

SOME CHALLENGES FACING THE APS IN GENERAL AND THE SES IN PARTICULAR

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Address to Senior Executive Leadership Program - Preparatory day

Hill Station, Canberra

19 May 1998

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I. Introduction

In my view the biggest challenge facing the Australian Public Service (APS) and, the SES Group in particular, is dealing with uncertainty and contradiction. But such has it long been. The difference is in the degree and range of quite significant issues confronting us, not least the changing nature and culture of public service. I know many public servants are starting to 'turn off' when the latter terminology is used. However, we cannot ignore that is just what is happening to this public service. The challenge is to manage such change.

My main thesis today is that we should be aiming to influence such changes not simply let them roll over us. Many of us have seen similar waves which can tend to engulf us and then recede leaving us in no particular position. For some, life simply proceeds as it did before. We need to capture the energy of such change but manage it so that we do not end up with unintended consequences and disruptive reversals which simply create frustration, loss of confidence and disillusionment with the public sector and the Service itself - not least from the people within these areas. The latter are also one of our major responsibilities.

That is probably the most coherent and reasonably structured message I may give this morning. The remainder of my comments are largely unstructured issues and views but are basically about the changing governance and corporate governance environments and a range of the various demands being placed upon us, without necessarily grading them in any order of importance or priority. That is what you will undoubtedly discuss in this Program.

Where am I coming from? I can say unreservedly I have a 'passion' for the public service. I believe in it as a central element of democratic government. When Bob Officer came to talk to me about issues that should be covered by the National Commission of Audit in the new government, I said that, in my view, the main message to the new Government should be that their major asset was an independent, ethical, highly performing, innovative and committed public service. I was subsequently disappointed that no such sentiment was reflected prominently, or otherwise, in the Commission's report.(#1)

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However, subsequently, I was really pleased to see in the Prime Minister's Garran oration(#2) last year his support for the imperative for any government to leave the public service in a better condition than it found it. So regardless of whether we generally agree on whether or not the public service is now in as good condition as this government inherited, it is my opinion that there are a number of concerns about its morale, professionalism and confidence despite the initiatives, and very good initiatives, that this government is taking, which I will discuss later. That said, I also consider that the APS has a lot to be proud of and publicly proclaim to sustain its confidence and morale.

I am dedicated to sensible reforms such as devolution of authority and commensurate accountability and performance-oriented management. The last mentioned is also one of the most significant challenges facing us particularly in the management of our people which I consider is greatly assisted by the more flexible workplace conditions that are now available. Again, the difficulty is knowing the boundaries and the unintended consequences. I am not in favour of undermining the concept of one Australian Public Service which I think is essential for the continued morale, professionalism and appeal of the public service to those whom we should be seeking to attract into the public service of the future.

I therefore consider we need a basic framework of service conditions upon which we can build flexible arrangements suitable to the needs of our organisations without unnecessary and counterproductive 'bidding wars' for staff. This is not to be construed as a retreat to the past and central agency direction and control. To the contrary, it is a recognition of the danger of creating a vacuum and the consequent need for cooperative leadership and clear strategic direction to ensure we remain a cohesive and credible public service.

I would like to reinforce the earlier message that we need to understand and influence the changing culture of the public service and its impact on our staff; their individual and collective motivation; their commitment; and their well-being. And I have no apology to make to anybody about insisting on maintaining the well being of our staff, for example, in trying to get a better balance for our people between their home and their work lives. Such an approach is supported by research such as that conducted by the London School of Economics and the

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University of Sheffield(#3) which concluded, among other interesting findings, that:

'The more satisfied the workers are with their jobs, the better the company is likely to perform in terms of profitability and, especially, productivity.'(#4)

The flexibilities that have been available in the development of Certified Agreements and Australian Workplace Agreements offer us the opportunity to achieve such outcomes. At the end of the day we need our staff to 'want' to work in the APS in general and in our agencies or entities, in particular. Individually, we need them to be totally committed to our functions or our business and to what they do in the agency or entity. Otherwise, we all seriously need to ask ourselves why we continue to be in it.

The address is in four segments followed by some concluding remarks. While all segments reflect various kinds of challenges, the first three are mainly directed to what we, as senior APS executives, should be doing to enhance the professionalism, credibility and reputation of the public service through leadership, accountability for proper implementation of legislation and promoting greater confidence in public administration through better recognition of its performance. The last segment, which you would not be surprised constitutes the bulk of the address in terms of length, is about challenges posed by the apparent 'privatisation' of the public sector.

In a recent book, entitled *The Human Equation : Building Profits by Putting People First*,(#5) Dr Jeffery Pfeffer of the Harvard Business School noted a range of empirical evidence for the absence of much planning or strategic thought in many organisations' downsizing and contingent work arrangements. He makes many observations with which I can agree but one in particular which gives me a good introduction to my first segment:

'The question is not just what people cost, but what they do for the organisation. ...It is the job of leadership to craft creative responses to competitive conditions that build competence, capability, and commitment in

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people, not to do things that destroy organisational memory, wisdom and loyalty.'(#6)

II. The Need for Leadership

What I have been implicitly advocating is the need for leadership, particularly from the top echelons of the APS which, importantly, includes this group. I have stressed this imperative in a number of public forums in recent times. We have to recognise the need to provide and encourage leadership in the APS particularly at this time. It is no exaggeration to conclude that, without it, we risk being a second rate public service which could turn out to be a self-fulfilling truth. As a consequence, privatisation of the public service would simply occur by default.

I recognise that many agencies are at least doing something about developing a higher leadership profile in their organisations. A number are part of programs that are being run collectively within the Public Service under the auspices of the Public Service and Merit Commission. The ANAO has developed a program with a Monash/Mt Eliza Business School Group that aims to encourage leadership at all levels in the ANAO so that our people understand what it is that leadership actually means to them and to the organisation. And it is no exaggeration to say that it has now become an essential element of our personal development approach and will be recognised as such even more so in the foreseeable future as part of our performance management system.

I also mention similar approaches in the Attorney-General's department (AGs), in the Australian Taxation Office (ATO) and in the Australian Bureau of Statistics (ABS). While it is always invidious to pick out particular agencies for comment where many others are taking similar initiatives, I note that the Senior Executive (SES) group in AGs, itself, set leadership standards to which all agreed, with each member including a Leadership Development Plan in his or her SES performance agreement.

The Australian Statistician has identified potential leaders in his organisation and provided them with opportunities for leadership development. In contrast, the

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Commissioner of Taxation has been equally supportive but somewhat less selective and/or directive, with his people being given the opportunity to virtually self select which would see a number succeed and others replaced by those who have a better chance of success. While there would be proponents of both approaches the important message is that there is recognition at the top of the kind of criticisms made by, for example, the Pusey(#7) and Kakabadse(#8) reports. It is certainly not difficult to agree with an observation in the latter report that:

'Poor example from the top spreads through the organisation like uncontrollable flames, inducing unhelpful behaviour and undermining morale internally and image externally.'(#9)

In terms of encouraging leadership at all levels of an agency there is no substitute for good example.

While we might talk about, consult about and argue about leadership selection methodologies and approaches, I am stressing the importance of recognising and providing strong support for initiatives taken by various agency heads on leadership development within their organisations. In short, we should not be diverted by any apparent differences but provide strong support for the initiatives being taken as part of continuous improvement on people issues.

The Australian Statistician has observed that sending people to leadership courses and seminars is not enough. I agree with him. While I confess that I do have a bit of a problem with his approach at least in the sense of personal 'anointment', I guess from a private sector point of view it probably gets ten out of ten for decisiveness and, perhaps good risk management. Now that may be alright in a risk management sense so long as we do not exclude people from the opportunity to participate on other than merit grounds and with no chance of reconsideration. Some might think, as the Commissioner for Taxation seems to do, that you need an opportunity to revise your opinions as necessary without sending people into catastrophic spirals of lack of confidence when you tell them that you made an initial decision which has not turned out to be correct, that they are not leaders for the future after all. The latter is always a hard message to sell. I do not think we can rely on the message being 'apparent' to those concerned.

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But another point I particularly want to highlight is that the Australian Statistician's focus is on relationships with people and the knowledge and understanding of that organisation and the environment in which it operates, and an appreciation, and this is his terminology which I can relate to, 'of life generally'. It is also easy to accept a private sector based view that:

'... if businesses treat their employees with dignity and respect through good people management, it will lead to increased productivity and profits.'(#10)

We could well emulate some of that thinking in the way in which we approach our leadership programs. It is not a one-way street. We need our people's understanding and commitment. That means their involvement.

Last year I noticed an article in the Business Review Weekly(#11) indicating the BHP had established an in-house management scheme providing leadership courses for more than 5000 of their staff including 1500 executives. That is an enormous investment by any corporation. While BHP might not be the leading organisation it once was it nevertheless remains a very significant corporation in this country. What this initiative obviously suggests to me is the clear importance that the management of the time placed on the leadership imperative.

And this same imperative was also specifically recognised by a survey of chief executives, mainly in the private sector, conducted by Price Waterhouse Urwick late last year in a publication entitled 'The Business Menu of Change - a CEO Perspective'.(#12) They note, among many other interesting observations, that the biggest single challenge CEOs see themselves confronting is the question of people, that is how best to lead, to utilise and to develop their key people resources. The Price Waterhouse Urwick report also noted that CEOs spend a large part of their time developing their management team, much of which is geared around leadership. The single largest component of CEOs' time is spent on leadership and communication.(#13) That observation would also apply to public sector managers.

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III. The Legislative Discipline

I have explained the need for leadership. Complementary to this focus I would clearly put a high store on the public service ethic, and the values as now outlined in the Public Service Bill languishing in the Parliament. One of the truisms that I keep on repeating is that the public service is good at developing, advising on and implementing legislation. We understand 'the rule of law'. Particularly in the core public sector, that strength will continue to be one of the most important imperatives for us as senior managers. At the end of the day we must abide by and protect the legislation. The legislation is what underpins any democratic society. And as professional public servants we have to be accountable for its implementation.

I rather like the comment attributed to an anonymous senior Victorian public servant to his Minister, the Treasurer, where he observed:

'Minister, I might not be an expert in privatisation, but I am an expert in accountability'.

And that is what we have to be, isn't it? We have to be experts in accountability. That is what the Australian parliament and the Australian public expect of us. So we need to be credible as the experts in public accountability. That applies particularly for any legislation we individually or collectively are responsible for.

Now of course the whole legislative framework is important to us. I earlier referred to the *Workplace Relations Act 1996*. The new Public Service Bill (on a rough road as we know) will provide important guidance for the public sector on public management into the next millennium. At least the Public Service Regulations, including importantly the APS values and Code of Conduct, look like staying in place. It was certainly tremendous, in my opinion, to see the three resource oriented Acts implemented on 1st January this year, that is, the Auditor-General's (AG) Act, the Financial Management and Accountability (FMA) and the Commonwealth Authorities and Companies (CAC) Acts.

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The foregoing is essential public service legislation that largely provides the accountability framework, the culture, the pattern and the direction of the public service for the future. It is there to assist us. The Charter of Budget Honesty will complement this package of legislation to provide a robust, but flexible, accountability framework to underpin a highly performing APS.

We should aim to facilitate our management task by using the flexibility that is embedded in such legislation which basically sets out principles of behaviour. They do not prescribe, as the current Public Service Act does in detail in numerous different ways, how to do what we should be doing. The legislation leaves it up to us to decide on the basis of the underlying principles that we should be observing when we undertake any particular task or function. I think that is a very important and useful approach to encourage a more flexible, highly performing management environment. Performance is at the heart of all major public service reforms over the last fifteen years.

By the same token, the legislation places a heavy emphasis of accountability on CEOs and on us as senior managers. Consequently, complementary requirements such as Chief Executive Instructions (CEIs), are not just bits of paper for filing. They have to be 'living' documents for day-to-day guidance to our staff. They are not just a one-time effort. 'Thank heavens we have got that out of the way', is not a sentiment we can indulge. Nor 'let's hope we don't need to do that again' or 'put it on the shelf'. Such documents should be available, preferably electronically, on a day-to-day basis as an essential aid to the management of our organisations. But we must also stress the basic principles to our staff in order to ensure they understand their application as indicated in the CEIs.

The CEIs are an important means of facilitating what we do. They are not simply dictums for the unthinking. We must reinforce the underlying principles as I have stressed. There should be an open invitation to staff that, if you have a problem in the application of these principles in terms of the requirements of the CEIs, let us talk about it. Let us not just implement them in the old public service way, virtually by rote. That is how we should be endeavouring to encourage our people to think and act. Many of us have underestimated our people for too long. They do have the necessary capacities to think and to contribute to the various outputs and

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outcomes of the organisation no matter at what level they might be. We are not automatons and we should not act as if we think our people are either.

IV. Recognising a Professional Public Service

Before proceeding to a discussion of one of the biggest challenges facing us, simply described as 'privatisation' of the public service, I would like to make a few observations on the need for recognition as a professional public service which, as I indicated earlier, has to be earned. In my view we have made a large deposit on that investment, as I said earlier.

Privatisation by default is not consistent with the well deserved reputation of the APS for its innovation, professionalism, pragmatism, independence, ethical standards, including freedom from corruption, and its high level performance in international circles over many years. And I have to say to you the APS, overall, still enjoys that reputation. We are still in constant demand around the world for our public service expertise. You would not form that view from the Australian press (with at least one local exception), and from comments by various politicians and commentators, including from the business community. In short, the negative perceptions have outweighed any positive comments, for example, from the Prime Minister or successive Ministers assisting on Public Service matters.

Contradictions prevail. One would therefore be excused for at least a degree of scepticism about claims we had a high level, professional and capable public service. So somehow or other we apparently have missed the boat. We seemingly have failed to convince our stakeholders which may be the result of too low a profile, inadequate communication and/or inability to demonstrate effectively the performance achieved. Nevertheless, while improvements can always be made, we need to recognise and make public our strengths and performance achievements at least to have a fighting chance of recruiting and retaining professional, dedicated and highly capable staff.

We know we have to continue to change. We have demonstrated we have the capacity to implement a range of public service reforms over the last fifteen years.

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And we had to change to survive as a credible public service. In a relatively recent address to the Australian Bureau of Statistics (ABS) staff, I observed that, for decades, they had been in demand as advisers to many international organisations, overseas governments and agencies. The Australian Statistician was 'head hunted' to be put in charge of the United Kingdom (UK) statistics group. Dr Malcolm McIntosh (CSIRO Chief) was also invited to fill one of the most prestigious Defence jobs in the UK. Many of my Finance and Treasury colleagues have established international reputations in the OECD, World Bank, International Monetary Fund and Asian Development Bank arenas.

Senior public servants in a range of agencies and entities are in constant demand to head, or be members of, international reviews, committees and inquiries as well as to provide papers to prestigious international conferences, seminars and workshops. Many of our management and processing systems, such as social security, tax, employment and passports, have been adopted or adapted and/or referred to as better practice in a range of developed and less developed countries. International organisations, such as those I have already mentioned, are constantly referring to Australia's better practice public service and funding visits and training programs for other government and bureaucratic advisers to learn from our experience. I could go on and on. Our various stakeholders, including the people who work in the public service, need to be aware of, and recognise, these achievements which should promote greater public confidence in the APS's capacity to deliver an effective public service. These are only some of the literally hundreds of examples of the overseas demands for Australian public sector expertise.

Undoubtedly there are mixed signals continuously being received by the APS as to its ability and worth which impact adversely on its self esteem and morale. This is not the place to go into the details of apparently conflicting messages. However, I would illustrate the point by reference to the apparent reduction in communication and coordination on policy and administrative decision making, particularly on across-agency issues. We recognise that, increasingly, we are not the only source of advice to Ministers. Most of us never thought we ever were. As well, we understand the acute political embarrassment and often negative impact of 'leaks'. Despite the criticisms I have to say that I am aware of very few investigations that have identified public servants as the source of such 'leaks'. Every public servant I have ever had contact with regards such behaviour as

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'unprofessional', and totally unacceptable and inimical to the hard won reputation of the APS.

As a long time public servant with experience in many agencies at senior levels, I have observed and support the strength of proper coordination practices across agencies and entities in the preparation of advice to Ministers and for Cabinet Submissions. It is essential that the public service provides 'frank and fearless' advice to the government of the day. The practice should be endemic to open democratic governance. It is in the nature of insurance and protection to good decision-making. We know we are not the founts of all wisdom even in areas where we are acknowledged experts. In many areas of government the complex interaction of a range of relevant issues is difficult to sought out in any one agency.

I am sure we have all had the experience that, even where we have done months of work on a project, an agency has come in with a coordination comment on our draft Cabinet submission that we had not thought of. Often we were simply not aware of it. But it could have had a decisive effect on the options and the recommendations we put to the government. And that is why I assert that, if we are aiming to get better informed, more professional governance, we need to have robust and accepted conduits to ensure that decision-makers are properly informed by a professional, independent public service.

Somehow or other we have to make the necessary changes, to promote greater confidence in the system to assure better consultation without involving unnecessary bureaucracy, including frustrating procrastination. Experience shows we do not take endless time to make decisions. We can make quick decisions. But people in this room also know the number of decisions taken in haste that we have lived to regret. It is even more unfortunate when those adversely affected by such decisions were the very people that the program or activity was supposed to help.

Often, a quick solution is not anywhere near the best solution. That is why there has been so much emphasis placed on risk management in recent years. There is really no alternative to systematic risk analysis, identification, assessment, prioritisation and treatment. We need to stand back and look at the real issues we

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need to address and actually make a segregation between those issues and the other imperatives that inevitably confront us as public servants. I recognise the 'other imperatives' because I understand what they are, having worked in both central and line agencies. I have also been a program manager. Basically such imperatives are politically oriented. 'I want this program up and going in three months time'. 'Minister we cannot have the computing systems in by that time'. 'That is your problem' or, perhaps, 'Do the best you can'.

Sometimes there is a need for 'non-involved' central and other agencies to point out that, from their experience, particular decisions need to take a little more time because, at the end of the day, they may well bounce back and 'bite' you. Some 'quick' decisions can be taken as long as the risks are clearly identified and assessed. These are the positive elements of good risk management which should be an integral part of any organisation's control structures which, in turn, contribute to better corporate governance. No one benefits from programs that do not meet their objectives and identified client needs. Likewise, no one benefits from badly delivered programs and services.

Politicians might say that they are the ultimate risk takers because at the end of the day they are judged in the polls. But there are many issues that do not rank as poll issues but are, nevertheless, matters of considerable significance to the welfare of the Australian people and they deserve better. They certainly do not deserve makeshift decisions made off the cuff. Or even made to look as if they are going to work. We know of examples where there was little relationship between the program outcome and what it was supposed to do. Agencies have an obligation to bring such outcomes to the early attention of Ministers with options to remedy the situation including the cessation of the program if it is clearly inappropriate. This requires confidence, trust and a commitment to public accountability by all concerned.

Let me put to you again the question you can answer for yourselves. How many programs do we know about that have failed to meet their objectives wholly or partly. Perhaps closer to home, how many programs do we have about which we cannot say whether they are meeting these objectives efficiently and effectively? Such failures have many causes but the point I am making is that often the people concerned have not put the investment into ensuring that, for the most part, they

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have anticipated all the problems, identified all the various implications that are likely to arise out of such problems and to provide the best advice or make the best decision they can. In part, this situation can be overcome by better communication and coordination in the decision-making processes aided by Ministerial confidence in the contributions and professionalism of the APS.

Now there are no guarantees in life. We know that. But it will always pay to communicate effectively. We may make mistakes and that is part of risk management. You systematically identify the risk; you assess the risk; you prioritise the risk; and then you constantly monitor and review the outcomes being achieved. And if you are going in the wrong direction, you do something about it in a timely fashion. You do not wait till something actually happens, particularly if it literally blows up in the Minister's face with acute political embarrassment. The result is loss of confidence and trust which, as we know, takes a considerable time to regain. Our obligation is to ensure that we do not allow such a situation to occur. But it does require a real sense of collective purpose - a partnership, involving mutual confidence and respect. That is also our challenge.

V. Privatisation of the Public Service

As I remarked earlier, 'privatisation of the APS' is obviously a major challenge for the Service as a whole and, in particular, for the various CEOs and the SES group. I am using the term 'privatisation' in a global sense to encompass the adoption and/or adaptation of private sector principles and approaches, including management techniques; the greater involvement of the private sector in the supply and provision of goods and services to the public sector, including policy and analytical advice; the greater commercialisation of public service functions and activities, including market testing; full costing and pricing of products/outputs/services as well as adherence to the Competitive Neutrality Principles; and partial and full privatisation of public sector functions, notably those conducted by GBEs.

Moving to accrual based management

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Convergence between the two sectors is also being reinforced by a range of other initiatives and changes that themselves pose challenges particularly for CEOs and the SES group. Perhaps the most pressing is the government's apparent intention to move to accrual-based budgeting on an outputs and outcomes basis from 1999-2000 which virtually requires agencies to adopt accrual accounting but, more importantly, means managing functions and programs in an accrual framework. While the growing 'commercial' elements of the public sector have already had to meet that challenge, the core public sector is not well equipped yet to do so. The two main requirements are training and systems oriented to management decision-making or decision-support.

The real difficulty is lack of relevant skills and understanding of the accounting and financial reporting concepts and how to use accrual-based information for management purposes. And this applies to all levels of an agency or entity. Managers will have to consider, for example, the cost of capital (including a risk-based premium); valuation of assets on a deprival basis; rates of depreciation on a range of assets; taxes and other regulatory charges, at least on a notional basis; maintenance of a bank account and cash flows, including interest charges and receipts; provisions in relation to debtors and creditors; accrued staff leave of various kinds; insurance premiums; and superannuation liabilities.

There will need to be a general understanding of cost and pricing methodologies and the relationships between the various costs and financial reporting for, say the branch, division, program, output/outcomes and for the agency as a whole. Such a requirement will put considerable pressure on the delivery of integrated systems better linked to organisational structures, including responsibility (cost) centres, particularly where activities and services are provided across programs in the new outputs/outcomes reporting and assessment environment. One of the ironies of the move to full costing of what we do is that the Commonwealth was a leader in cost accounting in the 1950s and 1960s. Agencies such as the then Posts and Telegraphs, Works and Civil Aviation had some of the most sophisticated costing systems in Australia, including the private sector.

The requirement for user-friendly management systems

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Earlier I mentioned the strengths the APS had exhibited in various systems development, particularly expert systems, many of which have been acknowledged as better practice internationally. However, we have not done so well in management information systems, particularly those oriented to the way we use our resources to produce program outputs and outcomes. Put simply, they have generally not been user-friendly nor supportive to good management. The move to managing on an accrual basis has emphasised the need for good data management; security of corporate data; ready access to required data throughout the organisation; data sharing; and data that is informative and tailored to particular management tasks and responsibilities, for example by exception reporting.

In particular, we need integrated and seamless systems that, for example, link program human resource management (HRM) and cost and financial information (financial management information systems-FMIS) with some kind of over-arching management information and/or decision support system that provides timely and relevant information at the desktop with the capacity to 'drill-down' for supporting data as may be necessary.

Some systems can be quite expensive and require careful planning, development and implementation. The problems facing managers, including the issue of outsourcing, vary across agencies, not least in relation to their nature and size. An immediate and significant challenge is to deal effectively with the so-called Year 2000 problem which is fundamentally a management issue. I should point out that the latter involves much wider complications than simply providing a computing 'fix'. (#14) A major concern is about what we do not know. There is really no alternative but to apply the appropriate resources, as quickly as possible, including outside expert assistance as necessary, not the least in the legal arena.

The budget focus on outputs and outcomes and contestability

That brings me to the 'likely' move to budgeting for outputs and outcomes. In this respect we should have learnt a lot about the definitions of, and relationship between, inputs, outputs and outcomes over the last decade or so under Program Managing and Budgeting (PMB). We are all well aware of the problems of appropriately assigning responsibilities for control, accountability and performance

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across the different stakeholders. Measurement has clearly been easier in assessing efficiency and administrative effectiveness in relation to individual inputs and outputs. There will be even more focus on those areas, as well as on their relationship to outcomes, for resource justification in the budget context in the future, particularly in the application of the Competitive Neutrality Principles, which I will discuss later, and with the periodical market testing requirements.

Not surprisingly, assignment of responsibility for, and assessment of, program outcomes has proved far more difficult and contentious. A major problem has been a general failure to properly link identified outputs with required outcomes. In fact, to overcome this problem, the Department of Finance and Administration (DoFA) has suggested, on the basis of lessons learned from others, that a distinction be made between high level and intermediate or lower level outcomes. (#15) The former define the long-term results for clients and/or the community of particular public service activities and indicate how they are linked to the relevant government objectives. This approach describes impacts and assesses appropriateness (which was an element of program effectiveness under PMB).

The intermediate or lower level outcomes are reflected in results which clarify whether the objectives concerned are achieved or not. Such results are more indicative of success than measures of the final 'total' impact of a program. Another contrast is that high level outcomes can generally be measured or assessed over a long period of time (perhaps several years) whereas action plans designed to achieve the objectives can be measured, as to their success, over a shorter time period, for example, annually. Repeating, the essential linkage is between outputs and outcomes which we need to address as a matter of priority.

Another requirement is to clarify who is responsible/accountable for outputs and outcomes. As a general observation, an agency should not be held accountable for results over which it has no control and/or influence. In DoFA's view:

'Today, the degree to which an agency is accountable for results depends less on the control it exercises than the influence it has exerted over them; the capacity to mobilise and organise resources and networks; or to convince and manage stakeholders'. (#16)

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In short, accountability for outputs and outcomes should be related to the means an organisation has to influence the result. Having established the means, we should be in a better position to identify appropriate performance measures. I agree with lessons learned from others that 'reporting on outputs and outcomes requires a performance culture of clarity and trust rather than one of blame'. (#17) A 'blame culture' risks a retreat into simply reporting on processes or activities particularly where those concerned think they have little or no control over results on an output or outcome basis. This is self-defeating, particularly where the Commonwealth's Accrual-Based, Outcomes and Outputs Framework involves:

- *'agencies and authorities specifying and setting prices for the outputs they will deliver and describing the planned outcomes to which outputs contribute;*
- *specifying outputs which involves identifying the price of the output and key attributes such as quantity and quality;*
- *specifying outcomes which involves providing performance information on the achievement of the department's or agency's planned outcomes and the contribution of outputs and administered items to those outcomes; and*
- *making a clear distinction between items controlled by agencies, that is, the outputs produced by departmental items, and the items which agencies administer on behalf of the government, that is, administered items'. (#18)*

The immediate challenge is to establish clearer links from the price, quantity and quality of outputs through to planned outcomes which reflect the strategic priorities of government. If that is achieved, the expectation is that the quality of performance information to managers will be improved. This reflects the greater results-oriented approach being taken as part of the reforms. However, I observe that good processes can provide better outcomes. In other words, while we should maintain a clear focus on the results required, we need to maintain a sensible balance of management attention to our use of inputs, the production of outputs and achievement of outcomes.

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Developing a robust corporate governance framework

The kinds of decisions that bear on the foregoing challenges are first and foremost of a strategic nature. They will be aided by agencies having a sound corporate governance structure in place. This is another area where we can learn from approaches and practices developed and used in the private sector, particularly over the last ten years. The key word is again 'integration' of all the various elements of corporate governance from setting of organisational objectives and strategies; establishing clear responsibility and accountability for performance; performance management; and provision of robust control structures through relationships with all stakeholders, including 'owners' and 'clients' or 'customers'.

The Australian National Audit Office (ANAO) has produced a discussion paper on applying corporate governance principles to budget funded agencies, particularly aimed at CEOs, which you might like to consider if you have not seen it. (#19) Corporate governance is basically about how we 'govern' ourselves and our organisations. The various public service reforms over the last fifteen years have provided much of the framework for public sector corporate governance. Why then did we generally not recognise the importance and relevance of those reforms for our organisation's corporate governance? The reason is that many of us have not really thought about how we should bring together all the reforms that we put in place over the years as a cohesive and integrated 'whole structure' to improve the performance of our organisation and its relationships with our various stakeholders. We have tended to put in place individual initiatives, such as PMB, risk management practices, performance measures, targets or benchmarks and service charters in an ad hoc fashion as they were required by government or suggested by central agencies.

But we have seldom stood back, as CEOs and the management team, and ask 'what are these initiatives doing for us in terms of enabling this organisation to perform better in relation to objectives that we established or were set for us'? How do we better integrate them into a complementary structure? How do we make sure that they are not unintentionally frictional or even actually operating contrary to each other, instead of being mutually supportive of the management

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task? How do we know whether our people aren't simply operating by rote; that they are actually thinking about what they do and why they do it and the principles underlying the various elements of the reforms that are intended to help them to do their jobs better? And, if there are indications they are not thinking about these issues, what are we doing about it?

Corporate governance is very much about improving organisational performance. I have talked about the importance of performance management, which particularly includes managing the performance of our people. The latter is an area where we have not been as successful as we should have been. A good illustration is the less than satisfactory experience with performance pay and inadequate recognition and other incentives for improved performance. I have also referred to the importance of risk management as a central element of robust control structures to improve performance.

As part of the ANAO's audits of financial controls and administration we usually prepare a better practice guide to assist agency management in assessing their practices and to make any improvements they consider necessary. On occasions, such Guides are prepared on the basis of Performance Audits in cooperation with other agencies. There are a number we have recently completed, or will be available in the near future, which detail the important elements of the corporate governance framework. The guide on control structures(#20) has received widespread favourable comment within and outside the APS, including internationally. Guides on Audit Committees(#21) now required by both the FMA and CAC Acts; on financial reporting on an accrual basis(#22); on asset management(#23); on internal audit(#24); on Performance Information Principles(#25); and on Customer/Client Service Charters(#26) should prove useful in testing these important elements of the framework.

There is a growing realisation among CEOs, particularly as a result of their legal responsibilities under the new financial management legislation, of the need for greater assurance about the use of their organisations' resources and more tangible expressions of accountability. In this latter respect, the ANAO is suggesting that a useful discipline of the new framework should be the requirement for personal 'sign-offs' for the particular programs, outputs and/or

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outcomes that senior executives are responsible/accountable for. This applies, for example, particularly in budgeting and in financial reporting. In my view, investment of senior management time and effort in establishing a well integrated corporate governance structure, including the above features, will be repaid many times over.

Another paper of interest is that on 'Governance Arrangements for Commonwealth Government Business Enterprises' (#27) . A GBE is now required to include in its annual report a statement of the main corporate governance practices it had in place in the reporting period similar to that required of private sector corporations by the Australian Stock Exchange (ASX) listing rules (#28) . An indicative list of matters a GBE may include in such a statement are listed at Attachment A of the above paper. The ANAO is currently examining the value of a companion discussion paper to our earlier corporate governance paper which would deal with CAC bodies.

Providing services to our customers/clients

I would like to make at least a few observations on Service Charters as one element of our accountability to our stakeholders, in particular for the services we provide. This rather 'new' notion of client or consumer, I prefer the term client, is an important part of the changing culture of modern public services. As you know, in August 1997 a Commonwealth Implementation Timetable was published outlining each Minister's commitment to develop service charters within his or her portfolio. Over 80 per cent of charters will be developed by June 1998, with the remainder due by June 1999. The Principles for Developing a Service Charter (#29) are quite simple and straight forward. The emphasis is again on what a charter can help us achieve, not just as a process we have to put into place. As the Principles document observes:

'A good charter can provide a substitute for competition, where no competition exists and can promote competition where like services are provided by other bodies. An additional benefit of charters is that they can be used as benchmarks for measuring service quality'. (#30)

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They need continuous attention, monitoring and review supported by a credible grievance handling process. Charters should clearly signal, on an on-going basis, to all concerned what our client groups can expect of the agency and from our staff. Terms such as marketing and client satisfaction are now being widely used in the APS bringing us even closer to private sector approaches.

We need to face the reality that there will be further privatisation of the public service in the above broad sense whether we like it or not. Now all this is occurring but at a rate and to an extent which I think warrants some careful and considered assessment basically because I am not sure that such assessments that might have been made in terms of likely improved economy, efficiency and effectiveness clearly justify what is actually happening. I will expand on this conundrum now.

Market Testing, Outsourcing and Competitive Neutrality

If you will bear with me, I would now like to work through some underlying considerations that are necessary to understand clearly as part of this seemingly inexorable move to greater private sector provision of public services and its more extensive involvement with the APS. This approach also allows me to identify some of my personal concerns that I echoed earlier about the future of a highly performing, credible and professional APS.

First, let me revisit the National Commission of Audit Report. The Commission agreed that there are both social and economic arguments for government involvement in the community's activities. This is also broadly recognised in the Australian Constitution setting out the Commonwealth and States' functions and relationships. There would be general agreement with the Commission's suggested framework of principles to guide government involvement in 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 promoted; and*
- *assess whether or not effective activities are being conducted on a 'best practice' basis.(#31)*

The third dot point is central to the issues being discussed in this section.

The Commission asserted that delivery of desired government outcomes is usually better if opened up to competition, so that suppliers within and outside the public sector can tender for the services required. The Commission went on to specify three requirements for 'best practice' operations as follows:

- *where possible, program beneficiaries should be given choice;*
- *governments, as far as possible, should operate as funders of programs, with funding separate from the actual delivery of the services involved; and*
- *service delivery should be as competitive as possible.(#32)*

The basic structural framework for such competition had been established by the National Competition Policy Review (known as the Hilmer Review) in 1993(#33) which recommended six main elements of such a policy of which the following two are relevant to this discussion:

- *reforming the structure of public monopolies to facilitate competition and restraining monopoly pricing behaviour; and*
- *fostering 'competitive neutrality' between government and private business where they compete.(#34)*

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All Australian Governments gave a commitment to implement the competitive neutrality principles in the Competition Principles Agreement 1995. In June 1996, the Federal Government released its own Competitive Neutrality Policy Statement. Recently *'Guidelines for Managers on Commonwealth Competitive Neutrality (CN)'*(#35) were made available to assist in putting the agreed principles into practice. The Guidelines state that:

'CN will assist public sector managers to more accurately assess whether the government should retain responsibility for certain business activities or whether alternative means of service provision should be considered.'(#36)

Not surprisingly, the relationship between CN and the processes set out in DoFA publications, *The Performance Improvement Cycle*(#37) and *Competitive Tendering and Contracting (CTC)*(#38) was drawn to managers' attention.

CN applies to all 'significant' Commonwealth business activities; significant generally being a commercial turnover exceeding \$10 million per annum. However, GBE and Business Unit activity is always considered 'significant' regardless of turnover. The following criteria apply in classifying activities as a 'business' for CN purposes:

- *there must be charging for goods or services (not necessarily to the final consumer);*
- *there must be actual or potential competition (that is purchasers are not restricted by law or policy from choosing alternative sources of supply; and*
- *managers of the activity have a degree of independence in relation to the production or supply of the goods or service and the price at which it is provided.*(#39)

The Guidelines indicate that the above criteria exclude from CN government functions which are budget funded service delivery functions where there is no distinction between the purchaser and provider of the service. However, where

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there is such a separation, such as in the case of competitive tendering with an 'in house' bid, the provider activity may be subject to CN if it is a business activity as defined and above the 'significance' threshold. CTC units with turnover under \$10 million still have to earn commercial returns but may incur other CN costs on a notional basis, for example tax equivalents. In most instances in-house activities are subject to tax equivalents rather than actual taxes.

The CN implementation arrangements are to be applied to all Commonwealth business activities so far discussed no later than 1 July 1998. An independent complaints body, known as the Commonwealth Competitive Neutrality Complaints Office, has been established within the Productivity Commission (administered in the Industry Commission until the latter was established). Ministers will report on the application of CN within their portfolios to the Prime Minister and the Treasurer in July each year.

Reading through the document on 'Commonwealth Competitive Neutrality Guidelines for Managers', a reader could easily form the impression that price is the vital factor determining whether or not an activity or service will be done in the public sector. Moreover, the seemingly endless references in various forums as to whether something can be done cheaper in the private sector has led many public service managers to believe that producing to a price is what is now basically expected of them.

The provision of public services is not just about price. Public service is about getting 'value for money'. The private sector often acknowledges that 'yes we agree, we must get value for money'. But we do know from experience that their notion of 'value' is often somewhat different to that normally used in the public sector. I recently noted two observations of relevance to the point I am trying to make. The Westpac Risk Advisory Services Director has been reported as observing that the decision to outsource must flow from strategic decision-making processes related to the objectives of the organisation. Such a decision should be based on a range of factors, for example, core competency considerations, value driver assessments, economic value-added and value-at-risk evaluations and value-based management decisions. The Director also specifically suggests that corporate governance issues need to be taken into account. The second observation is from the Head of Coopers & Lybrand's UK Consulting Practice

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noting that the Blair Government has moved away from compulsory competitive tendering (CCT) to embracing 'best value' which is seen as a replacement for CCT.

My simple point is that value for money considerations are far more complex than just price comparisons, even allowing for quality differences, the more one is removed from the competitive market place and enters the world of public interest, fair play, honesty, justice and equity. In my view, it is useful to identify differences in 'bottom line' requirements between core government and non-core government activities and services in any continuum of commerciality and competitiveness and in any comparisons with the private sector. This is the subject of my following comments which aim to provide another perspective to the application of market testing, outsourcing and of the Competitive Neutrality principles.

Distinguishing between core and non-core government

In order to make my arguments clearer, I will discuss the distinction at two levels - first, in terms of broad functions and, second, in relation to particular services and/or activities within entities. But we know they are not mutually exclusive situations even if they involve different considerations of private sector involvement in the public sector.

Differentiating functions from a whole-of-government perspective

There are clear similarities in many of the considerations of what constitutes core and non-core business in both the public and private sectors. However, there are also differences, as I have already noted, not least in the legal and public interest constraints that apply in the public sector. I reiterate this point because, in my view, it makes the distinction between core and non-core public sector functions even clearer, as I will endeavour to show. I think it is reasonable to apply to the government and Parliament of the day the analogy of private sector executives and Boards deciding what is their core business, or functions, and how it (they) should be conducted.

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I stress again I am not talking here about commercially-based outsourcing of services or activities in individual entities as part of good management which, for my present purposes, is a second order issue which I will discuss separately. Nevertheless, I recognise the boundary between these two concepts is shifting, where traditionally regarded 'core' government activities such as providing policy advice, social welfare and employment services and public infrastructure are being increasingly provided by the private sector.

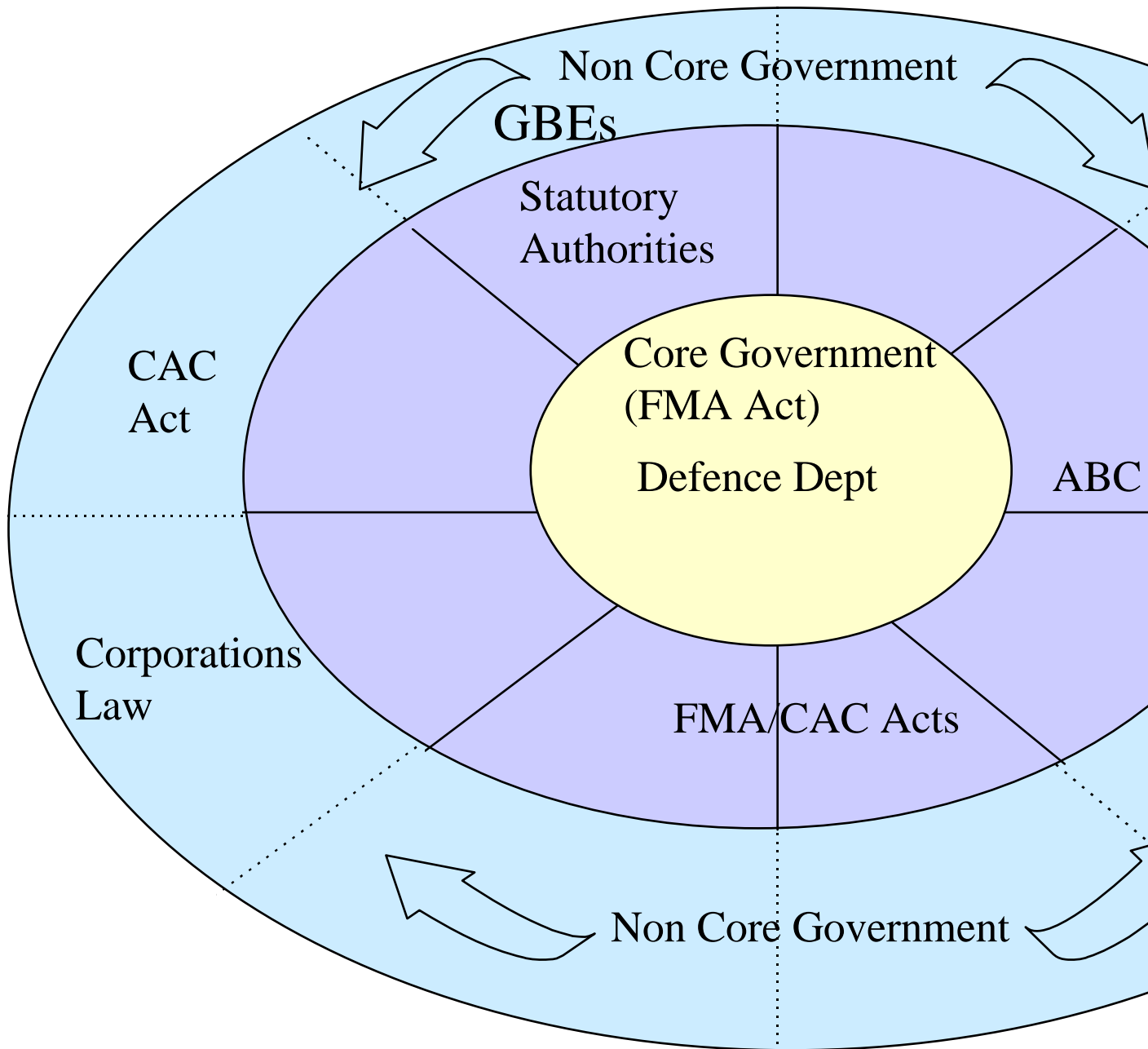
I simply observe that such boundary changes are occurring in an unplanned, apparently haphazard and unstructured way with no clearly defined rationale that I am aware of. It is perhaps no exaggeration to suggest, as I did earlier, that the simple test seems to be whether the function and/or service can be provided by the private sector and at a lower price. I contend that the public interest and accountability requirements demand much more careful consideration of any 'privatisation' of core government functions than might be accepted as necessary in the case of non-core functions particularly those that are business-oriented. Another contention is that decisions about core and non-core functions and their private sector provision are often interrelated, which I will explain later.

I will illustrate some of the distinctions between core and non-core government functions in the current context and, I trust, provide a better understanding of the concerns being expressed, by reference to Chart 1 which follows.

CHART 1: Differentiating between core and non-core Government

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Private Sector



The chart shows three segments of government, one of which I would like to think is in a transitional stage. The inner segment is core government covering functions such as Defence, Justice, Foreign Affairs and Trade, Social Welfare and Treasury/Finance. The next segment is a mixture of core and non-core functions and is largely represented by budget funded or partly budget funded statutory authorities such as the ABC and CSIRO. The outer segment reflects non-core

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functions performed mainly by Government Business Enterprises (GBEs) which generate their own revenues and most resemble private sector corporations. Some actually do regard themselves more as part of the latter than as public sector bodies. But they are, statutorily, public sector bodies that are expected to act commercially and often in direct competition with their private sector counterparts. They are not private sector corporations that happen to operate in the public sector.

In my view, a helpful parallel to the distinction between core and non-core government could eventually be provided by the coverage of the FMA and CAC Acts. Such a dichotomy also reflects the degree of Parliamentary and Executive Government interest and involvement in the performance, nature of accountability requirements and day-to-day operations of the organisations covered by the two Acts. The middle segment of Chart 1 is a complication which I think will gradually be resolved and, hopefully, not a problem. There are some organisations currently in that segment whose attributes indicate it could be appropriate to reconsider their classification as either an FMA or a CAC organisation. A real problem exists where organisations are classified as both FMA and CAC bodies. Such separation clearly presents a difficult management problem for those managers concerned. This adds to the pressure to reconsider what role and purpose are served by particular entities and their initial classification under the two Acts. It would certainly simplify considerations of accountability and performance assessment for all parties if a clear on-going distinction could be made for each Commonwealth entity. That is not to say that they would have some kind of permanent status in that classification.

Simply put, the classification of entities in accordance with the FMA and CAC Acts seems to me to provide a useful basis for determining how best to bring about the most appropriate involvement of the private sector in the performance of public sector functions. In my view, the FMA agency classification is one way for the government to define what they consider to be the core public sector where the broader range of accountability, including public interest, concerns need to be taken into account by Ministers and senior executives in determining what functions might be outsourced. In these circumstances, market testing and competitive neutrality principles need to take into account the inevitable trade-offs between considerations of efficiency, basically reflected by price, and public interest concerns. I will return to this issue.

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While the Parliament will be interested in any public sector organisation and its accountability, their concern is heightened when public funding and/or obligations are involved. The perceived accountability trade-offs are likely to be of less concern where the emphasis is more on price competitiveness and return on funds employed. It would be no surprise therefore that issues of contestability and competitive neutrality are more central to management of CAC bodies. Broadly speaking, the more open and effective the competitive environment, the more likely the bodies are to be privatised, in whole or part. I should note that there are questions as to whether the risks, ambiguities and uncertainties inherent in any partial privatisation are justified other than as part of a staging process to full privatisation.

Any government has the right, preferably with the support of the Parliament, to determine what are, or are not, core government functions. Such a decision can clearly change over time. However, in my view, it would encourage better performance and greater stakeholder, including client, confidence if there were more certainty about the classification of public sector functions, and over what timeframe. Everyone accepts that change is now a constant element which has to be managed and virtually nothing is guaranteed. But, again, trade-offs are involved and need to be seriously considered in any decision to involve the private sector in the provision of public service functions.

Reasonable certainty of entity status as part of core government for a specified time period would greatly assist strategic planning, better resource use, continuity of relationships with various stakeholders, including staff, which would greatly boost their ownership and commitment. There are obviously many other uncertainties that have to be well managed and any clear direction in these respects would, I am sure, be greatly welcome by managers and agency clients. A parallel is reflected in the long time major criticism of government by the private sector about the former's asserted inability to lay down clear guidelines, including what is required of business. In particular, the private sector would like the government to maintain a stable 'set of rules' for reasonable periods of time instead of the seemingly constant, often unannounced and disruptive changes that reflect an apparent pre-occupation with the short term and a perceived need to react to political concerns and their impact on electoral prospects. This is not

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surprising at the Federal level with elections often being held about every 24 to 30 months over the last two decades.

Concerns about economy, efficiency and effectiveness of core public sector functions could be met, for example, by performance targets/measures, appropriate benchmarking and quality assurance reviews. Where relevant, comparisons could be made with other public sectors and the private sector. The challenge is to ensure core government functions are achieving the required objectives cost effectively. That does not have to mean continuous market testing and the threat of competition for the functions involved with the former's inherent uncertainties and possible diversion from the efficient and effective conduct of these functions and related accountability concerns. I stress again I am not referring to market testing of products and services which do not involve such concerns, or at least not to the same significant degree.

The situation for non-core government is at least different in degree and indeed, in substance, particularly at the outer perimeter bordering on the private sector. Some of the broader concerns expressed above are also relevant, such as the need for a reasonably certain and consistent planning framework. In my view, it is a reasonable supposition, when entities are appropriately classified within the FMA/CAC dichotomy, that all non-core functions could potentially be undertaken by the private sector. At the very least this means that the entities concerned have to be at least contestable with the private sector even where they are not in actual competition. Consequently, market testing and competitive neutrality principles are highly relevant to non-core or more business-like government functions as I earlier observed.

Nevertheless, there are several issues that need to be addressed in any comparative analysis of the benefits and costs of non-core functions being performed by either the public or private sectors. First, there is the ubiquitous 'level playing field' concept that seems to have dominated discussion about the private sector's involvement over many years. From my viewpoint, it has been a rather one-sided debate in public forums, largely highlighting the difficulties the private sector has had because of the stated advantages of the public sector in not being subject to a number of Commonwealth and State regulatory requirements or costs, such as taxation, insurance and other charges, and

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problems of access accentuated by impediments, subtle or otherwise, erected by the public sector organisations concerned. Actions taken by successive governments over recent years, and most recently, to redress such 'advantages' have largely counteracted this criticism.

My concern is more about the limitations placed on public sector provision of functions which do not seem to have been recognised to the same extent as the private sector criticisms noted above. The most obvious limitations are those placed on use of public resources by the Constitution and by other elements of the statutory framework which includes any specific legislation applying to the entity itself and the whole gambit of legislation applying to the public service such as the Public Service Act, the Auditor-General's, FMA and CAC Acts, Crimes Act, Freedom of Information Act, Privacy Act, Administrative Appeals Tribunal Act, Occupational Health and Safety (Commonwealth Employment) Act, Remuneration Tribunal Act and Data-matching Program (Assistance and Tax) Act, to name but a few. We are all aware how difficult it is to cost these factors but the restrictions they place on the public service can at least be identified. In general, such legislative requirements form part of the accountability framework associated with being in the public sector.

Coupled with the broad social and economic arguments, I referred to earlier in this address, that provide a case for government involvement, there is also a question as to whether a government sees a need for the above accountability requirements and their costs or, more particularly, whether they are perceived to unduly inhibit the economy, efficiency and effectiveness of the functions involved. In a very good article(#40) by Professor Richard Mulgan of the Australian National University late last year he discusses this point at length in relation to outsourcing and observes, among other things, that:

'...there will always remain a significant difference between the unconditional, open-ended right of intervention accepted by public servants and the contractually circumscribed conditions accepted by contractors.'(#41)

I would argue that this comment would equally apply to Ministers and public functions as well as to public service managers and the particular services or

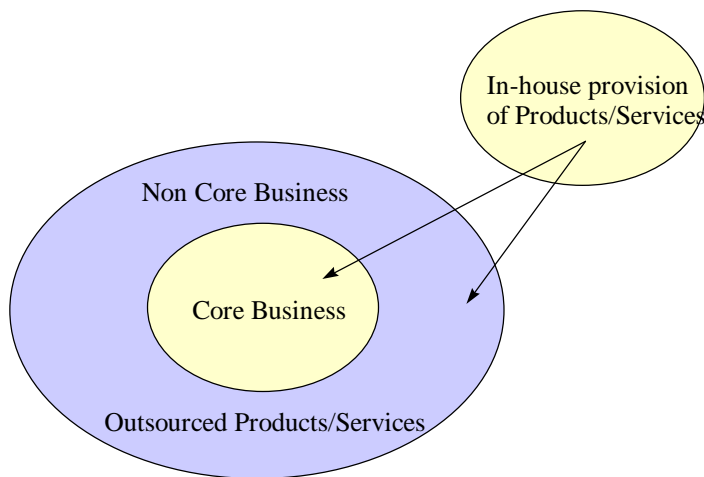
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activities that they employ to perform those functions. That brings me to the second element of the distinction between core and non-core government and its activities.

Differentiating provision of services or activities within particular organisations

Turning now to the provision of specific services or activities by the private sector to particular organisations, we have a rather different set of circumstances and, consequently, somewhat different decisions to make. I am now looking at private sector involvement within individual entities and will use the simple illustration in Chart 2 below to make just a few observations about issues I consider need to be addressed by public service managers.

CHART 2: Differentiating between core and non-core business activities in individual entities



I start from the premise that the CEO and the executive team in particular, and the organisation in general, need to know the business they are in or, expressed in public service terms, the functions they are responsible for. I prefer to use the private sector terminology of 'business'. From that standpoint, they should then

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be able to define their 'core' business and, therefore, what is 'non-core' and take appropriate decisions as to their conduct.

I can illustrate by using the ANAO as an example. Simply put, our core business is as the public audit practice for all agencies that are budget dependent, which includes all those agencies that are, or will be, covered by the FMA Act and the majority of statutory authorities which come under the CAC Act. The ANAO derives its public sector expertise and comparative advantage from its virtual day-to-day involvement in nearly all Commonwealth entities. The ANAO does not deliver just one audit. We deliver a total audit service. Our non-core business therefore broadly covers entities that are not in the budget sector (that is, in general, commercial entities covered by the CAC Act). This 'neat' dichotomy is complicated by the situation I described earlier in the middle segment of Chart 1 where the organisation status in terms of coverage of the FMA and CAC Acts may need to be reviewed and therefore some re-classification of entities in terms of their coverage under the two Acts might occur as a consequence. The entity distinction between the two Acts is logical and can be easily understood and, consequently as I have also observed earlier, provides a potentially useful basis for future decisions about the nature, classification and operation of Commonwealth entities in relation to the way in which we conduct our audit business.

Experience shows we all need to ask ourselves from time to time just what is our core business and thereby identify our non-core business. But we then need to decide whether or not we conduct our non-core business in-house (in conjunction with core business as necessary) or whether we outsource it, as shown in Chart 2. If we simply look at applying competitive neutrality principles, I have no doubt that most managers would put in-house provision in the non-core area. However, this may not be in the overall interests of the organisation concerned. The questions have been posed succinctly as follows:

Granting that the competencies defining the firm and its essential reasons for existence should be kept in-house, should all else be outsourced? In most cases, common sense and theory suggest a clear "no". How then can managers determine strategically, rather than in a short-term or ad hoc fashion, which activities to maintain internally and which to outsource.'(#42)

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There are situations where we need to argue for sufficient time to make more considered and better informed decisions about outsourcing to prevent unnecessary, and perhaps counter-productive and costly, outcomes. Considered in isolation, it might be cost effective to outsource particular activities. However, if looked at in terms of the total business, it might be, even if only marginally, quite cost effective to continue in-house and/or deliver a better value for money outcome than would have otherwise been possible. That sounds a sensible management judgement to make. I think it is. At the very least the issue of value for the whole business has to be addressed rather than taking partial and/or premature decisions which may be virtually impossible to reverse.

Senior entity management should take effective action, including regular monitoring and review, to ensure they are not risking the efficiency and effectiveness of their core functions by random, ad hoc, outsourcing, the effects of which are not confined to the services or activities being outsourced. Put bluntly, they risk under-performance on their core functions if they are 'slicing off' elements of their business without considering the collective, as well as the individual impact, of such decisions on their capacity to deliver those functions efficiently and effectively.

What they actually could be doing is redefining their core business, virtually by default, which could eventually put it at risk of being outsourced because it becomes far too costly to provide in the public sector even where there are public interests of the kinds I outlined earlier. No-one benefits from decisions that are literally forced on them because of earlier failures to address issues that are central to the best outcome for all those involved, not least being the staff, direct clients and the general public. Many times we have to make difficult decisions which can draw us into conflict between competing ends. However, that is what we are being paid to do as managers.

I would like to pose a question to you. Would a private sector firm take such an approach that I have just outlined? I do not think so. What does a private sector firm do? They look at their total business. Importantly, they examine the impact of non-core activities on core business. In short, they do not examine outsourcing activities in isolation from its effects on their overall business. Cost attribution,

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cost allocation, marginal costing and pricing, skills retention and critical mass are central to decisions on such activities. A simple example is the many activities that are undertaken on the basis of marginal pricing because of the contribution they make to the fixed cost elements of the business and retention of desired skills and/or experience that will benefit other parts of the business.

Competitive neutrality requires that government business activities do not have net competitive advantages over their private sector competitors simply as a result of their public ownership. This is intended to help ensure that resources available for public expenditure are used in a most efficient manner possible. As the CN Policy Principles indicate, subjecting government businesses to CN arrangements will also improve transparency and accountability by presenting costs in a comparable manner to that of the private sector(#43) . Competitive neutrality will assist public sector managers to more accurately assess whether the government should retain the responsibility for certain business activities or whether alternative means of service provision should be considered.

In relation to specific services and/or activities that might be more efficiently and effectively provided by the private sector as part of an entity's non-core business, the most obvious current example for many organisations is their Information Technology (IT) services. I should stress that I am not advocating IT as non-core business as a matter of course. For many agencies, IT is increasingly very much part of core business, at least in its strategic management and applications development. There is also growing realisation that IT outsourcing is not the 'easy' option. For example, a recently reported international survey across twenty-five countries in six major industries by Deloitte and Touche Consulting Group listed cost reduction, vendor expertise and expected quality improvements as the 'three areas of greatest disappointment with IT outsourcing'. The survey concluded:

'Outsourcing shows little sign of helping companies reduce technical complexity or cut costs.'(#44)

You would probably also be aware of the current initiatives being taken by DoFA to market test their Corporate Services for possible outsourcing. Printing services is another area where there has been considerable agency outsourcing, as well as for internal audit which raises its own particular problems(#45) .

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The public sector is not circumscribed absolutely from marginally, or even differentially, pricing as I read the principles. The criteria for classifying activities as a 'business' include managers having a degree of independence in relation to 'the price at which it (good or service) is provided' (#46) . But we are required to avoid any 'cross-subsidy' from budget-funded activities that provide any 'unfair' advantage. But I would contend that there are legitimate advantages associated with 'level playing field' operations in the public sector. It seems to me to be good business practice to differentially or marginally price to maintain or increase market share on the basis of costs which reflect, for example, the use of government purchasing power and/or any other particular legitimate cost advantages or benefits to other activities the public sector might be able to take advantage of, as I discuss later. Differentially or marginally pricing in competition with market oriented firms in the private sector in these latter respects does not seem to be simply using unwarranted advantages of being in the public sector. After all, that is precisely what those firms do to achieve market advantage against their competitors, including the public sector. I therefore do not think it is sufficient just to state that:

'Cross-subsidisation is undesirable as it is not a transparent use of government funds and places private sector competitors at a disadvantage.'(#47)

In my view, we need to think beyond this proposition with which none of us would disagree in the narrow context in which it is put in the principles.

Properly using cost and price advantages is what competition is all about. At the end of the day, so long as one earns the overall return on funds employed that the organisation is seeking to achieve (including an agency or ministerial determined 'commercial' rate), private sector managers would say well done. Therefore we should be very clear about what business principles public sector managers are supposed to follow. There will be times when it could be argued that in-house provision makes sense because of the contribution that the in-house option makes to core business, for example, by providing the expertise that is available on tap for undertaking other tasks in the core business on a fully costed basis, that is with no cross-subsidisation. This is just one example.

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Managers could actually 'contract' the staff concerned with any in-house option to undertake a range of tasks in which they have valuable experience on both their own and associated activities or programs. Managers might like them to use their public service expertise to respond to particular ministerial requirements, questions or difficult correspondence in related areas. Such staff could have the necessary experience and expertise to answer some potentially difficult questions that might come up in day-to-day core activities which would simply not be available in the private sector or, if so, at a much greater cost. Such considerations underpin major strategic management concerns with the following outsourcing risks:

- loss of critical skills or developing the wrong skills;
- loss of cross-functional skills; and
- loss of control over a supplier.(#48)

There are a lot of areas where I could make valuable use, in my small organisation, of , for example, accrual and system based auditing expertise which is in very short supply generally in the currently high competitive market for such resources. What I am trying to do is leverage off my core auditing expertise and knowledge of the public sector for other audit products and services. Quite clearly, there will be areas where it makes good sense to have private firms undertake my non core audits under contract management arrangements. But I might want at least some involvement in those areas so I can actually reinforce my ability to do my core business. There is a trade-off or balance to be struck. Am I mistaken? I don't think so. These issues are constantly exercising my mind.

As with other APS managers I am looking for ways to undertake my statutory responsibilities more cost effectively and stretch my budget and achieve best value for money. But, I hasten to add, not at the expense of my core business and this includes unjustified cross-subsidisation of audit activities which could put my core business under stress in any peer view and/or benchmarking performance assessment exercise.

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I have to confess a deal of sympathy over the years for the various businesses in the previous Department of Administrative Services (DAS). It appeared that they had virtually one arm tied behind their backs if they were expected to be fully competitive with the private sector and bear all the costs experienced by that sector. DAS Removals seemed to me to be a case in point. Suppose DAS Removals had been contracted to move a Defence family from Canberra to Perth. No doubt they would have endeavoured to secure some kind of backloading that they were authorised to undertake. A private sector trucking company would have no such restriction. The latter could literally backload anything and dramatically reduce their overall costs. DAS Removals, except fortuitously, may have seldom had that advantage and lost the business to the private sector competitor by default.

Let us look at the issue from another angle. I am precluded by my Act from seeking private sector business, perhaps not surprisingly. However, there have been many indications that the public audit function should at least be contestable with private sector accounting firms. The virtual privatisation of the Victorian Audit Office has accentuated that expectation. An inability to compete on price raises questions of efficiency and undue imposts on auditees in today's full cost/pricing environment. But, like most government entities, I am restricted in what I am empowered to undertake, such as providing consulting services, which I could leverage off my experience and skill base derived both from core and non-core auditing products and services. I am therefore very limited in my ability to spread my fixed costs and marginally price.

On the other hand, the soon to be 'big five' accounting firms can use their audit services as loss leaders in order to have the opportunity to obtain quite lucrative consulting work. In some corporations the latter is many times the value of the former. Their capacity to 'price' to the market makes it very difficult for me to be contestable on a full cost basis which I am required to charge for my audits. This is hardly a 'level playing field'. No wonder there are morale problems when Commonwealth entities are required to observe competitive neutrality principles but are clearly restricted in their capacity to compete.

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There are other apparent inconsistencies in the application of competitive neutrality principles. For example, the APS is apparently to be expected to bear the average risk premium for the private sector in our costs of capital to ensure we do not have an advantage over that sector. We are not therefore allowed to have the advantage of a lower level risk premium on the debt charge because we are part of government. But what about some other resources. If public service salaries are generally lower than those of our private sector competitors, should we be increasing the salary component of our costs so that we make them comparable to the private sector? Taking another example, the public sector has, as I earlier observed, enormous purchasing power which we should still be interested in using in order to secure best value for money at the very least for our more significant contracts. Many private sector companies do not have similar purchasing power. Should we therefore be making some concessions on competitive neutrality grounds for that advantage?

I am aware that Commonwealth businesses may have lower transitional rate of return targets to accommodate Commonwealth employment cost disadvantages for up to a maximum of three years. However, no such accommodation has been indicated in relation to differences in depreciation costs. As you are aware, the public sector values capital generally on a replacement value (deprival value from 1 July 1998) and the private sector mostly values on an historical cost basis. It would be clearly counter-productive to the DoFA financial reporting principles on asset valuation to give consideration to recognising any public sector cost/price disadvantage that resulted from the valuation method determined for the public sector. Nevertheless, the difference would generally result in a higher public sector price that has nothing to do with that sector's competitive abilities.

These questions may be regarded by some as 'nit picking' or setting up 'straw men'. But if we are talking about principles we should at least ensure we are consistent in their application. Frankly, while I understand the logic of ensuring that public sector activities should not receive favourable treatment, say by not having to pay tax, at the expense of the private sector resulting in unrealistic assessments of relative efficiency, I am perplexed by any notion that 'justifiable' advantages associated with operating in the public sector should not be reflected in any price comparisons with that sector. The problem is even more disturbing if price is largely seen to be the determining factor for outsourcing decisions, more particularly in core government activities. Managers need to be supported in

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making 'balanced' decisions in particular cases which look at the total 'business case' and the inevitable trade-offs that have to be made. That is more than simply redressing any apparent competitive advantage which the public sector might have over the private sector. It is more about observing basic business principles aimed at achieving value for money outcomes.

The requirement for project and contract management expertise

In some minds I may have left the most pressing challenge till last, particularly in a more contract-oriented public service which is rapidly becoming the most significant task undertaken by many public servants at all levels. Recent audit reports have noted significant costs associated with less than adequate project and contract management skills in the APS. We know we cannot outsource accountability. It may be surprising that, over such a long period of time, the APS has acquired relatively limited really good project management skills. But perhaps not so surprising, is our minimal contract management skills basically because they have been in limited demand.

The management imperative is to secure the required contract outcomes. That is not just the responsibility of managers to get the job done within the specified time, cost and quality. It is also a lot of 'backside protection' for all stakeholders. Securing the required result is absolutely essential in contract management. I am on the public record as saying that the best contracts are those that we can literally leave in the bottom drawer. A sure sign that something has gone wrong is when we have to resort to the contract clauses and seek legal advice. What I actually meant by such an observation is that I should be able to work in partnership with the private sector, that is, a genuine partnership where each party understands the imperatives confronting the other.

Public servants are not naive nor are we bereft of experience in dealing successfully with the private sector. I know that there are private sector companies out there that simply 'mouth' sentiments of cooperation, commercial relationships and joint ownership while taking advantage of, or being critical of, their public sector 'partners' in other forums. As well, I know that many play the game hard but, we would expect, fairly. Most of us understand the 'profit' imperative but the Commonwealth does not operate an 'open cheque book'

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approach. We also understand the respective obligations to stakeholders which can clash at various times. That has to be managed by both parties.

We have to protect the Australian taxpayer. That is why we are employed in the public sector. Consequently, we will operate as responsible managers and we will try to act in a productive partnership. We will try to come to agreed solutions and work out changes that need to occur from time to time. We will endeavour to understand and respond as appropriate to the commercial 'realities' facing our service providers and/or suppliers. If that means contract amendment, so be it. The interests of both parties need to be considered. But we do not take endless time in negotiating contract changes at the expense of getting the project done at a cost to both interests.

These are just some of the problems that we are increasingly confronting. They illustrate why the public service is regarded as generally lacking relevant skills and sense of commercial reality. The pervasive perception is that we do not get on with the job; we are buried in process and forms; and we are unable to see what needs to be done to get the contract completed successfully. By the same token, we need to be more commercially disciplined in our approach to ensure that the private sector provider is delivering according to the contract terms.

We have had some unfortunate experiences. I can assure the Defence representative that I refer to recent audit reports and JCPAA inquiries on JORN(#49) ,(#50) and Collins Class Submarines(#51) to make the point clearly, mainly because they have all received quite a deal of adverse publicity in the media. In my view, the Commonwealth was unnecessarily exposed to financial risks over which it apparently left itself limited room for recourse with the suppliers concerned despite the 'apparent protection' of 'fixed price' contracts. Similarly, as also with the Department of Employment, Education, Training and Youth Affairs (DEETYA)(#52) , we exposed ourselves unnecessarily to high payouts on contracts where we had not had the equivalent value delivered. And that is the responsibility of the public service. No-one else. In essence, it comes down to those who are responsible and therefore accountable for contract outcomes.

Our aim is to achieve value. The private sector talks about value for money but I doubt there is often a common understanding of what that involves in the two

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sectors. Let us focus on achieving that value. And we are not paying until we get that value. Importantly, we need to have accepted methods of ensuring that we are being sensible about that outcome. For example, we need to identify clearly milestones that have to be met and the various elements of the contract that are deliverable within specified time, cost and quality. There should not be any equivocation about required performance nor the responsibilities of both parties.

On the other side of the fence I can understand why the private sector people get so annoyed. It is frequently apparent that we do not adopt commercial principles in our contract management arrangements nor spend the time and effort explaining, say, the public sector accountability imperatives. Some exhibit no understanding about what commercialisation means in contract performance. So it is no wonder there is criticism of our performance. We need to ensure our people have the skills and ability to understand the commercial nature of contracts. We have to develop 'experts' in the public service on contract management. It is today's imperative; not tomorrow's problem. And we are the ones who largely have to do something about it.

VI. Concluding Remarks

The changing environment of public administration is creating considerable concern and uncertainty among public servants not just about their future but also about what is expected of them professionally, ethically, managerially and operationally. It seems to me such a situation requires clear strategic direction and management. That, in turn, demands leadership, which includes this group, but particularly focuses on Chief Executive Officers (CEOs). The various public sector reforms over the last fifteen years and recent legislation, implemented or currently in bills for parliamentary debate, have seen a shift from central agency control to a framework of devolved authority with enhanced responsibility and accountability being demanded of public sector entity CEOs, Boards and senior management.

I have particularly stressed the importance of people management and their personal development as part of our leadership challenge. And there are vital

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lessons for all of us in a climate of down-sizing or right-sizing or simply in any re-structuring of our organisations that might result from government decisions directly or indirectly through initiatives, such as business process re-engineering, to improve our performance. We need to redress any negative impact, and/or perceived adverse consequences, of such changes by credible, confidence building positive action which must include clearly recognising and overtly valuing our staff. Dr Pfeffer gives us a clear message that is highly relevant to our changing environment:

'To tell employees that the organisation has no long-term commitment or obligation to them is fine, as long as the firm is willing to bear the consequence of a mutual lack of long-term attachment and commitment on the part of its employees.'(#53)

Our credibility as leaders would also be enhanced by the clear identification and 'protection' of our core functions or business through the development of performance strategies and supporting resource capabilities, including timely and appropriate staff training, which would inspire confidence in those directly involved and help meet the high expectations of our various stakeholders including our clients, the Executive Government and the Parliament. Central to our core business is the legislative framework. It guides us in the what, how and why of our functions, responsibilities and accountability. These characteristics are central to our comparative advantage as public servants. The now largely principled-based financial management and administratively oriented legislative framework provides us with significant scope and flexibility for innovative, imaginative and comprehensive corporate governance approaches focussed on achieving the required outcomes and results.

Such an environment would also be a useful building block for us, as leaders, to use in promoting the reputation of the APS as a world class public service. This is essential for the pride, morale, ownership and commitment of those working in the Service as well as for the trust, confidence and on-going support of our various stakeholders. We have enjoyed, and still do retain, the high respect of many international organisations and other national public services for our professionalism, competence and innovation. We clearly have not 'sold' this reputation well to the foregoing groups. The apparent implication is that we have

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still to develop such a reputation in the new environment. We need to do better with our communication and be more pro-active in demonstrating we can deliver timely, high quality products and services. Not only do we have to perform, we have to provide convincing evidence in order to earn our stakeholders' trust, respect and confidence. In short, the APS has to be valued for its contribution to good governance. And that will not happen without considerable effort on our part.

Complementary to the points just made, it would be a clear sign of failure if we were to experience 'privatisation' of the public service virtually by default. That unfortunate conclusion could simply be due to our inability to perform either by not delivering the required outputs and outcomes or by being too narrow or introspective in our management approach to what should be the 'main game'. There are clearly significant management challenges at all levels of the public service from what I have broadly described as 'privatisation' ranging from adoption or adaption of private sector principles, approaches, concepts and techniques to the actual provision of public service functions and services by private sector firms.

I start from the proposition that there are fundamental differences between the public and private sectors not the least because of the political and institutional factors that are all pervasive, particularly in what has traditionally been regarded as core government functions such as Defence, Foreign Affairs and Trade, Justice, Treasury and Social Welfare specifically recognised in the Australian Constitution. I also recognise that some public services in these functional areas such as the provision of policy advice and delivery of welfare are increasingly being performed by the private sector. Significant issues relating to accountability trade-offs and the public interest have been raised. In my view, it is incumbent on government to identify what it considers to be core government functions and explain its judgement about the various trade-offs associated with any involvement of the private sector, in particular about any potential conflicts of interest and accountability trade-offs that might arise and how they should be dealt with.

The latter concerns are not so crucial in the non-core government areas which tend to be more commercialised and more closely resemble the private sector.

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While public service values and conduct are still important in these areas, the financial performance imperative tends to loom much larger in the government's consideration. That is, there is a much closer relationship with the private sector's 'bottom line' measurement of performance. There is still a need to explain why the function should be in the public sector. However, it would be no exaggeration to conclude that such functions are much more than less likely to be candidates for full privatisation. I consider the dichotomy between the FMA and CAC Acts can provide a useful basis for considering what is core and non-core government and the different public interest imperatives and accountability disciplines that go with such a distinction. Therefore a review of entity classifications under those two Acts would be helpful to all concerned particularly where there is any apparent inconsistency in, and/or question of appropriateness of, individual entity classifications under both Acts.

Outsourcing of the provision of services or activities by individual entities involves somewhat different considerations where the issues are, or should be, primarily about economy and efficiency. It is quite feasible for a number of products, services or activities to be outsourced by core government entities with favourable impacts on their outputs and outcomes, involving virtually no trade-off in accountability. The situation should generally be even less unencumbered in the non-core areas. The main concerns would be about effective contract management and, perhaps, any inadvertent impact on the entity's core business because managers took a partial, rather than whole of business, approach to outsourcing decisions. The challenge is to ensure managers have, or seek, timely and appropriate advice and/or acquire the necessary skills to make the required decisions effectively without unintended consequences for the entity's functions, overall efficiency and effectiveness.

There is no doubt that market testing, competitive tendering and contracting and the application of Competitive Neutrality Principles have placed new and different demands on APS managers. The essential challenge, in my view, is to use these techniques positively to improve our performance. They are not some kind of substitute for good management or abrogation of responsibility and accountability. There is general acceptance that entities cannot outsource their accountability. Any apparent trade-offs in accountability need to be brought to the Minister's/Government's attention for decision. Such decisions should be transparent. As part of good corporate governance and the proper application of

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risk management, all risks should be systematically identified, assessed, prioritised and treated. Importantly, there should be regular monitoring and review to ascertain whether the initial judgements are reasonable and whether the outputs/outcomes required are actually being achieved.

The increased focus on robust corporate governance arrangements in the private sector, particularly in the last five years, provides some useful insights and lessons for both the public sector core and non-core entities. While the main elements of corporate governance have been introduced over the last decade or so by the various public service reforms, we have generally not integrated them into a coherent and complementary governance framework which is focussed positively on organisation performance, responsibilities to stakeholders, sound control structures, financial reporting and client service. The ANAO has produced a series of Better Practice Guides in these and related areas which should prove useful for public service managers.

The greater client or customer orientation which is being reinforced by the requirement for Government Service Charters presents particular challenges not only for public sector performance but also for the attitudinal changes necessary to ensure that the charters are not simply another process. The move to 'one stop shop' provision of services with its orientation towards fitting the programs to the client rather than the reverse is a significant cultural change for many public servants.

We should also not underestimate the effort involved in moving to managing and budgeting on an outputs/outcomes basis and using accrual accounting concepts and information for cost, price and financial information. No doubt most are aware of the significant management information systems deficiencies we generally face. There is a chicken and egg dilemma for managers. Learning to manage the production of required outputs/outcomes on an accrual as opposed to a cash basis is difficult enough but is virtually impossible if our systems do not provide the necessary management information in accrual formats. Periodical conversions of cash to accrual information is of little or no assistance to most managers.

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And, finally, I would like to re-iterate the growing importance of contract management in particular and project management in general. A number of Parliamentary and audit reports in recent years have pointed to the urgent need to improve public sector approaches and skills in these areas. The nature of the contractual relationship is recognised as being fundamental to the success of contracting-out. A recent Senate Finance and Public Administration References Committee report indicated that:

'The approach to contract management should in general be based on:

- *commitment to open communication, trust and mutual support;*

- *flexibility; and*

- *product or service.'*(#54)

There has been general agreement about the need to ensure appropriate performance measures form part of contract arrangements. However, as Professor Richard Mulgan 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 contractual arrangements come to the degree of control and accountability exercised in the public sector(#55) . He goes on to conclude that:

'Contracting out inevitably involves some reduction in accountability.'(#56)

This is in contrast to the Industry commission's argument that contracting-out may actually increase accountability(#57) . While I am in agreement with Professor Mulgan, the clear message is that we ensure that appropriate accountability mechanisms are in place with clear lines of responsibility for the ultimate outputs and/or outcomes. The real test is the successful achievement of the required results. And that is the ultimate challenge for all of us.

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