

Secretaries' Forum

Seeking to Make a Real Difference: Confronting Long- held Cultures and Attitudes

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SEEKING TO MAKE A REAL DIFFERENCE:
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ATTITUDES

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I. INTRODUCTION

A significant part of my role as Auditor-General is as a catalyst to continuous improvement in the public sector. The major imperative is to achieve accountability for performance both in the ways resources are used and for the purposes (objectives) identified by the Government and/or Parliament, notably in legislation. The public sector, particularly over the past few years, has operated in an environment of dynamic change. The Government has instituted significant changes to public sector management, complemented by principles-based legislation which provides greater flexibility in decision-making in order to achieve better performance.

My role is not, therefore, simply confined to audit of financial statements nor of compliance with, say, legislation. The Australian National Audit Office's (ANAO's) major aim is to add value to public administration. We do this by both contributing to the development of public service reforms and by providing assurance that those reforms are being implemented efficiently and effectively in public sector agencies and bodies. But, more broadly than this, my Office works hard to confront inbred, or long-held, cultures and attitudes within the public sector to help facilitate the adjustments necessary for a successful transition to a more contestable and more demanding environment which is increasingly involving the private sector as an active partner, supplier and competitor.

In the Commonwealth public sector we have long been conscious of the need to move towards, and adopt, best practice wherever that may be found. The environment described above puts personal pressure on all of us to be accountable and to do better, in particular to find new and better ways of delivering quality public services while continuing to meet prescribed ethical and professional standards. These demands reflect changing community views and expectations about the role and performance of government and its supporting bureaucracy. It is in this very visible context that we perform beyond our assurance role to promote and encourage the implementation of better practices and a commitment to achieve high level results or outcomes.

The Government has accepted the basic principles set down by the National Commission of Audit for determining what activities should be undertaken within the public sector National Commission of Audit 1996. *Report to the Commonwealth Government*, AGPS, Canberra, June.

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

- Assess whether or not there is a role for government.

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

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

The Committee recommended that agencies should be required to market test all activities over the next 3 to 5 years unless there is a good reason not to do so (page 84). This is now government policy.. As you may know, this has led to an increase in privatisation and outsourcing of government services and activities. But it has also meant that even traditional 'core' government services have become more contestable or have had to be more directly competitive with private sector providers. Undoubtedly, one of the most significant developments in public service reform has been the requirement to test the market with a view to determining the most efficient and effective method of service delivery.

In the time available, I will identify briefly some of these major changes occurring in the public sector and their implications both for public audit and for a more results oriented public sector. I will also discuss some of the major challenges we face as public sector administrators and how we are addressing them. I will indicate how we are learning from the private sector in implementing these changes and solutions, and possibly how the private sector could learn from us, say, on control structures as part of good corporate governance. But first, I need to outline briefly my role and mandate to assist your understanding and perspective of the ANAO's contribution to public administration.

II. THE ROLE OF THE AUDITOR-GENERAL

The Auditor-General is the external auditor of the Commonwealth Public Sector. Briefly put, I provide an independent view of the performance and financial management of Commonwealth public sector agencies and bodies. My performance audit reports, numbering about 50 per year, and around 320 audit opinions on financial statements, are an important means of assisting the Parliament to fulfil its accountability role on behalf of the Australian community. In round figures, I am assisted by 280 staff in the ANAO, a statutory body, with a budget of \$50 million of which a quarter is outsourced to the private sector for the provision of audit and other services.

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The vision of my office is 'to achieve recognised excellence in public sector audit services.' In a continuing environment of change, our key values are independence, objectivity, professionalism, and knowledge and understanding of the public sector environment. We are highly regarded for the role we play in encouraging improved accounting and financial management practices that contribute to the efficient functioning and processes of the public sector. One of our most important values is a client focus. We challenge the traditional 'gotcha' mentality usually attributed to auditors. Rather, we see ourselves as well-placed to assist agencies to manage their functions (business) in a WIN-WIN outcome. We focus on adding 'real' value to public administration, that is, more than just audit providing an assurance of 'compliance', important though that might be. No-one wants fraud and corruption but, equally, no-one wants waste, inefficiency or programs that do not meet their objectives cost effectively.

The Office of the Auditor-General was originally established under the *Audit Act 1901*, the fourth Act of the Australian Parliament. From 1 January last year, that Act was replaced with three Acts which provide a robust framework for the financial management of the Commonwealth public sector. The three Acts are:

- (a) The Auditor-General Act which provides for the appointment, independence, status, powers and responsibilities of the Auditor-General; the establishment of the ANAO, and for the audit of the ANAO by the Independent Auditor.
- (b) Financial Management and Accountability Act (FMA) which sets down the financial regulatory/accountability/accounting (accrual based) framework for Commonwealth bodies that have no separate legal existence of their own (ie they are simply agents of the Commonwealth)
- (c) Commonwealth Authorities and Companies Act (CAC) which provides standardised accountability, ethical and reporting provisions for Commonwealth bodies that have a separate legal existence of their own (eg Commonwealth controlled companies and their subsidiaries and those statutory authorities whose enabling legislation gives them legal power to own money and assets).. They took almost ten years in the making and will contribute to evolve, hopefully without significant change, as they are largely principles, rather than process, based legislation.

The Office of the Auditor-General and the Australian National Audit Office are now established by the *Auditor-General Act 1997*. Under the Act, the Auditor-General is an 'Independent Officer of the Parliament'. That description reflects the concern to emphasise the total independence of the Auditor-General. In short, I cannot be directed by anyone in relation to the performance of my functions. But that certainly does not mean I operate without reference to the Executive and the Parliament. Nor does it mean I have an 'open cheque book' for resources.

Our principal client is the Parliament. We maintain a strong relationship with the Parliament, working through the Joint Committee of Public Accounts and Audit (JCPAA) as the Audit Committee of the Parliament. That Committee has the responsibility to review the resources for the ANAO and recommend to the

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Parliament an annual budget for the Office. As well, we have considerable involvement with other Committees which may also review our reports. However, the accountability of the Parliament means that we too are ultimately accountable to the Australian people.

The Government is accountable to its citizens for the provision of public services, in at least two interrelated ways. First, it has to ensure that the public sector provides quality services that are appropriate, effective and equitable, at minimum cost to the taxpayer. This is a major driver behind the Government's policy of 'market testing' public services to improve their effectiveness. However, the Government also has to ensure that the accountability, and therefore transparency, of the public sector in the delivery of these services is maintained, and, indeed I would argue, enhanced over time. It is the balance between these responsibilities that is difficult to ascertain and maintain. My Office's role is to provide assurance to the Parliament and the people on these two aspects, that is, public sector performance and accountability for that performance. While the public sector reforms demand a greater focus on achieving efficient and effective outcomes for citizens, we also need to recognise that such outcomes also depend importantly on robust and credible administrative and management processes.

III. THE AUDIT MANDATE

I am mandated to conduct financial statement audits and performance audits of Commonwealth agencies, authorities and owned and controlled companies. Government Business Enterprises are not subject to performance audits as a matter of course. However, I can be requested to conduct a performance audit of these bodies by the responsible portfolio Minister, the Finance Minister or the JCPAA. This is a new initiative embodied in the Auditor-General Act but which has not yet been used.

To meet my responsibilities to the Parliament, the Government, audit clients, public sector agencies and the general public, my office produces a range of audit reports and related products and services. The latter are intended to assist public sector entities to improve their performance and accountability as well as to better manage their business. The audit strategy is to deliver an integrated audit service comprising a range of different types of audits tailored to the needs of our clients and which complement other internal or external reviews, investigations and evaluations. The main products are financial statement and performance audits, complemented by audits of financial control and administration, and assurance control and assessment audits, as well as better practice guides. These are briefly explained below. More detail can be found in our recently released Audit Activity Report. ANAO Report No.33, 1998-99, *'Audit Activity Report: July to December 1998 - Summary of Outcomes'*, Canberra.

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We are committed to providing sound, efficient and professional auditing services that are timely, cost-effective, and reflect international best practice. The emphasis is on quality. This is achieved largely through personal development programs focussing on leadership and professional skills, which we complement with outside expert advice and assistance as required. Under the Auditor-General Act I am required to publish my auditing standards which are based largely on professional accounting standards. All of our products conform to professional auditing standards. Innovative audit methodologies and technology are developed and applied to all our work. Our audits are benchmarked against best practice in both the public and private sectors and reports are produced on structured, well-founded analysis and evidence.

One notion we have learned from the private sector, and still do, is the necessity of providing a quality service to clients. This has increasingly been recognised as fundamental to the operations of any organisation providing a service.

The ANAO worked with the former Department of Industry, Science and Tourism and the Management Advisory Board in 1997 to produce a Better Practice Guide and tool kit on Quality in Customer Service MAB/ANAO 1997. *Better Practice Guide to Quality in Customer Service*, Canberra, November.. This Guide was aimed at the broad public sector as providing assistance in the implementation of a client focus in our operations.

As with other elements of a more contestable public service environment, such as contract management, customer or client service to Australia citizens is not a discretionary activity, nor is it just a process. It represents a cultural change for most public servants. To an extent it is a mindset problem but quality service also demands different skills from those that have traditionally been required in the public service.

My Office is seeking to improve its own client focus through a more pro-active association with the Parliament, agencies and entities. We also have and will continue to review the progress of agencies towards adopting and implementing a client focus as part of our audit processes. In addition, as the concept of client service continues to evolve in the public sector, we will identify better practices and promote them to all agencies. You may be interested in an audit report that examined client service initiatives being taken by the Australian Trade Commission (Austrade). ANAO Report No. 4, 1998-99. *'Client Service Initiatives - Australian Trade Commission (Austrade)'*, Canberra.

Auditing Financial Statements

My financial statement mandate covers audits of government departments, statutory authorities and government business enterprises. The public sector is currently facing a number of challenges with the recent changes to the financial

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reporting environment. The new legislation I mentioned earlier, primarily the *Financial Management and Accountability Act 1997*, has resulted in a reduction in centralised control and monitoring, and this is being accompanied by the introduction of accrual budgeting and accounting. The major challenge for the public service is to manage outputs and outcomes on an accrual basis.

Through our financial statement audits, we aim to improve the standard of financial management and administration across the public sector. We work through a number of means, such as client seminars, the publication of a quarterly Financial Reporting Bulletin and acting in an observer role on public sector audit committees, to provide professional advice and assistance in relation to auditing and accounting matters generally. Audits of financial control and administration are conducted as major cross-agency investigations focussing on financial control and administration issues, including common support business processes such as purchasing. Assurance control and assessment audits examine basic administration processes in agencies to provide assurance that agencies are meeting their obligations under financial legislation, for example, receipts and payments of money and payroll arrangements.

The first audited Whole-of-Government financial statement report on an accrual basis was prepared for the year 1996-97 Department of Finance and Administration 1998, *'Consolidated Financial Statements for the Year Ended 30 June 1997'*. Commonwealth Government of Australia, Canberra.. The report is based on an accrual accounting approach for all Commonwealth agencies and bodies, similar to that used in the private sector, and is accompanied by a commentary on overall financial management by the Government. Such a report contributes to improved public sector management, by providing credible information upon which more informed decisions can be made about the Government's overall objectives and choices about the allocation of scarce resources to its various priorities and commitments. Primary statements focus on revenue and expenses (to show financial performance); assets and liabilities (to show financial position); and cash flows (to show how activities are financed).
Ibid., (page 5).

The move towards both accrual budgeting and reporting is an important element in assisting departments and agencies to develop useful performance information systems. It will help agencies to become more outcome-focussed in reporting, providing improved information to both agency management and the Parliament and encouraging an effective corporate governance framework.

Performance Audits

Performance Audits evaluate the economy, efficiency and effectiveness of the management of public sector entities by examining and assessing resource use, information systems, performance outputs and outcomes including indicators and measures, monitoring systems and legal compliance. Performance audits can

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take a number of forms: as an audit of a selected function within an agency, such as the management of a contract; or an audit of a selected function across several agencies, such as approaches to dealing with the Year 2000 computing problem.

There are also broader performance audits which evaluate the performance of a large number of agencies in regard to a specific issue, for example management of assets or the internal audit function, with the results summarised as a general report card on the performance of the agencies concerned. Depending on the subject and nature of information collected during the audit, we might produce a Better Practice Guide. Such guides aim to assist agencies and other bodies to test their own systems and, where applicable, improve their practices and performance. As well, these guides may be used by the ANAO as a checklist for review of management action, or lack of action, in later audits. In part, this check was instituted to provide assurance to the JCPAA of appropriate follow-up action on audits of financial control and administration.

An Integrated Audit Service

As I have already mentioned, we aim to provide an integrated audit service that assists agencies with all aspects of their operation. As an example of this I will briefly discuss our work on internal audit in agencies. During the financial statement audit process each year, we evaluate the effectiveness of internal audit in terms of assessing its contribution, if any, to the financial audit process. In addition, we also periodically assess the internal audit function from a broader perspective; for instance, in terms of its overall contribution to the internal control structure of an organisation and the value it adds to management decision-making.

More broadly still, in the past year we have conducted a financial control and administration audit of internal audit arrangements across a number of agencies. This was tabled as a report to Parliament on the status across the public sector of the internal audit function. To accompany the audit, we released a better practice guide *New Directions for Internal Audit* ANAO Better Practice Guide 1998. '*New Directions for Internal Audit: A Guide for Public Sector Managers*', July.. This guide draws on the good practices identified through our various audits of agencies as well as drawing on other local and international experience to provide practical guidance to agencies on their internal audit arrangements. We anticipate that agencies will draw on the good practices identified in this Guide and apply them to their audit function, thus improving internal audit across the public sector.

Internal audit is only one of several issues we address in this manner.

In addition to the more formal side of our business, an integral part of our performance and financial statement audits is the advice and assistance provided to agencies during the course of an audit. We often find that our presence in an

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agency helps to focus management's attention on particular issues, thus preventing minor problems from becoming major ones. A particularly pleasing feature of our audit work is the increasing extent to which agency management is willing to discuss and adopt our suggestions during the course of an audit. Much of such activity is not formally reported but, nevertheless, can make an important contribution to improved public administration.

IV. AUDITING IN A MORE CONTESTABLE PUBLIC SECTOR ENVIRONMENT

Convergence of the public and private sectors

As I mentioned in my introduction, the public sector is undergoing significant changes. In particular, the introduction of the notion of contestable service delivery has led to the outsourcing of a growing proportion of public sector activity, even in so-called 'traditional' public services such as policy advising and delivery of social welfare. That is, not only is the private sector providing more goods and services to the public sector but it is also delivering an increasing range of public services direct to citizens, often in competition with the private sector. The public sector is shifting from being a provider of services to a purchasing role. Such 'privatisation' of the public sector has also been accompanied by a growing 'commercialisation' of public sector organisations in both their structures and ways in which they operate.

I have already alluded to the movement of the Commonwealth public sector towards an integrated accrual-based, outcomes and output focused resource management framework. This latter framework will increase the emphasis on the performance and accountability of the Australian Public Service. The difficulty is to identify in a practical and quantifiable way, where feasible, just what these concepts actually convey in terms of reporting results.

Delivering improved public sector accountability in a more devolved and flexible environment is an important focus of our work. Key themes for contemporary public sector management that have emerged from our audits have related to performance information, procurement and contract management and asset management. These themes have raised questions about what is the 'bottom line' for the public sector; its relationship with the private sector in procuring, and contracting for, goods and services; and in making best use of, and preserving, public sector assets which, under a cash-based system, were often taken for granted by public sector managers and regarded as virtually 'costless'.

The bottom line is essentially about maintaining broadly defined accountability for, and achievement of, the performance of the public sector. The contracting out of

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services requires a robust accountability framework to ensure that the transparency of the government's use of resources is preserved. A major contributor to this is the maintenance of accurate, informative and current performance information. Performance information is more than just about reporting against the financial bottom line and includes a whole range of non-financial requirements such as compliance with legislation, fair play, equity, justice and privacy. It is also about providing assurance about an agency's performance against its targets. This assurance relates to all aspects of an agency's operations: in addition to the management of assets, it takes in a broad range of information about how the work of the agency is contributing to the achievement of its goals and objectives.

I will discuss later the importance of this performance reporting in the public sector. However, the important difference in this respect between the public and private sectors is the imperative for the public sector to retain the accountability for, including the transparency of, its management and administrative processes.

Over the past decade there has been a gradual convergence of the public and private sectors. From your perspective, you might see this as a shift in public sector practices towards those of the private sector. Certainly we have compared our practices in the ANAO with those of the private sector accounting firms and attempted to bring our practices closer to those of our 'competitors' or, more strictly correct, those with whom we should be 'contestable'. The latter is in the nature of a benchmarking exercise since, as I have already indicated, I am mandated to conduct financial statement and performance audits of all public sector entities. However, as you may be aware, changes in other jurisdictions have meant that, for example, the Victorian Auditor-General has virtually no capacity for audit work and relies increasingly on private sector accounting firms for audit capacity.

The approach I have taken in this more contestable environment is to define clearly our 'core' business and the 'critical mass' of resources needed to deliver that business efficiently and effectively. In short, our core business is to provide a totally integrated audit service covering all budget funded agencies and statutory bodies particularly those that make up the bulk of activity reflected in the Whole of Government financial statements. Our 'non-core' business relates to statutory bodies, mainly Government Enterprises (GBEs), that derive their own revenues from their activities and are generally in competition with the private sector, for example Telstra and Australia Post. We also outsource a range of audit work in budget funded agencies and/or their Offices in locations other than Canberra on economic grounds. As well, we are rotating segments of our core business as an experiential and benchmarking opportunity. Outsourced audits provide both a window into the activities of the public sector agencies or statutory bodies involved and an opportunity for learning about private sector expertise and practices and for personal development of ANAO staff.

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There are many issues of key importance that I continue to identify in my work in the public sector that are relevant to, and often drawn from, the operations of private sector companies. For example, issues of contract management, purchasing processes, life-cycle costing, asset management, control structures, risk management and corporate governance, the importance of which I emphasise in my public sector work, are equally relevant to, and practised by, the private sector. The remainder of this address canvasses some of the issues involved which will give you a greater appreciation of the similarities of interest and the interactions that occur, or need to occur, if the public sector is to achieve the required results and outcomes.

Purchasing Public Goods and Services

Traditionally, purchasing in the public sector has focused on goods such as equipment, facilities, furniture and stationery. Today, it encompasses the purchase of services previously delivered in-house, such as information technology and, possibly more significantly, the public sector is purchasing the services of third parties to deliver a range of social, industrial and other services to the public.

In addition, the public sector has carried a high level of social and political responsibility and accountability in respect of procurement of the many services it needs to operate effectively. These responsibilities flow primarily from the fact that public interest demands, among other things, achievement of value for money and fairness in the treatment of potential suppliers to government. However, the increasing emphasis on purchasing in the public sector has raised the profile of the public interest in an across sectoral manner. This has had particular implications for other fundamental principles such as open and effective competition, accountability and reporting, national competitiveness and industry development, and support for other Commonwealth policies.

The purchasing power of the Government is not insignificant. Focusing the purchasing decisions of the Government has the potential to provide great opportunities for Australian business. The Department of Finance and Administration (DoFA) has recently released new industry development criteria relating to the letting of large Government contracts Department of Finance and Administration 1999. *'Model Industry Development Criteria for Major Projects'*. (http://www.ctc.gov.au/toolkits/Indevel/guidenotes_main.htm). These criteria focus government officials' attention on the importance of local industry development, by asking agencies to take into account the need to provide opportunities for small and medium enterprises. The guidelines also focus on other issues such as the development of the Australian stock of industrial plant and equipment; the potential to provide a springboard for innovation, research and development; and the potential to boost employment and training in regional areas.

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The development of such guidelines is timely given the new regulatory framework under which agencies are operating following the enactment of the Financial Management and Accountability Act. The Act provides greater financial flexibility for Chief Executive Officers (CEOs). The guidelines are important in providing direction to CEOs to ensure that the potential of the government's purchasing power to benefit Australian business is not wasted.

Another initiative in promoting the use of small and medium Australian businesses is the endorsed supplier system. This system allows for companies to register as Commonwealth endorsed suppliers. If the company is assessed as meeting certain quality standards, its details are then promoted to Commonwealth agencies. This system has recently been expanded from information technology and major office machines to include office furniture and auctioneering services.

The Financial Review 1999, *'SMEs Win New Guidelines'*. 27 February (page 61)

The procurement of goods and services pervades virtually all government programs; involves substantial direct and indirect expenditure; and directly or indirectly supports a large segment of Australian industry. It is therefore important that purchasing activity is conducted within a well-developed framework to ensure the consistency of processes in meeting the specified requirements for government purchasing.

The JCPAA is currently in the process of conducting an inquiry into purchasing policy and practice in the government JCPAA 1999. *'Inquiry Into the Australian Government's Purchasing Policy and Practice'*, Canberra.. One of the focuses of this inquiry is on the assurance that the government has that its approaches to purchasing are both fair and provide value for money. I made a submission to this inquiry in September of last year as we have conducted a number of audits that have assessed purchasing activities and the contracting processes. Important issues which we have identified as common concerns in the government purchasing process include:

- whether the process has obtained value for money;
- whether purchase arrangements have been successful in continuing to deliver value for money after the initial contractor selection;
- whether there were measures in place to assess the ongoing effectiveness of the purchase arrangements; and
- whether the evaluation processes used in contractor selection found that the processes adhered to the guidelines for the development of Australian and New Zealand industry.

One of the major challenges facing public sector managers is the management of large contracts to ensure that they are obtaining value for money for the Commonwealth while maintaining adequate accountability for the results including

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quality service delivery. This is particularly evident in the Department of Defence with a range of significant acquisitions which have marked implications for Australian business. I have recently received a copy of a submission by the Defence Council of the Australian Industry Group expressing reservations about comments in audit reports concerning the Jindalee Operational Radar Network (JORN) Project Audit Report No. 28, 1995-96. *'Jindalee Operational Radar Network (JORN) Project'*, Canberra. and the New Submarine Project Audit Report No. 34 1997-98. *'New Submarine Project'*, Canberra.. Their basic concern was about the impact of any criticism on achievement of export markets in a very competitive environment.

I have assured the Defence Council that our reports were tabled only after a careful assessment of the evidence and consideration of responses from the Department and relevant contractors. We did this to ensure that our reports gave a properly balanced view of these very substantial projects for the Parliament and the Government. The ANAO has had considerable experience with these types of projects for more than a decade. This experience was supplemented, for example, in both the projects mentioned above by relevant private sector experience. We have been particularly concerned to assist agencies to improve their project and risk management capabilities including the adoption, or adaptation, of private sector approaches and techniques.

We would have done the Parliament and the Government a disservice had we limited our findings to simply focussing on commercial interests. It must be appreciated that these projects are being undertaken primarily for national defence purposes and all those involved should recognise, and work together, to achieve such objectives. Nevertheless, there are always trade-offs to be made when multiple objectives have to be met. The reports' main message was that Defence needed to do far more in the acquisition stage to get the JORN radar and the submarines into a form capable of contributing to Australia's national defence in the manner intended.

Our reports have sought to prompt better project management by Defence with a view to achieving better outcomes for both Defence and industry. The audit report on the JORN Project put it this way:

'... unless Defence maintains a rigorous approach to planning, oversight and management of large projects, it will not acquire the contracted product at the required cost, time and standard. It will also fall short of its broader policy endeavour of promoting efficiency in Australian industry.' Ibid (page xv).

I should observe that the previous Minister for Defence House of Representatives Hansard 1997. Quote from Mr Ian McLachlan, Minister for Defence, Canberra, 26 November. (page 11051) and the Joint Committee of Public Accounts and Audit (JCPAA) Joint Committee of Public Accounts and

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Audit 1998, Report No. 357. *'The Jindalee Operational Radar Network Project'*, Canberra March. were far blunter in their assessments of the JORN Project than we were.

Our report on the New Submarine Project identified satisfactory findings with respect to Australian industry participation. A key finding in the report was that the Project had achieved a number of significant project management, engineering and construction outcomes which in many ways demonstrate the capacity of Australian industry to produce to world-class standards. Other key findings were that local manufacture makes it easier to obtain required quality outcomes and that most platform construction problems appeared to have arisen in overseas-supplied items. The Minister said he welcomed the audit's constructive findings and that the report contains some valuable lessons which will be useful in the management of all major Defence projects.

The message I want to leave you with is that we spend quite a lot of time and effort to ensure our reports are balanced in their comments and analysis. As well, they reflect all the considerations that are endorsed in the Procurement Guidelines, not the least being Australian industry participation. The following are good examples. A 1995 audit report on the ANZAC Ship Project contract amendments ANAO Report No.29, 1994-95, *'ANZAC Ship Project - Contract Amendments'*, AGPS, Canberra. (pages 32-34). found arrangements for evaluating, processing and approving amendments of the contract with Transfield Shipbuilding to be satisfactory. An audit report last year on acquisition of aerospace simulators ANAO Report No.17 1998-99, *'Acquisition of Aerospace Simulators'*, Canberra. reviewed Defence's acquisition of simulators being built by CAE in Montreal and Wormald in Sydney. The report commented favourably on the Australian product indicating that the Wormald simulator is expected to significantly enhance the mission training capability of Strike Reconnaissance Group F-111C aircrews.

Contract management

Contract management is now one of the most significant challenges facing the Australian Public Sector (APS). Many recent reports conducted by my office have commented widely on contract management practices in government agencies. Contracting for government services is often a complicated and time consuming process for all concerned. While, ideally, the latter should be minimised, it is crucial to maintain accountability and transparency throughout the process, with the ultimate end of achieving cost efficiencies and effective outcomes. A potential conflict between these aims is one of the major difficulties facing the public sector. We come from the background of a bureaucracy with its emphasis on many complicated administrative processes or simply 'red tape'.

As part of the process of contracting-out our business, we in the public sector have been forced to review our processes and become more flexible so that we

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can maintain the difficult balance of contracting-out and achieving cost efficiencies while maintaining appropriate accountability for the results. There is a practical trade-off between those management imperatives well articulated by Professor Richard Mulgan of the Australian National University. He argues that some aspects of accountability are inevitably reduced under contracting out Mulgan Richard, 1997. *'Contracting Out and Accountability'*. Discussion Paper 51, Graduate Public Policy Program, Australian National University (page 2).. The use of outsourcing and other new ways of delivering public services in fact strengthen the need for accountability. This is particularly the case with the less direct relationships that result from the introduction of a new player in the accountability chain: the private sector service provider. On this issue I refer to the following observation by Richard Mulgan:

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

Optimising the trade-off between accountability and efficiency requires senior public service managers to ensure they are not risking the efficiency and effectiveness of their core functions by ill considered, ad hoc, outsourcing, the effects of which are not confined to the particular services or activities being outsourced. To do this, ex-ante strategic examination of which activities should continue to be provided by the public sector (core business) and which to outsource (non-core business) is essential. To maximise overall value for money, it is important that this assessment take place in the context of the total business of the organisation in order to manage the risk that, by considering outsourcing individual activities in isolation, counter-productive and costly outcomes may result from outsourcing.

Sound contract management, and accountability for performance, is dependent on adequate and timely information. Therefore it is important that agencies consider the level and nature of information to be supplied under the contract and access to contractors records they require to monitor adequately the performance of the contractor. However, as Richard Mulgan also suggests, the more detailed the performance standards, the specific requirements for rigorous reporting and monitoring and the need for frequent renegotiation and renewal, the closer the

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contractual arrangements come to the degree of control and accountability exercised in the public sector *ibid.*, (page 8).. In essence, the issue is about trade-off on accountability requirements and their impact on cost/price.

As the Secretary of the Department of Finance and Administration has said in relation to the issue of contracting out public sector services:

'Our concern is to have a regime that protects the integrity of outsourced services, but does not make doing business with government so tied up with red tape and regulation as to lock businesses, including small businesses, out of the government marketplace.' Boxall Peter, 1997. Canberra Bulletin of Public Administration, No. 86. December (page 8).

With the increasing emphasis across the APS on market testing and outsourcing, sound tendering processes and good contract management are playing an ever increasing role in ensuring that public resources are used efficiently and effectively.

The trend towards contestability in contracting of services has produced a number of benefits, not least, those of enhanced flexibility, greater access to particular skills, reduced cost of supply and in the adoption of more innovative approaches to service delivery. However, with all such reforms there is the need to monitor arrangements to ensure that the public interests are adequately protected, not least achieving the contracted outcome specified.

I earlier referred to our relatively extensive use of contractors in undertaking audits. This is an integral part of our overall strategy to ensure that we have the capacity to adjust to current and future changes associated with the move to a more contestable and commercially oriented environment in the public sector. It also allows us to tailor the expertise available in our office to the needs of a particular audit, and thus to provide for the agency expert advice and understanding of their business processes. The key to success of effective audits is to ensure a sound knowledge and understanding of the organisation's business and the environment in which it operates.

We are in the process of conducting an audit of Management of Contracts which is evaluating agency processes in relation to key better practice principles for managing contracts, dealing with:

- provider performance monitoring frameworks;
 - management information for tracking expenditure, milestones and outputs;
- and

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- implementation of purchaser, provider and other contract stakeholder feedback mechanisms.

The ANAO's performance audit reports are increasingly referring to the need for improved contract management across the public sector. In particular, reports have flagged a need for care in assessing value for money and negotiating, preparing, administering and amending major contracts. The importance of management of the contract to the effective delivery of government services cannot be overstated. We are expecting to complete a Financial Control and Administration Audit on Contract Management, limited to common business sources such as cleaning, and a complementary Better Practice Guide this financial year.

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

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

The competent management of the contract is often the Commonwealth's key means of control over its outputs and their contribution to outcomes.

- *Commercial-in-confidence issues/records access*

Transparency of the processes is essential in the context of outsourcing. Access powers of the Auditor-General are an important aspect of maintaining public sector accountability in this context. One of the central issues, particularly in the case of contracting out of traditionally public sector activities is the auditors' and, through them, the Parliament's access to contractor records.

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The provision of government services by contractors is one of the most significant issues in contemporary public sector administration. It represents a major challenge for public service managers to ensure an appropriate balance is struck between achieving cost-effective outcomes and accountability for the manner in which public sector resources are used.

The issue of access to third party records in the case of private sector contracts for government services has received much attention in recent times. This issue was addressed by the above Senate Committee in its 1997 Inquiry into Contracting Out of Government Services. *Ibid.*, (pages 49 to 52). My submission to that Inquiry noted that:

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

I do not mean to suggest that agencies should have unfettered access to contractors' records but contractual arrangements must enable agencies to have sufficient information to enable their managerial and accountability responsibilities and obligations to be fully met. This issue is particularly important to me because the ANAO needs to have access to records and information relating to contractor performance in order to fulfil its statutory duty to the Parliament.

I recently spoke on this issue at the Australasian Conference of Public Accounts Committees in Perth Barrett Pat, 1999. *'Commercial Confidentiality - Striking the Balance'*, Presentation to the 1999 ACPAC Biennial Conference, 21-23 February.. I stressed the role of appropriate contractual arrangements in promoting accountability in the public sector in the context of the changing public sector environment occurring at all levels of government in Australia. The Australasian Council of Auditors-General has produced a statement of principles as guidance on the issue of commercial confidentiality and the public interest.

Australasian Council of Auditors-General 1997. *'Statement of Principles - Commercial Confidentiality and the Public Interest'*. Melbourne, July.

The Auditor-General Act provides a range of powers for access by the Auditor-General to records (including contracts) which are relevant to an audit, including records and information held by third parties so long as any access is for the

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purposes of undertaking an Auditor-General function. Commercial-in-confidence claims do not limit my right of access to relevant records. However, I do not have access to contractors' premises under that Act. There is provision for me to exclude 'sensitive' material from public reports if I consider that its disclosure is not in the public interest.

I have proposed a set of standard clauses for inclusion into contracts with the public sector. These clauses provide for me to access records (including premises) relating to the contract that are in the possession of a private sector contractor. These clauses are not necessary to provide me with access to information as such but they are important in flagging to contractors that they are required to give full access to the Auditor-General for proper accountability. In my view it is a matter of educating both parties that is, in the private and the public sectors, to the relationship or contract. Vague relationships do not assist either party nor lend confidence to the partnership or use of contractual arrangements. This is another aspect of the public sector environment with which the private sector is becoming more familiar as the trend towards outsourcing continues.

Asset management

My office has found that asset management is a major concern of most agencies and to the Parliament. The issues go well beyond physical security and proper maintenance, as important as those issues are. The missing link is an assessment of their impact on program outputs and outcomes. In the past, the tendency was to take assets for granted and consider them to be costless in day-to-day decision-making, as I said earlier.

Last year the JCPAA completed an inquiry into Asset Management by Commonwealth Agencies. The Committee identified this as an area warranting investigation as:

'At 30 June 1997, Commonwealth assets amounted to some \$113.8 billion, of which some \$72.5 billion was held in the general government sector... Consequently, improvements in the management of these assets, even if small in percentage terms, can result in significant savings for the Commonwealth.' Joint Committee of Public Accounts and Audit 1998. *'Asset Management by Commonwealth Agencies'*. Report No.363, July.

It is fairly self-evident that, with shrinking budgets, program managers have to start looking at ways to use assets more effectively, and even to see if they can do without, or moderate the demand for, particularly expensive and underperforming assets. Clearly, they should not be reviewed in isolation from other resources, particularly when there can be substitution or alternative means of provision such as outsourcing or leasing. The introduction of accrual reporting

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in recent years and accrual budgeting for 1999-2000, has meant that asset management can no longer be ignored. One could argue it never should, given that requests for replacement or additional maintenance would most likely have to be made in tight budget situations.

My office has produced a better practice guide ANAO Report No. 27 1996. 'Asset Management', AGPS, Canberra. 14 June. that gives guidance to agencies on better practices for managing their assets. The guide focuses on assisting managers to implement the principles of asset management as a means of controlling program costs. These key principles are:

- reduced demand for new assets by adoption of 'non-asset' solutions;
- maximising the service potential of existing assets;
- lowering the overall cost of owning assets through the use of life-cycle costing techniques; and
- ensuring a sharper focus on results by establishing clear accountability and responsibility for assets. Ibid., (page 22)

Life cycle costing is a key consideration in terms of asset management, particularly when reviewing whether assets are 'performing'. I will go on to discuss this principle further.

- *Life Cycle Costing*

The introduction of an accrual budgeting framework and an outputs and outcomes structure in the public sector has forced agencies to improve their understanding of their management role and their performance. Life cycle costing is one approach for an agency to assist in managing its business responsibly into the future. Life cycle costing allows an agency to estimate the costs of purchases, in terms of the initial outlay and the ongoing costs over the life of the purchase. This is particularly important in the light of the emphasis on market testing of non-core services within the public sector. The public sector is now involved in significant purchases on an agency as opposed to a government-wide basis.

An understanding of the long term implications of a purchase in terms of its cumulative cost is crucial as a basis for making informed decisions in circumstances which have the potential to affect the agency's and the government's financial obligations into the future. The public sector has a particular responsibility to ensure that its purchasing decisions are transparent and fair to Australian businesses. Applying life cycle costing to purchasing decisions also helps to increase the understanding of agencies about the likely impact of the costs on their outputs and outcomes.

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V. FOCUS ON CORPORATE GOVERNANCE

Establishing a Corporate Governance Framework

Improving performance is a primary focus of both the private and public sectors. It has been increasingly recognised in both those sectors that appropriate corporate governance arrangements are a key element in corporate success. They form the basis of a robust, credible and responsive framework necessary to deliver the required accountability and bottom line performance in whatever way that is measured or assessed.

For some time, corporate governance has been a theme, or a specific issue, addressed in a number of our performance audits. Corporate governance is about how an organisation is managed, its corporate and other structures, its culture, its policies and the ways in which it deals with its various stakeholders.

Barrett Pat, 1996. *Managing the Risk as Part of Good Management - AN ANAO Perspective*. Address at the launch of MAB/MIAC Report No. 22 'Guidelines for Managing Risk in the Australian Public Service'. Canberra, 10 October (page 3).

A corporate governance framework, involving sound cost structures and risk management processes provides the foundation on which we are building a cost effective, transparent and accountable public sector. The principles concerned are important to any business no matter how they might be implemented to suit the nature and extend of that business.

Effective corporate governance requires leadership from the executive management of agencies and a strong commitment to quality control and client service. Corporate governance is basically concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes. Major elements are planning, risk management, performance monitoring and accountability. The framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outcomes.

My Office has released a publication entitled *'Principles for Core Public Sector Corporate Governance'* ANAO 1997. *'Principles for Core Public Sector Corporate Governance: Applying Principles and Practice of Corporate Governance in Budget Funded Agencies'*. Canberra. which provides an outline of a corporate governance framework for the 'core' public sector as well as principles for the operation of a public sector Executive Board. The framework is very much people-oriented and reinforces the importance of better communication; a more

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systematic approach to corporate management; a greater emphasis on corporate values and ethical conduct; risk management; skills development; relationship with the general public as clients; development of government service charters; quality service delivery; and published performance measures.

I am currently preparing a related discussion paper on the principles and practices of corporate governance applying to Commonwealth Authorities and Companies. This paper focuses on the practical application of the principles of corporate governance covered by the Commonwealth Authorities and Companies Act.

ANAO 1999. Discussion Paper on *'The Principles and Practices of Corporate Governance applying to Commonwealth Authorities and Companies'*. (to be released in April). We aim to provide constructive guidance on how to develop a robust corporate governance framework in the complex operating environment of government organisations.

The pressure on the Commonwealth government to provide more services with less has led, in part, to the introduction of private sector approaches to the structuring of government businesses including, for example, the appointment of Boards of Directors. This has focused attention on corporate governance but, I hasten to add, not just for commercially oriented government organisations. Accountability structures such as those used in the private sector are increasingly important in all government agencies.

Accountability is not the only benefit of corporate governance. An effective corporate governance framework assists an agency to identify and manage risks in a more systematic and effective manner.

You may also be interested in an audit report that examined the corporate governance framework of the Australian Electoral Commission which canvassed many of the above issues in relation to that organisation. ANAO Report No. 1, 1998-99. *'Corporate Governance Framework - Australian Electoral Commission'*, Canberra.

Risk Management

Risk management is an important element of corporate governance underlying many of the reforms which have taken place in the public sector. It is not a separate activity within management but an integral part of good management process, particularly as an adjunct to the control environment.

Risk management requires the identification of all risks, determining their priorities and an evaluation of such risks for their potential impacts on the resources required and outputs/outcomes achieved in accordance with the risk assessments made. Further evaluation and reporting of results follows at a later date to ensure

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that appropriate decisions were made and, where applicable, revised decisions are made and timely action taken, including effective 'damage control'.

As I have mentioned, the overall aim of my office is to improve public administration and the accountability framework. Managing risk efficiently and effectively is a key way that this can be achieved. It is a major challenge for public sector managers, particularly as the culture under which they have operated has traditionally been risk averse. Parliament itself, and its Committees, are still coming to grips with the implications of managing risks instead of minimising them, almost without regard to the costs involved.

The concept of risk management is fundamental to our own auditing activities. Professional accounting standards require us to identify and assess the risks which exist in the agency being audited. We base our audit programs on an assessment and prioritisation of the risks of various programs, to ensure that our resources are applied to the areas of greatest risk. For example, my office has adopted risk management techniques in the selection of performance audit topics. We apply an analytical framework to identify the risks that a program or function will be poorly managed. This way we can apply our available resources to auditing those programs which will provide the greatest returns in terms of improved accountability, economy, efficiency and administrative effectiveness.

At the same time, we have in place a number of internal risk management structures which ensure that we are not exposed to unnecessary risks internally. These include, for example, the risk of issuing an incorrect audit opinion.

Risk Management is thus important both in the conduct of our work and in the operation of our organisation. We emphasise in our audit reports the importance of effective corporate governance including risk management frameworks in agencies. I consider that the implementation of these two concepts has been markedly instrumental in changing the culture of the public sector including a more outcomes focus. Strengthening the internal framework of agencies allows for management attention to be directed at the core business of the agency reflected in its outputs and outcomes.

A corporate governance strategy is an essential basis for improving agency performance. Such formal governance can greatly enhance accountability for performance through establishing effective systems of control. The ANAO has released a publication entitled *'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes : A Better Practice Guide to Effective Control'* ANAO 1997 *'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes': A Better Practice Guide to Effective Control*, Canberra, December.. Control is broadly defined as 'a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency's objectives.' Ibid., (page 5)

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In the better practice guide, we indicated that a framework for effective control can only be achieved if, within its capacity to do so, an agency is able to:

- control its environment;
- control its risk;
- control its activities;
- control its information and communication; and
- monitor and review its control arrangements.

The purpose of the Guide is to assist public sector managers assess the appropriateness and effectiveness of their organisation's control structures. It also can be used as a tool to encourage the review, design and implementation of a control structure which fits the nature, assessed risks and required performance outcomes of the agency or entity.

The notion of a control environment has to start from the top of an agency. To be effective it requires clear leadership and commitment. This imperative is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. The control environment of the agency will strongly influence the design and operation of control processes and procedures to mitigate risks and achieve the agency's objectives. The clear intent and message to staff should be that such processes and procedures should be designed to facilitate rather than to inhibit performance. This approach should be promoted as good management. In short, the control environment is a reflection of management's commitment and attitude to ensuring well controlled business operations that can demonstrate accountability for performance.

The key to developing an effective control framework lies in achieving the right balance so that the control environment is not unnecessarily restrictive nor encourages risk averse behaviour and indeed can promote sound risk management and the systematic approach that goes with it. Agencies need to concentrate on the potential of an effective control framework to enhance their operations in the context of the more contestable environment we are creating as part of government reform policy.

Making a difference to the bottom line

The various public sector reforms over the last fifteen years and particularly the recent changes to financial and industrial legislation have seen a shift from central agency control to a framework of devolved authority with enhanced responsibility and accountability being demanded of public sector agencies and statutory bodies. The requirement for market testing of services also pose important

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accountability questions. However, there is wide acceptance that public sector entities cannot contract out their accountability obligations even though the responsibility for delivery of goods and services might reside with a private sector contractor.

The framework I have just been describing assists an agency to put in place a credible regime of internal control structures to ensure proper accountability for the use of resources. However, there is still the primary need to report on the effectiveness of the agency in achieving its outputs and outcomes and that means performance measures, preferably of a quantitative nature but recognising that qualitative assessments can also be important providing they are clearly spelt out.

The public sector is subject, under the current reforms, to increased levels of scrutiny of its performance and effectiveness. A culture of ongoing performance assessment is important in maintaining the Parliamentary and public confidence in the public sector. While we know we will be increasingly judged on results achieved, we are also sensitive to concerns about how this occurs.

A well governed agency will provide to its Chief Executive Officer (CEO) and/or any governing Board and its Minister and other stakeholders reliable, well founded assurances and evidence that it is meeting its performance targets. However, it is important to recognise that, despite the greater involvement of the private sector, performance assessment in the APS continues to be more than just about a financial bottom line. It covers a range of measures, both quantitative and qualitative. As well, the agency has to be accountable, for example, for the implementation of the Government's requirements with respect to public sector reforms and for meeting legislative, community service and international obligations; for equity in service delivery; and for high standards of ethical behaviour.

Performance assessment draws together aspects such as robust corporate governance structures and user friendly management information systems that provide an agency with the information to assure itself that it is performing effectively. In many of its performance audits, my office provides an assurance to Parliament that agencies are fulfilling their requirements to maintain effective control structures and provide access to key information about their performance. As with most other public sectors, there is still some way to go in establishing credible, reliable and useful performance targets, indicators and assessments. Our focus is primarily on a limited number of high quality indicators that will be used both by managers to manage and by stakeholders to assess how well they have succeeded.

The accrual-based outputs and outcomes reporting framework will require a cultural change in the APS if it is to focus effectively on the above aspects of an agency's performance in delivering the identified outcomes sought by Government. My office has an important role in assisting agencies to implement

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that framework effectively, and in assuring the Parliament that the required framework is in place and operating effectively. We aim to execute this role with a broad client focus. By working closely with agencies to implement the changes to their reporting, we can make a difference to the way this important initiative is taken up and provide assurance of a better outcome to Parliament.

VI. CONCLUDING REMARKS

The public sector is operating in an environment of constant change accentuated by a range of reforms aimed both at the adoption, or adaptation, of private sector approaches and its greater involvement in delivering goods and services to agencies and citizens. As well, there is an increasing emphasis on finding more innovative and cost effective ways of delivering government programs. The public sector is also becoming increasingly characterised by greater management flexibility and more personal responsibility, underpinned by largely principles-based legislation. The requirement for market testing will ultimately determine what is carried out in the public sector and by what means.

One aspect of the environment of change is the increasing pressure for accountability to match the more flexible, results oriented culture with the seemingly inevitable trade-offs between requirements for accountability and greater efficiency. This is most apparent in contract management with the private sector, which demands different accountabilities and skills than required in the past. The issue of any trade-off is one for the Government and Parliament to resolve. I would expect our audit reports both to contribute to any resolution of that issue as well as indicating whether it meets the terms of that resolution (that is, assurance).

The ANAO works within this environment to fulfil its role of providing independent assurance particularly to the Parliament. However, we know that we are well placed to fulfil a broader role based on our across-the-sector perspectives and virtual day-to-day involvement with agencies and statutory bodies, including GBEs. Such exposure carries with it a responsibility to share with the public sector the better practices of agencies and bodies that we identify in our work. Whether it is by identifying and disseminating better practices; facilitating the implementation of government reforms; or by helping to change cultures and attitudes, which is often the fundamental change required to make administration changes effective; we aim to add value and be recognised for the excellence of our audit products and services. That requires sound, innovative leadership, strategy and commitment at all levels of the ANAO. We will be judged by the results we achieve as are all those operating in the public and private sectors, even if our 'bottom lines' are different.

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NOTES AND REFERENCES