decide on trade-offs between public sector accountability and private sector cost efficiency. 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.*<sup>188</sup>

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 auditors should not need any more information and/or evidence than the accountable public servants would require in order 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.*<sup>189</sup>

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.

Sound 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. 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.*<sup>190</sup>

At the very least, audit institutions 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.

So, we come to the question – are there gaps in public sector accountability in the context of PPPs? The overall accountability framework does exist to deal

sensitively with private sector concerns, while maintaining accountability for the public funds used. In many cases, the extent to which that framework is effective will depend upon the approach taken by governments to the question of balancing confidentiality questions with the public and parliament's right to know, as well as the approach parliaments and Auditors-General choose to take in exercising their information access and reporting powers. Depending upon the approach to accountability taken by governments, agencies and private sector entities, this may involve exercising those powers in a manner, and with a frequency, not previously seen. There is a need for a disciplined approach to accountability by all players. As a former New South Wales Auditor-General noted:

*The science of accountability involving, as it now can, performance indicators, service obligations and quality measures allows the government to commercialise its activities in an accountable manner. All that is needed is the will.<sup>191</sup>*

The on-going question for Parliaments is whether this is sufficient for their notion of accountability and the confidence and assurance that goes with it.

## NOTES AND REFERENCES

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<sup>1</sup> 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.

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<sup>3</sup> *ibid.*

<sup>4</sup> Management Advisory Committee, 2002, *Australian Government use of information and communication technology*, Canberra.

<sup>5</sup> United Kingdom, Cabinet Office, Central IT Unit 1999, *Modernising Government: Vision*, London, p.1, [Online], Available: <http://www.citu.gov.uk/modern> ov/whitepaper/chap1.htm

<sup>6</sup> Lewis, Mervyn K. 2002, *Risk Management in Public Private Partnerships*, National Australia Bank Professor, University of South Australia, Adelaide, p.1.

<sup>7</sup> Tasmanian Department of Treasury and Finance 2000, *Guiding Principles for Private Sector Participation in Public Infrastructure Provision*, Appendix A, July, p. 28.

<sup>8</sup> New South Wales Government 2001, *Working with Government: Emerging PFP Opportunities*, Sydney, November, p. 1.

<sup>9</sup> These were the subjects of two Reports by the Audit Office of New South Wales: *Private Participation in the Provision of Public Infrastructure: The Roads and Traffic Authority*, 1994, and *Roads and Traffic Authority: the M2 Motorway*, 1995

<sup>10</sup> For further discussion see, for example: Barrett P. 2000, *What's New in Corporate Governance*, Presentation by the Auditor-General for Australia to the CPA Australia, Annual Congress, 17 November, Available: <http://www.anao.gov.au>.

<sup>11</sup> For example, the introduction of privately operated prisons in Victoria was considered in a performance audit undertaken by the Victorian Auditor-General's Office in 1999, *Victoria's prison system: Community protection and prisoner welfare*. Special Report 60, Melbourne, May.

<sup>12</sup> National Commission of Audit, 1996, *Report to the Commonwealth Government*, AGPS, Canberra, June, p. 196.

<sup>13</sup> Lewis, Mervyn K. 2002, *op. cit.*, p.8.

<sup>14</sup> UK National Audit Office 2001, *Managing the relationship to secure a successful partnership in PFI projects*, Report by the Comptroller and Auditor General, HC 375 Session 2001-2002, 29 November, p.1.

<sup>15</sup> For example, the Commonwealth Policy Principles for the Use of Private Financing released by the Minister for Finance and Administration in June 2002 identify transparency and accountability as two of the three core principles that are to guide the evaluation of private financing proposals. Similarly, the Victorian policy also requires an assessment of the impact of the project on accountability and transparency, with consideration of whether the partnership arrangements ensure that the community can be well informed about the obligations of the Government and the private sector partner, and that these can be oversights by the Auditor-General: *Partnerships Victoria*, 2000, Melbourne, p.8.

<sup>16</sup> Department of the Parliamentary Library 2002, Research Paper No. 1 2002-03, *Public Private Partnerships: An Introduction*, Canberra, September, p. 4.

<sup>17</sup> Tasmanian Department of Treasury and Finance 2000, *op. cit.*, p.4.

<sup>18</sup> Minchin Nick The Hon., Minister for Finance and Administration 2002, *Commonwealth Policy Principles For The Use of Private Financing*, Canberra, June, p. 9.

<sup>19</sup> *ibid.*, p. 3.

<sup>20</sup> NSW Public Accounts Committee 2002, *Case Studies and Issues in the Private Financing of Public Infrastructure and Services*, Report No.134, Sydney, October, p. 1.

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- <sup>21</sup> Harris, A. C., New South Wales Auditor-General 1998, *Credulity and Credibility in Infrastructure Funding*, presented to “BOOT – In the Public Interest” Conference, Australian Centre for Independent Journalism and the University of Sydney Australian Mekong Resource Centre, University of Technology, 20 March.
- <sup>22</sup> Department of the Parliamentary Library 2002, op. cit. p. ii
- <sup>23</sup> Commonwealth Policy Principles For The Use of Private Financing 2002, op. cit. p. 9.
- <sup>24</sup> For example, the 1999 Ralph Review of Business Taxation recommended that section 51AD be abolished and that Division 16D be replaced: *A New Tax System Redesigned*, p. 392, quoted in Department of the Parliamentary Library 2002, op. cit. p. 18.
- <sup>25</sup> Coonan, Helen Senator The Hon., Minister for Revenue and Assistant Treasurer 2002, Speech to AFR Infrastructure Summit, Melbourne, 15 August.
- <sup>26</sup> Commonwealth Policy Principles For The Use of Private Financing, op. cit. p. 9.
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- <sup>30</sup> Partnerships Victoria Guidance Material 2001, *Risk Allocation and Contractual Issue- a guide*, Melbourne, June, p.20.
- <sup>31</sup> NSW Public Accounts Committee 2001, *Inquiry into the Funding of Capital Projects by the New South Wales Government: Parramatta Rail Link Pre-Tender Procurement – A Case Study*, Report No.126, Sydney, January, p. 33.
- <sup>32</sup> Partnerships Victoria Guidance Material, op. cit. p. 8.
- <sup>33</sup> Lewis, Mervyn K. 2002, op. cit, p.9.
- <sup>34</sup> UK National Audit Office 2001, *Department of the Environment, Transport and the Regions: The Channel Tunnel Rail Link*, Report by the Comptroller and Auditor General HC 302, Parliamentary Session 2000-2001, London, March.
- <sup>35</sup> *ibid.*, pp.8-10.
- <sup>36</sup> Audit Office of New South Wales 1997, *Review of Eastern Distributor*, Sydney, July, p. 18.
- <sup>37</sup> *ibid.*, p. 25.
- <sup>38</sup> Auditor-General’s Office Victoria 1999, *Report on Ministerial Portfolios*, Melbourne, May, pp. 123-4.
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- <sup>40</sup> *ibid.*, pp. 2-3
- <sup>41</sup> *ibid.*, p. 3.
- <sup>42</sup> ANAO Audit Report No. 63 2001-02, *Management of DASFLEET Tied Contract*, Canberra, 26 June, pp.15-16.
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- <sup>47</sup> Department of the Parliamentary Library 2002, op. cit., p. ii
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- <sup>50</sup> Reith, Peter The Hon. MP, Minister for Defence 2001, Media Release Min 240/01, 8 July.
- <sup>51</sup> Hill, Robert Senator the Hon., Minister for Defence 2002, Media Release MIN 316/02, 28 June.
- <sup>52</sup> Flynn, Colin. 2000, *The Real Role of Risk*, Australasian Risk Management, Vol. 10, No. 2, March, p. 9.
- <sup>53</sup> For example, the Victorian policy, *Partnerships Victoria* (p. 8) and the *Guidelines for Privately Financed Projects* (p. 10) issued by the NSW Government both include a specific public interest test, incorporating a requirement for adequate accountability and transparency.
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- <sup>56</sup> Commonwealth Policy Principles For The Use of Private Financing 2002, op. cit., p. 11.
- <sup>57</sup> Victorian Public Accounts and Estimates Committee 2002, Issues Paper: *Inquiry into Corporate Governance in the Victorian Public Sector*, Melbourne, April, p. 11.
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- <sup>59</sup> NSW Public Accounts Committee 2001, *Inquiry into the Funding of Capital Projects by the New South Wales Government: Parramatta Rail Link Pre-Tender Procurement – A Case Study*, Report No.126, Sydney, January, p. 31.
- <sup>60</sup> NSW Public Accounts Committee 2002, *Case Studies and Issues in the Private Financing of Public Infrastructure and Services*, Report No.134, Sydney, October, p. 1.
- <sup>61</sup> Victorian Auditor-General's Office 2002, *Report on Public Sector Agencies, June 2002*, Melbourne, paragraph 3.7.
- <sup>62</sup> *ibid.*, paragraph 3.9.
- <sup>63</sup> *ibid.*, paragraphs 3.10-3.12.
- <sup>64</sup> *ibid.*, paragraph 3.13.
- <sup>65</sup> *ibid.*, paragraphs 3.14-3.17.
- <sup>66</sup> *ibid.*, paragraph 3.23.
- <sup>67</sup> Department of the Parliamentary Library 2002, op. cit. p. 7.
- <sup>68</sup> UK National Audit Office, 2001, *Department of the Environment, Transport and the Regions: The Channel Tunnel Rail Link*, op. cit., p.1.
- <sup>69</sup> *ibid.*, p. 3
- <sup>70</sup> *ibid.*
- <sup>71</sup> Arthur Andersen and Enterprise LSE, 2000, *Value for Money Drivers in the Private Financing Initiative*, Report commissioned by The Treasury Task Force, London, January, pp.21-23
- <sup>72</sup> UK National Audit Office 1999, *Examining the value for money of deals under the Private Financing Initiative*, Appendix 2: 'Risk Allocation', London, August, p. 64.
- <sup>73</sup> UK National Audit Office 2002, *The Public Private Partnership for National Air Traffic Services Ltd*, Report by the Comptroller and Auditor General HC 1096, Session 2001-2002, London, July, p. 1.
- <sup>74</sup> *ibid.*
- <sup>75</sup> *ibid.*, p.43.
- <sup>76</sup> *ibid.*
- <sup>77</sup> The Economist, 1994, 'Watching the boss: A survey of corporate governance,' 29 January, p. 18.
- <sup>78</sup> ANAO Audit Report No.11 2001-02, *Administration of the Federation Fund Programme*, Canberra, 19 September.

<sup>79</sup> *ibid.*, p.17

<sup>80</sup> *ibid.*

<sup>81</sup> Lewis, Mervyn K. 2002, *op. cit.*, p.6.

<sup>82</sup> In the 1996 Third Tranche Sale of the Commonwealth Bank of Australia, 30 per cent of selling commissions on sales to institutions were reserved for selling syndicate members with the remaining 70 per cent allocated among all stockbrokers according to how many shares they sold. In the 1997 Telstra Initial Public Share Offer, the competitive component of the commission in institutional sales was reduced to 60 per cent, meaning a higher proportion of commissions was allocated to brokers in the selling syndicate rather than rewarding selling performance.

<sup>83</sup> ANAO Audit Report No. 10 1998-99, *Sale of One-Third of Telstra*, Canberra, 19 October.

<sup>84</sup> Statement of Accounting Standard AAS21 1985, '*Accounting for the Acquisition of Assets (including Business Entities)*'.

<sup>85</sup> ANAO Audit Report No. 20 2000-01, *Second Tranche Sale Telstra Shares*, Canberra, 30 November.

<sup>86</sup> ANAO Audit Report No. 4 2001-02, *Commonwealth Estate Property Sales*, Canberra, August.

<sup>87</sup> *ibid.*, p. 89.

<sup>88</sup> Fahey, John The Hon, Minister for Finance and Administration 2001, Transcript, *The World Today*, 2 August.

<sup>89</sup> Humphry, Richard 2000, *Review of the Whole of Government Information Technology Initiative*, Canberra, pp. 10, 13, 30, 31 and 32.

<sup>90</sup> ANAO Audit Report No. 9 2000-01, *Implementation of Whole-of-Government Information Technology Infrastructure Consolidation and Outsourcing Initiative*. Canberra, 6 September, p. 177.

<sup>91</sup> *ibid.* p. 171.

<sup>92</sup> Humphry, Richard 2000, *op. cit.* p.10.

<sup>93</sup> *ibid.*

<sup>94</sup> Fahey, John The Hon 2001. *Review of the Implementation of the Whole of Government Information Technology Outsourcing Initiative*, Media Statement, Canberra, 12 January.

<sup>95</sup> 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, Canberra, August, p.xv.

<sup>96</sup> *ibid.*, p. xvi.

<sup>97</sup> Industry Commission 1996, *Competitive Tendering and Contracting by Public Sector Agencies*, Report No.48, Melbourne, 24 January.

<sup>98</sup> For example, ANAO Audit Report No. 10 1998-99, *Sale of One-third of Telstra*, 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.

<sup>99</sup> ANAO Audit Report No. 34 1999-2000, *Construction of the National Museum of Australia and Australian Institute of Aboriginal and Torres Strait Islander Studies*, Canberra, 16 March, p. 13.

<sup>100</sup> *ibid.*

<sup>101</sup> *ibid.*

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- <sup>102</sup> Senate Finance and Public Administration References Committee 1998, *Contracting Out of Government Services*, Second Report, The Parliament of the Commonwealth of Australia, Canberra, May.
- <sup>103</sup> Barrett, P. 2000, *What's New in Corporate Governance*, a presentation to the CPA Australia Annual Congress, Adelaide, 17 November, pp. 30-31.
- <sup>104</sup> O'Looney, J. A. 1998, *Outsourcing State and Local Government Services – Decision-Making Strategies and Management Methods*. Quorum Books, London, p. 147.
- <sup>105</sup> Industry Commission 1996, *Competitive Tendering and Contracting by Public Sector Agencies*, AGPS, Canberra, pp. 333-5.
- <sup>106</sup> Seddon, N. 1995, *Government Contracts: Federal, State and Local*, Federation Press, Sydney, p. 74.
- <sup>107</sup> OECD – Public Management Committee 1999, *Performance Contracting*, Lessons from Performance Contracting Case Studies, OECD, Paris, 17 November, p. 41.
- <sup>108</sup> ANAO Audit Report No. 24 1997-98, *Matters Relevant to a Contract with South Pacific Cruise Lines Ltd*, Canberra, 15 December.
- <sup>109</sup> ANAO Audit Report No. 34 1997-98, *New Submarine Project*, Canberra, 24 March.
- <sup>110</sup> ANAO Audit Report No. 24 1999-2000, *Commonwealth Management and Regulation of Plasma Fractionation*, Canberra, 22 December.
- <sup>111</sup> UK National Audit Office 2001, *Managing the relationship to secure a successful partnership in PFI projects*, op. cit., p.1.
- <sup>112</sup> McIntosh, M. K. and Prescott, J. B. 1999, *Report to the Minister for Defence on the Collins Class Submarine and Related Matters*, Commonwealth of Australia, Canberra, p. 29.
- <sup>113</sup> Audit Review of Government Contracts 2000, *Contracting, Privatisation, Probity and Disclosure in Victoria 1992-1999: An Independent Report to Government*, Report, State Government of Victoria, Melbourne, May, p. 30.
- <sup>114</sup> ANAO Audit Report No. 63 2001-02, *Management of DASFLEET Tied Contract*, June, pp. 49-51.
- <sup>115</sup> ANAO Audit Report No. 9 2000-01, op. cit. p. 198.
- <sup>116</sup> *ibid.*, p. 241.
- <sup>117</sup> Victorian Auditor-General's Office 1999, *Victoria's prison system: Community protection and prisoner welfare*, op. cit., paragraph 5.42-5.44.
- <sup>118</sup> Blake Dawson Waldron 2000, *Canberra Notes—A Summary of Current Developments*, Issue No. 1, January, pp. 13-14.
- <sup>119</sup> Kheir, Majed 2001, Diagnosing accountability and ensuring responsible corporate governance when outsourcing in the public sector, Address to IIR Conference 'Managing Risks When Outsourcing in the Public Sector', Canberra, 2 May, p. 8.
- <sup>120</sup> *ibid.*
- <sup>121</sup> ANAO Audit Report No. 9 2000-01, op. cit., p. 235.
- <sup>122</sup> ANAO Audit Report No. 9 2000-01, op. cit., p. 235.
- <sup>123</sup> Joint Committee of Public Accounts and Audit 2000, *Contract Management in the Australian Public Service*, Report 379, The Parliament of the Commonwealth of Australia, Canberra, 2 November.
- <sup>124</sup> ANAO Audit Report No.12 1999-2000, *Management of Contracted Business Support Processes*, Canberra, 14 October.
- <sup>125</sup> ANAO Audit Report No. 42 1999-2000, *Magnetic Resonance Imaging Services—Effectiveness and Probity of the Policy Development Process and Implementation*, Canberra, 10 May.
- <sup>126</sup> ANAO Audit Report No. 14 2002-03, *Health Group IT Outsourcing Tender Process*, Canberra, 29 October, p. 31.
- <sup>127</sup> *ibid.*



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<sup>128</sup> ANAO Audit Report No. 45 2001-02, *Recordkeeping*, Canberra, May.

<sup>129</sup> Joint Committee of Public Accounts and Audit 2001, *Review of the Auditor-General Act 1997*, Report No. 386, Canberra, August, quoted in Barrett, P. 2002, *Some Perspectives on the Audit Relationship with Parliament*, op. cit., p.4.

<sup>130</sup> Commonwealth Policy Principles For The Use of Private Financing, op. cit., p. 11.

<sup>131</sup> Stewart, Dr Jenny 2001, *Hands off the Auditor!*, in the Public Sector Informer, Canberra, October, p. 6.

<sup>132</sup> Australasian Council of Auditors-General 1997, *Statement of Principles: Commercial Confidentiality and the Public Interest*, Canberra, November.

<sup>133</sup> Senate Finance and Public Administration References Committee 2001, *Accountability in a Commercial Environment – Emerging Issues*, Interim Report, Inquiry into the Government's Information Technology Outsourcing Initiative, Parliament of the Commonwealth of Australia, Canberra, April, p.21.

<sup>134</sup> *Freedom of Information Act 1982*, section 43.

<sup>135</sup> de Maria, W 2001, *Commercial-in-Confidence: An Obituary to Transparency?*, Australian Journal of Public Administration, vol. 60, no. 4, p.93.

<sup>136</sup> Barrett, P. 2002, *Some Perspectives on the Audit Relationship with Parliament*, op. cit., p.10.

<sup>137</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Government's Information Technology Outsourcing Initiative*, op. cit., pp. 159-160.

<sup>138</sup> Senate Finance and Public Administration References Committee 2001, *Re-booting the IT agenda in the Australian Public Service*, Government Senators' Minority Report, *Final Report on the Government's Information Technology Outsourcing Initiative*, Parliament of the Commonwealth of Australia, Canberra, August, p.240.

<sup>139</sup> Senate Finance and Public Administration References Committee 2001, *Accountability in a Commercial Environment – Emerging Issues*, op. cit., p.26.

<sup>140</sup> Australasian Council of Auditors-General 1997, op. cit.

<sup>141</sup> 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 Audit Report No 38 2000-01, *The Use of Confidentiality Provisions in Commonwealth Contracts.*, Canberra, 24 May, p. 13.

<sup>142</sup> *ibid.*, p. 15.

<sup>143</sup> *ibid.*, p. 55-60.

<sup>144</sup> *ibid.*, p. 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.

<sup>145</sup> *ibid.*, p. 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.

<sup>146</sup> 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).

<sup>147</sup> ANAO Audit Report No. 8 2002-03, *The Senate Order for Department and Agency Contracts (September 2002)*, Canberra, September, p. 12.

<sup>148</sup> ANAO Audit Report No. 33 2001-02, *Senate Order of 20 June 2001 (February 2002)*, Canberra, February and ANAO Audit Report No. 8 2002-03, *The Senate Order for Department and Agency Contracts (September 2002)*, Canberra, September.

<sup>149</sup> ANAO Audit Report No. 8 2002-03, op. cit., p. 15.

<sup>150</sup> *ibid.*, p. 16.

<sup>151</sup> Dr Nick Seddon, quoted in Senate Finance and Public Administration References Committee 2001, *Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts*, op. cit. p.4.

<sup>152</sup> Senate Finance and Public Administration References Committee 2002, *Departmental and agency contracts: Report on the first year of operation of the Senate Order for the production of lists of departmental and agency contracts*, Senate Printing Unit, Parliament House, Canberra, December.

<sup>153</sup> *ibid.*, p. 33.

<sup>154</sup> *ibid.*, pp. 36-51.

<sup>155</sup> Tasmanian Department of Treasury and Finance, 2000, op cit. p. 9.

<sup>156</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts*, op. cit. p.8.

<sup>157</sup> The Victorian Public Accounts and Estimates Committee had earlier also endorsed the view that the decision as to whether or not to disclose commercially sensitive information should be made according to the general principle that information should be made public unless there is a justifiable reason for withholding access to it; *Inquiry into Commercial in Confidence Material and the Public Interest*, 35<sup>th</sup> Report to Parliament, Melbourne, March 2000, p. xxxi.

<sup>158</sup> New South Wales Government 2001, *Working with Government: Policy for Privately Financed Projects*, Sydney, November, p. 2.

<sup>159</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts*, op. cit., p.8.

<sup>160</sup> Audit Office of New South Wales 1999, *Contracting Out Review Guide*, Sydney, June, p.1.

<sup>161</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts*, op. cit., p.5.

<sup>162</sup> *ibid.*, p.7.

<sup>163</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Government's Information Technology Outsourcing Initiative*, op. cit, p.164.

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<sup>164</sup> Audit Office of New South Wales 1995, *Roads and Traffic Authority: The M2 Motorway*, Sydney, January, p. 3.

<sup>165</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Government's Information Technology Outsourcing Initiative*, op. cit. p.167.

<sup>166</sup> For example, Section 50 of the Australian Constitution empowers the Senate to delegate to committees certain powers to conduct inquiries. The Senate Standing Orders, the Senate's rules for the conduct of its proceedings made in accordance with Section 50 of the Constitution, confer on committees the power to invite the attendance of a person or the production of a document, and if that invitation is declined, to require the attendance of that person, or that document.

<sup>167</sup> *Egan vs Willis and Egan vs Chadwick & Ors*, referenced in Sendt, B. NSW Auditor-General 2002, *Keeping Governments Accountable: The Taxpayer's Right to Know*, Presentation at Seminar, Institute of Chartered Accountants of New Zealand, 25 March.

<sup>168</sup> Odgers' *Australian Senate Practice*, 10<sup>th</sup> Edition, 2001, p. 398: Odgers' identifies the two qualifications as: there is probably an implicit limitation on the power of the Senate to summon members of the other House or of a state or territory legislature, and this limitation may extend also to all state officers. It may also be held that the investigatory power of committees is limited to matters within Commonwealth legislative power as delineated by the Constitution. Neither possible limitation has been adjudicated.

<sup>169</sup> Odgers' *Australian Senate Practice*, op. cit., p. 398.

<sup>170</sup> Senate Finance and Public Administration References Committee 2001, *Inquiry into the Government's Information Technology Outsourcing Initiative: Accountability Issues, Two Case Studies*, The Parliament of the Commonwealth of Australia, Canberra, June, p. 31.

<sup>171</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Government's Information Technology Outsourcing Initiative*, op. cit. p. 166.

<sup>172</sup> *ibid.*, p.167.

<sup>173</sup> Odgers' *Australian Senate Practice*, op. cit., p. 482.

<sup>174</sup> Senate Finance and Public Administration References Committee, *Final Report on the Government's Information Technology Outsourcing Initiative*, op. cit., p.157.

<sup>175</sup> *ibid.*, p.6.

<sup>176</sup> *ibid.*,

<sup>177</sup> *ibid.*, p.168.

<sup>178</sup> Australasian Council of Auditors-General 1997, op. cit.

<sup>179</sup> Commonwealth Procurement Guidelines, September 2001, subsection 1.2.

<sup>180</sup> Commonwealth Policy Principles For The Use of Private Financing, op. cit., p. 11.

<sup>181</sup> *ibid.*

<sup>182</sup> Australasian Council of Auditors-General 1997, op. cit.

<sup>183</sup> *ibid.*

<sup>184</sup> Victorian Public Accounts and Estimates Committee 2000, *Inquiry into Commercial in Confidence Material and the Public Interest*, op. cit.

<sup>185</sup> *ibid.*, pp. xix and. 80-81.

<sup>186</sup> 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.*

<sup>187</sup> Senate Finance and Public Administration References Committee 2001, *Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts*, op. cit., p.7.

<sup>188</sup> Mulgan, Richard 2000, *Comparing Accountability in the Public and Private Sectors*, Australian Journal of Public Administration, Vol.59, No.1, March, p. 96.

<sup>189</sup> Hughes, Owen E. 1998, *Public Management and Administration – An Introduction*, Second Edition, Macmillan Education Australia, Melbourne, p. 229.

<sup>190</sup> Senate Finance and Public Administration Legislation Committee 2000, *Report on 1998-99 Annual Reports*, Parliament of the Commonwealth of Australia, Canberra, March, p. 9.

<sup>191</sup> Harris, A. C., New South Wales Auditor-General 1998, *Accountability and Commercialisation in the Public Sector*, presented to CPA Congress '98, Technical Session 31, Tuesday 13 October.