

The Auditor-General  
Audit Report No.59 2001-02  
Performance Audit

## **AusAID Contract Management**

**Australian Agency for International Development**

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of Australia 2002

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Canberra ACT  
20 June 2002

Dear Madam President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Agency for International Development in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *AusAID Contract Management*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett'.

P. J. Barrett  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

## AUDITING FOR AUSTRALIA

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## Abbreviations/Glossary

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ANAO	Australian National Audit Office
AMB	Activity Monitoring Brief
AMC	Australian Managing Contractor
AMS	Activity Management System
ATL	Australian Team Leader
AusAID	Australian Agency for International Development
CSG	Contract Services Group
KRA	Key Result Area
PCC	Project Coordination Committee
PDD	Project Design Document
PID	Project Implementation Document
PSCG	Private Sector Contractors Group
SOS	Scope of Services
TAG	Technical Advisory Group
TAP	Technical Assessment Panel





# **Summary and Recommendations**



# Summary

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## Overseas aid

1. In 2001–2002, the Australian Government will provide \$1.57 billion in overseas aid through the Australian Agency for International Development (AusAID). Australian aid promotes Australia's fundamental national interests in regional peace, stability and prosperity and is often delivered in high-risk environments. Papua New Guinea, Pacific island countries and the poorest regions of East Asia are the areas of highest aid priority, with assistance concentrated in key areas such as governance, agriculture, health and education.
2. AusAID manages the delivery of this aid through a number of major programs, with each program comprising a range of individual aid activities. AusAID's systems and processes were recognised by the Development Assistance Committee of the Organisation for Economic Cooperation and Development in 1999 as placing 'Australia at the top end of management practices in Member aid agencies'.<sup>1</sup>

## Commercial contracts

3. Australian firms and individuals under contract to AusAID play a major role in delivering Australia's aid program. During 2000–2001, AusAID managed more than 1600 commercial contracts with a total contract value of approximately \$2.3 billion<sup>2</sup>. AusAID estimates that the aid delivered through these contracts represents annually around 90% of Australia's bilateral aid program, which accounts for some 60% of the overseas aid program.
4. The aid contracts managed by AusAID vary widely in purpose, complexity and scope, and therefore in contract value. At one end of the spectrum are many short-term, relatively simple, consultancies. Such consultancies can involve pre-feasibility studies; development of full project designs; or the provision of technical advice to AusAID. At the other end of the spectrum, there are complex, multi-million dollar construction and institutional strengthening projects.
5. With Australian contractors playing such a major role, effective management and delivery of aid through these contracted arrangements is critical to successful aid outputs and outcomes. However, the contractual

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<sup>1</sup> *Development Co-operation Review—Australia*, Organisation for Economic Cooperation and Development, December 1999.

<sup>2</sup> Many of the larger contracts last for several years, and so their total value is in excess of annual aid expenditure.

relationship is not a straightforward one between two parties. It involves relationships with a number of key stakeholders, including:

- the *partner government*—the government of the country receiving the aid;
- the *counterpart agency*—the department or agency of the partner government that the contractor works with when delivering an aid project;
- the *Australian Managing Contractor (AMC)*—typically a large Australian company, partnership or consortium contracted to deliver the aid project;
- the *Australian Team Leader (ATL)* and project team—employed or contracted by the AMC to deliver the project in the recipient country;
- the *desk*—an AusAID officer(s) stationed in Canberra who has primary responsibility for managing the aid project; and
- the *post*—an AusAID officer(s) stationed in the recipient country who monitors project delivery and liaises with the ATL and partner government in-country.

## The audit

6. The overall objective of the audit was to assess AusAID’s management of commercial contracts to deliver Australia’s overseas aid program. To this end, the audit examined whether:

- there are sound supporting structures for contract management;
- AusAID effectively manages risks;
- contracts clearly define deliverables;
- services are delivered and payments are made in accordance with the contract;
- there are appropriate arrangements to manage contractor performance;
- strategies appropriately assess and allocate risk between AusAID and contractors; and
- contracts deliver the desired aid outcomes.

7. The audit focused on major contracts (see paragraph 4) and on the management of contracts after they had been signed. The audit did not address tendering processes, nor funding of voluntary non-government organisations or Australian Development Scholarship contracts<sup>3</sup>.

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<sup>3</sup> These have been the subject of recent audit reports: ANAO Audit Report No.18 1998–99 *Accounting for Aid—The Management of Funding to Non-Government Organisations-Follow Up Audit* and ANAO Audit Report No.15 of 1999–2000 *Management of the Australian Development Scholarships Scheme*.

8. The ANAO was assisted in the audit by the technical advice of specialist contract management experts<sup>4</sup> and an AusAID officer. The audit criteria were derived from recognised good practice, including the ANAO's Better Practice Guide on *Contract Management*<sup>5</sup>. The audit methodology included fieldwork and on-site visits in Papua New Guinea, Viet Nam and Vanuatu, and in depth examination of the management of 14 randomly selected contracts worth \$272 million.

### AusAID strategic reforms

9. During the course of the audit AusAID completed a wide-ranging review of its strategic direction. The resulting Strategic Plan: *Improving Effectiveness in a Changing Environment* (December 2001) identifies three main areas of change: increased emphasis on program quality; enhanced policy and analytical capacity; and strengthened people management and corporate systems. A number of initiatives flowing from the Plan relate to improving contract management in areas identified in this audit as warranting attention. The ANAO kept AusAID informed of emerging findings throughout the audit to assist in its reform process.

## Conclusion

10. Many aspects of AusAID's aid contract management are soundly based and well managed. However, there are some inconsistencies in contract management and weaknesses in supporting process and practice that require strengthening. AusAID has been conscious of many of these shortcomings and has been working in recent years to put in place remedial action, including initiatives flowing from the new Strategic Plan.

11. Overall, AusAID has the necessary **supporting structures** to facilitate effective contract management, including guidance; central coordination and advice; and appropriate training. However, guidance mostly does not set minimum standards nor requirements, leading to a variety of approaches to managing contracts, often not related to specific contract features. Contracting responsibilities are in practice fluid, sometimes leading to duplication of effort and conflicting advice to contractors. Furthermore, high desk officer turnover is having an adverse ongoing impact on the quality of contract management.

12. AusAID has a sound framework for **managing the risks** that are inherent, and often unavoidable, in the delivery of overseas aid. This includes the

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<sup>4</sup> Currie and Brown, who also assisted the ANAO in the development of the Better Practice Guide on *Contract Management*, ANAO, February 2001.

<sup>5</sup> ANAO Better Practice Guide on *Contract Management*, February 2001.

development of project risk management plans, which are part of the contractual arrangement. However, some strengthening of risk management is desirable, including by identifying the party with primary responsibility for the management of significant risks.

13. **Contract deliverables** are generally clearly defined in AusAID's commercial contracts, with milestones clearly set out in terms of time, cost, quantity and quality. However, some contracts have excessive numbers of milestones, leading to micro management. AusAID is aiming to address this through more flexible and less prescriptive project design and measures to simplify contracts.

14. There are systematic arrangements for **project monitoring and review**. However, formal reporting by contractors is often excessive, impacting on the cost and quality of projects. AusAID has recently implemented some measures aimed at reducing contractor reporting.

15. AusAID follows appropriate processes for **contractor payment**, including **verification of service delivery**. However, inconsistent invoicing practices across the agency need to be addressed.

16. The high-risk overseas environment, combined with long implementation times, and changing project needs, mean that contract variations are common. This can result in contractors undertaking work that has not (yet) been the subject of an approved contract variation. It would be prudent for AusAID to assess the risks arising from this situation and the means of managing it more formally and effectively.

17. Feedback on **contractor performance** is critical to project success. Assessment occurs through two channels. Firstly, AusAID desk officers are expected to provide performance feedback to contractors regularly and in writing. However, this policy was not consistently implemented. Secondly, AusAID has a new scheme to assess the performance of major contractors. This scheme links past performance to the contractor's capacity to win future contracts and has resulted in some significant improvements in performance. Notwithstanding this, the scheme could be improved through the collection of more quantitative information on performance.

18. The environment in which AusAID operates means that there are unique considerations that sometimes makes **allocating responsibility for risk management** difficult. In reality, when problems arise, AusAID adopts a practical and cooperative approach, acknowledging that some risks are beyond the contractor's control. There would be merit in contracts including provisions more clearly articulating AusAID's intended approach to contract management, including problem resolution, but without weakening the Commonwealth's position.

19. The flexibility of AusAID's relationship with contractors, for the more complex and high-risk contracts, actually reflects features normally found in cooperative/partnering arrangements. This provides a good foundation for entering into a more formal partnering contractual arrangement after award of tender. Such 'post-award partnering' offers a number of potential benefits for AusAID, particularly where project risk is hard to define and requirements are difficult to specify.

20. Assessing the performance and quality of aid activities is recognised as a challenging task. AusAID has developed a sophisticated assessment system, which provides a sound basis for assessing the quality of aid outcomes. However, there are aspects of the system that warrant enhancement, in order to improve the information available to AusAID, the Parliament and other stakeholders.

21. In 2000–2001, AusAID rated [77% of aid activities at, or above, the minimum acceptable standard](#).<sup>6</sup> This compares with an overall target of 75%. Aid performance in some countries and sectors was below the target. The performance of contractors in managing and delivering these activities has been assessed as mostly satisfying AusAID requirements.

## AusAID response

22. AusAID agreed with all 10 recommendations in the report and commented:

AusAID welcomes the ANAO review of contract management which we believe confirms the essential quality and accountability of the Government's aid program, and reinforces the current and next generation of contracting improvements within AusAID.

AusAID appreciates ANAO's recognition of the role of the Australian Government's aid program within the broader Government agenda: that Australian aid promotes Australia's national interests in regional peace, stability and prosperity; and that the environment for aid delivery in developing countries poses unique risks and challenges.

The positive assessments of the ANAO report confirm AusAID's capacity with respect to the core issues of effective and accountable contract management. This includes having a sound framework for managing the risks that are inherent and often unavoidable in the delivery of overseas aid.

AusAID agrees with the audit report's recommendations—which essentially build on the existing framework—to further strengthen management and delivery of the aid program. As noted in the report, AusAID has been conscious of a number

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<sup>6</sup> However, the ANAO notes that an AusAID quality assurance review has suggested that the ratings scheme may be erring towards over-optimism.

of inconsistencies in application of policies and has been actively addressing these. Importantly, the significant and wide-ranging nature of AusAID's strategic plan itself sets an agenda for further significant reform—including contract management and related matters such as performance measurement. The ANAO recommendations reinforce the substantial moves in that direction envisaged under the plan. Thus, each of the recommendations is being, or will be, addressed as existing resources permit.

AusAID therefore welcomes the ANAO findings and recommendations as a reinforcement of the directions that the agency is pursuing.



# Key Findings

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## AusAID Structures for Contract Management (Chapter 2)

23. The key role of contractors in delivering Australia's overseas aid means that sound contract management is critical to meeting AusAID's aid objectives. This is a complex task, since aid contracts are spread across many different countries with different cultures and administrative structures; provide many different types of aid; and range from small, short duration tasks to long term multi-million dollar projects. In these circumstances, a systematic and structured approach to contract management makes it more likely that contract management practices and risk management are appropriate. It also provides assurance that minimum corporate standards, including legal requirements, are met.

### Guidance and standards

24. The need for contract management guidance is met by AusGUIDE, which is AusAID's key reference for contract managers and contractors. However, while AusGUIDE is seen as a valuable tool by AusAID and contractors, its guidance is mostly not mandatory. That is, apart from some basic risk management and accountability procedures, it does not set minimum standards or requirements.

25. AusAID has advised that the ability to interpret and adapt this guidance reflects the fact that delivery of aid assistance is often a complex task that requires flexibility. However, this has led to a variety of approaches to managing, monitoring and reviewing, and reporting on, contract implementation and contractor performance. Contractors advised that this was particularly the case in relation to requirements for contractor reporting. The ANAO found that the differences in approach were often not related to specific features of the project/contract.

26. There would be substantial merit in distinguishing those elements of AusGUIDE which are mandatory from those that are optional. This would permit appropriate flexibility in approach, as desired by AusAID, whilst facilitating a common understanding between AusAID and contractors of minimum requirements. It would also facilitate a more consistent approach across AusAID.

### Contract management roles and responsibilities

27. The formal AusAID contract manager is the desk officer. However, specific contracting responsibilities are in practice divided between the Canberra desk and the overseas post, although their respective roles and responsibilities are

only broadly defined. This has led to different approaches across AusAID and to duplication of effort. This is particularly the case in relation to the monitoring of activities and can lead to confusing or conflicting advice to contractors, creating the risk that inefficiencies in the contractual relationship are passed on in the contract price or affect the progress of the aid project.

28. AusAID's Strategic Plan proposes focussing activity management and monitoring more in-country, which it expects will substantially address the desk/post relationship issue. Past experience suggests that the new arrangements would benefit from being documented to provide the necessary assurance that desk and post officers have, and act upon, a common understanding of their roles and responsibilities.

### **Contract management skills and knowledge**

29. AusAID has a focus on contract management skill development, with training provided to all relevant Australian staff and courses available for locally contracted staff overseas.

30. AusAID has a high rate of staff turnover, largely because of internal mobility. (For example, the average time a desk officer spent in one position was recently estimated to be about 10 months.) The consequences of this high turnover include unfamiliarity with the project—affecting speed and quality of decision making—and the need for contractors to invest time and effort in frequent briefing of new desk officers.

31. Effective filing procedures and handover arrangements would partly help to mitigate the impact of the turnover. However, there were shortcomings in both these areas. AusAID has advised that it intends to develop further initiatives to address this problem. The effectiveness of AusAID's measures in addressing this matter warrants continuing assessment, given the evidence in this audit that high desk officer turnover is having an adverse ongoing impact on the quality of contract management.

### **Management information**

32. AusAID's computerised project management information system has a number of limitations. While some of these have been addressed in recent years, there remain deficiencies in the accuracy and timeliness of data. For example, 15% of contracts were not entered on the system in a timely manner and only half of the required number of project status reports had been prepared in the system. AusAID is seeking to address these shortcomings by installing a more user-friendly web-based application.

## Accountability arrangements

33. The Joint Committee of Public Accounts and Audit has recommended that 'all agencies establish and maintain an effective contract register'.<sup>7</sup> AusAID meets this recommendation by maintaining an adequate contract register. AusAID officers also keep records of key communications with contractors, although the requirement is that officers keep records of all such communications. This appeared to be adequate, although there would be merit in clarifying guidance for those concerned.

34. AusAID gazettes all initial contracts. However, some 12% of contracts were not gazetted within six weeks of the contract sign date<sup>8</sup>, as required. Contract variations have not been gazetted as required. AusAID has only recently become aware of the need to do so.

35. In the past, many AusAID contracts have not contained clauses explicitly providing for Auditor-General access to the contractor's premises. However, AusAID has recently implemented a new suite of standard contracts that do provide for such access. The suite of contracts also contain confidentiality clauses that prevent disclosure by the contractor of 'AusAID Confidential Information', but which do permit AusAID to disclose information to, among other things, the Parliament, facilitating public accountability.

## Communication arrangements with overseas stakeholders

36. Good communication with overseas governments and stakeholders is an important element of the management of contracted aid projects, particularly as partner governments are not formally included in the contractual arrangements. The ANAO found that relationships between contractors and partner governments and AusAID were generally positive and satisfactory.

## Managing Risks (Chapter 3)

37. The delivery of aid overseas is inherently risky, involving multiple relationships, complex contractual arrangements and challenging development problems. The working environment is difficult with external factors ranging from differences in business ethics, procedures and practices to environmental disasters, civil unrest and war. It is neither possible nor desirable to eliminate all this risk. Risk is implicit in all that AusAID does and therefore needs to be managed well.

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<sup>7</sup> JCPAA Report 379, *Contract Management in the Australian Public Service*, October 2000, p. 43.

<sup>8</sup> The ANAO looked at contracts signed between 1 July 2000 and 19 May 2001.

## Management of risk through bilateral relationships

38. The capacity of the partner government to support a project during and after implementation varies during a project's life. Consultation with partner governments is therefore important to ensure that potential risks are identified and managed. The ANAO found that consultation with partner governments on risk identification and management occurred for most of the contracts examined, both during project design and project implementation.

## Risk management processes

39. AusAID's risk management processes involve, among other things, development of a risk matrix at the project design stage and subsequently requiring the successful tenderer to prepare a risk management plan. These processes provide a sound framework for managing project-related risk. However, there is limited risk management training offered for key contract management staff, which has the potential to limit the effectiveness of these processes.

40. Recent contracts specify and identify how risk is to be managed by the contractor, which is a substantial improvement in risk management (these provisions were rarely included in contracts prior to 1999). However, risk management plans often identify a number of parties as having joint responsibility for some risks, including the partner government and counterpart agencies, which are not parties to the actual contract. The identification of the party with *primary* responsibility for the management of each *significant* risk would lessen the likelihood of those risks being overlooked.

## Risk monitoring and review

41. AusAID requires the contractor to provide regular reporting and updated assessments against the risk management plan. However, reporting was normally of *emerging* risks on an exception basis, that is contractors did not undertake a systematic reassessment of the original risks. The latter is necessary periodically in the event that changing circumstances alter risk priorities or weaken the operation of controls. AusAID's more recent contract proforma do require contractors to update the risk management plan, but do not specify a timeframe for this to occur.

## Specifying Contract Requirements (Chapter 4)

### Project design

42. AusAID has a systematic approach to designing aid projects involving three stages: project identification and initial assessment; project design<sup>9</sup>; and appraisal and approval of the project. The resulting Project Design Document is agreed with the partner government and is a key document in project approval, tendering and contract negotiation, and is influential throughout the life of a contract.

43. AusAID requires project design teams to consider a wide range of matters, which can contribute to complexity of design. This can result in sometimes large, complex and overly ambitious design. As well, some designs assume an unrealistic level of counterpart agency capacity. This was also a frequent concern of contractors. It has been recognised by both AusAID and contractors as contributing to difficulties in implementing some projects.

44. AusAID has recently commenced some initiatives to make designs more flexible and less prescriptive, including a 'phased' approach (comprising the short-term delivery of inputs with the design to be developed over a longer period) and a 'rolling design' approach during the life of a project.

### Deliverables

45. Contract deliverables are generally expressed as one, or a combination of: outputs, such as the construction of a building or bridge; activities that produce outputs, such as the delivery of a training program; or inputs required to produce an output, for example, the procurement, distribution and installation of equipment.

46. Deliverables in AusAID's commercial contracts were generally well described, quantifiable and unambiguous. Contracts examined (apart from one) contained detailed information on the goods and services to be delivered by the contractor, and included milestones for each component.

### Milestones

47. The ANAO found that contract milestones were generally clearly set out in terms of *time*, *cost*, *quantity* and *quality*. The milestones were generally achievable (for example, requiring contractors to produce reports, provide training, run workshops, produce course outlines etc), with the outputs usually within the contractor's control.

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<sup>9</sup> Project design is normally contracted out to the private sector.

48. There was wide variation in the number of milestones employed in (often similar) contracts. Some contracts contained excessive numbers of milestones—one extreme example involved the contractor meeting 114 milestones over the two-year life of a \$3 million project. This can lead to micro management by AusAID and continuous, repetitive reporting by contractors which was of little benefit to AusAID. AusAID uses the term ‘milestone madness’ to describe this practice, and has recently undertaken a number of initiatives to minimise the number of contract milestones. This has had some success, with some recently signed contracts having just four or five milestones a year. AusAID’s moves in this direction have been aided by a contract simplification process, which has involved moving away from outputs based contracts (see paragraph 62).

49. The ANAO found that AusAID had established, and set out in the contract, the means of verifying progress for most of the projects examined. However, this was not always the case. For example, one institutional strengthening project did not have a regime to verify (or require the contractor to verify) the quality of outputs against identified milestones, requiring the desk officer to develop ad hoc arrangements to verify claims.

## Managing Contract Delivery (Chapter 5)

### Monitoring and progress reporting

50. There are arrangements for regular project monitoring and review, including Project Coordination Committee meetings with the partner government. The key arrangement is based on the relationship between the post and the contractor’s Australian Team Leader (ATL). The ANAO found that these relationships were effective, with posts keeping in regular contact with the ATL. AusAID plans to increase the extent to which activity management and monitoring occurs in-country, which is likely to substantially address concerns observed in this audit that some (Australian-based) desk officers visited projects infrequently.

51. ATLs are required to produce a range of reports on the implementation of projects. However, there is often excessive reporting, reports can be quite large, and in practice AusAID officers do not read many of the general (non-milestone) reports. (One example examined involved a report of over 60 pages, which was one of more than 45 milestone reports to be produced in just over two years.) This can have an impact on an ATL’s work—one estimated that he would spend over 60% of his time writing reports, significantly reducing the time available to transfer skills to the counterpart agency. There is also an impact on project cost, for example, in management costs. As well, AMCs advised that they take account of reporting commitments in pricing tenders.

52. AusAID has been seeking to address these concerns. Measures underway, or commenced during the audit, included 'contract simplification', involving reduced reporting for new and some existing contracts.

### **Verification of service delivery**

53. For the most part, AusAID appropriately verified the achievement of contract milestones, including through site visits and reports from Technical Advisory Groups (TAGs) or the contractor. The TAGs are small teams contracted by AusAID to provide independent technical advice. Their use has grown substantially in recent times but in a somewhat uncoordinated way. The result was that they sometimes duplicate post monitoring and lead to extension and complication of the reporting/verification process.

### **Contract variations**

54. The challenging environment in which aid is delivered and lengthy implementation times often results in delays in, or changes to, project implementation requiring alterations to the scope of services, basis of payment or term of a contract. About half of all contracts in force during 2000–2001 had been varied at least once, with the likelihood of variation increasing with the value of the contract (for example, some 86% of contracts valued over \$5 million had been varied).

55. It is common practice for a contract to be signed with both the contractor and AusAID aware that a variation would be required at an early opportunity. This sometimes reflected changed requirements since the initial design, but sometimes also poor design. The initiatives to improve project design (paragraph 44), providing greater flexibility and responsiveness to evolving circumstances, appear to offer the prospect of fewer variations resulting from design limitations in the future.

56. Changing project needs, the cyclical way in which variations are submitted and approved, and the time that may be involved in formally approving variations, means that contractors are sometimes undertaking work additional to that provided for in the existing contract without a formal variation to the contract. In some of these cases, contractors received letters of comfort but in others oral commitments were given. As well, AusAID officers sometimes employed informal 'work-arounds'. While this reflected a reasonable level of trust between AusAID and contractors, there was some discomfort amongst contractors concerning the informality of the way this ongoing issue was managed. It would be prudent for AusAID to assess the risks arising from this situation as well as the means of managing it more formally and effectively, including assessing current practices for appropriateness and identifying better practice.

## Payment arrangements

57. AusAID has appropriate processes for approving and making payments. However, invoicing requirements vary widely from desk to desk and can change for the same contract with a change of desk officer. AMCs advised that this created problems in preparing invoices and increased costs, which were then passed on to AusAID. AusAID has advised that it intends to simplify invoicing requirements for future contracts.

## Assessing contractor performance

58. Contractor performance is critical to project success. Assessment and feedback on contractor performance occur through two channels. Firstly, and most immediately, AusAID desk officers are expected to provide performance feedback to contractors regularly and in writing. However, this policy was often not followed. Feedback that was given tended to be ad hoc. The provision of day-to-day feedback to contractors would benefit from greater regularity and consistency across AusAID.

59. Secondly, AusAID has recently introduced a scheme to assess the performance of the seven major contractors that account for about half of total contract value (with two further contractors to be included by December 2002). Contractor strengths and weaknesses are assessed under the same assessment criteria used for the tender assessment process and conveyed to the contractor in a formal performance discussion. The contractor is given six months to take any remedial action before the process is repeated. A final assessment is then prepared, which is used in tender assessment.

60. This scheme is an improvement on previous arrangements, with the linking of past performance to the contractor's capacity to win future contracts being a strength. Evidence indicates that AMCs were acting, or planning to act, on identified shortcomings. AusAID advised that there have been significant improvements in the performance of some AMCs as a result of the scheme.

61. AusAID envisages that the scheme will evolve, in consultation with contractors. The ANAO considers that areas that warrant strengthening include collecting more *quantitative* information on performance to complement the *qualitative* information currently collected; expanding the scheme to cover a wider range of contractors; clarifying how the tender assessment process is to be equalised for new contractors or those not assessed; and ensuring that desks/posts maintain sufficient documentation to support their assessments.



## Strengthening AusAID's Contracting Approach (Chapter 6)

### AusAID's contracting approach

62. AusAID's contracting approach has evolved over time. Contracts initially had a focus on *inputs*; this later changed to a focus on *outputs*. While output contracts remain AusAID's preferred approach for small value and construction activities, it now often uses *hybrid* contracts for major services such as institutional strengthening and capacity building, where payments are linked to essential project inputs and the achievement of a limited number of significant and strategic milestones.

63. The environment in which AusAID operates means that there are unique considerations that make some risks hard to manage by either party. AusAID seeks to protect the Commonwealth by the selective use of penalty clauses, unconditional financial undertakings and performance guarantees. Risks arising from the partner government's contribution to projects are addressed by *extension of time* contract provisions for circumstances that arise and are beyond the contractor's reasonable control.

64. In between the two extremes is a substantial grey area where it is not possible to precisely attribute causes of delay. In reality, when problems arise AusAID adopts a practical approach, acknowledging that some risks are beyond the contractor's control, and seeks resolution through cooperative discussion. However, this approach is not reflected in contract provisions. There is a risk, acknowledged by AusAID, that existing provisions may deter new contractors from tendering and may impact adversely on price for complex, high-risk projects. There would be merit in the contracts reflecting AusAID's intended behaviour more than they do now but without weakening the Commonwealth's position. This might involve, for example, the inclusion of provisions identifying roles in relation to the project and a joint approach to problem resolution.

### Building on AusAID's contracting approach

65. AusAID is planning to expand the range of contracting choices available to it. In this context, it is currently developing a trial of contract alliancing<sup>10</sup> to establish its usefulness and cost/benefit in contracted aid delivery.

66. The ANAO found that AusAID's relationship approach, for the more complex and high-risk contracts, actually reflects features normally found in

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<sup>10</sup> Alliancing involves the purchaser and provider assuming a degree of joint management responsibility involving a shared risk/reward regime linking remuneration to the achievement of exceptional performance.

cooperative/partnering arrangements (for example, kick-off meetings to brief the contract team; joint problem solving; a reluctance to enforce penalties and a low level of disputation). Combined with a tender assessment process that already puts a strong weighting on technical merit<sup>11</sup>, this provides a good foundation for a more formal, and systematic partnering approach for some projects. This would involve, for example: flagging an intention in the tender documentation to both award the contract on the basis of merit and adopt a post-award partnering approach with the preferred bidder; developing procedures and guidelines to ensure that desks, posts and contractors share a common understanding; developing training for relevant contract management staff; and enhancing kick-off meetings so that they cover a wider range of issues.

67. Such ‘post-award partnering’ is likely to be most beneficial where project risk is hard to define and the requirements are difficult to specify. Potential benefits include greater assurance that an appropriate relationship is employed for projects; more systematic identification of projects that would benefit from a partnering-type relationship; and better contractor understanding of what is required of them.

## Evaluating Aid Quality and Capturing Lessons Learned (Chapter 7)

### AusAID’s quality rating system for aid activities

68. Assessing the performance and quality of aid activities is recognised as a challenging task. This is because donor agencies work in many different countries and sectors. As well, activities often focus on issues such as capacity building, policy reform and good governance, which are difficult to measure.

69. To address these challenges, AusAID has developed a sophisticated assessment system, involving desk and post officers preparing project status reports known as Activity Monitoring Briefs. Officers assess the quality of individual aid activities by addressing four key quality attributes:

<b>Good aid activities should:</b>	Have appropriate objectives and design	Achieve their objectives	Be professionally managed	Have sustainable outcomes
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<sup>11</sup> Assessment normally involves a weighting of 80% technical merit and 20% price. The focus on technical merit will generally ensure that the contractor with the best team, experience and processes is selected. These elements are important where the success of the project depends on the quality of the relationship with the contractor.

70. The following five-point rating system is employed ('satisfactory overall' is the lowest score that satisfies AusAID requirements<sup>12</sup>), and achievement of the overall aid objective is assessed by aggregating ratings for individual activities.

Weak	Marginally Satisfactory	Satisfactory Overall	Fully Satisfactory	Best Practice
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71. Development and implementation of this system are considerable achievements. The World Bank and the United Kingdom's aid agency had earlier adopted similar performance rating systems. Overall, the activity rating system provides a sound basis upon which to assess quality of aid outcomes. It addresses important issues such as the likely sustainability of outcomes; it has flexibility, such as the ability for narrative comments on performance to be recorded; and it records the overall quality rating for each activity, as well as separate ratings for the four quality attributes.

72. However, there are some aspects of the system that warrant enhancement, in order to improve the performance information available to AusAID, the Parliament and other stakeholders. For example, about 30% of aid activities in the country and regional program are exempt from the requirement to be rated, because they are not, by themselves, expected to produce sustainable benefits and are often low cost.<sup>13</sup> Collection of performance information on exempt activities, where it is appropriate and cost-effective to do so, would enhance AusAID accountability for the aid quality of a broader range of its activities. AusAID is now considering ways to do this.

73. AusAID requires that at least 90% of non-exempt activities be rated. This target has not been achieved, with completion rates of 85% for 1999–2000 and 79% for 2000–2001, weakening confidence in the validity of the performance data. Changes to the reporting arrangements were made in August 2001 to improve compliance, but their effectiveness has not yet been assessed.

74. The ratings of aid quality by posts and desks are largely subjective; and are therefore subject to the risk of over-optimism. A 1999 quality assurance review confirmed this risk by rating 40% of activities sampled as lower than the ratings given by desks and posts (10% were rated higher). If these results applied generally, the percentage of activities rated 'satisfactory overall' or higher in 1999–2000 would have fallen from 84% to 64%. AusAID has sought to improve the reliability of ratings by, among other things, asking the assessing officers to canvass a greater range of staff and stakeholders. However, there have been no

<sup>12</sup> It represents an activity that has some minor weaknesses as well as strengths, but where the weaknesses are not severe enough to threaten the activity.

<sup>13</sup> Such activities include project feasibility studies, design missions and monitoring activities undertaken by Technical Advisory Groups.

further quality assurance checks to assess whether rating reliability and objectivity have improved.

75. AusAID's 2000–2001 Annual Report included an overall assessment of the performance of the aid program and stated, among other things, that AusAID achieved the performance target of 75% for the country and regional component. However, it did not provide any further quantitative information, nor acknowledge limitations in the data. Transparency and accountability would be enhanced by providing a wider range of appropriate information on quality ratings for example, where meaningful, for key result areas and countries / regions, and by explaining any data quality limitations.

### **Aid performance outcomes**

76. AusAID has a target that 75% of activities are rated at, or above, 'satisfactory overall' (the lowest rating that satisfies AusAID requirements). The overall country and regional aid ratings for 1999–2000 and 2000–2001 exceeded the specified target, with 84% and 77% respectively of activities achieving the required level<sup>14</sup> (although the caveats at paragraph 74 regarding data reliability are pertinent to this conclusion). AusAID's view is that the decline in rating reflects 'unduly positive' ratings in the first year of the scheme, rather than a decline in aid quality. According to this view, the 2000–2001 ratings are likely to be more reliable indicators of aid quality.

77. Of the 77% of activities rated as 'satisfactory overall' or higher in 2000–2001, 12% were rated as 'fully satisfactory', and less than 1% as 'best practice'.

78. AusAID expects that some countries and sectors will be above, and some below, the aid quality target. This reflects, for example, the different development challenges and risks associated with aid delivery to a diverse range of countries. In this context, two out of 10 countries / regions had quality ratings of under 70% in 2000–2001. Three of the seven key result areas, namely environment, governance and health, were below the 75% overall quality target.

79. AusAID does not have data readily available that provides further dimensions to the quality assessment. There would be considerable merit in widening the analyses prepared from the system to include, for example, aid quality by size of project (or by weighting by expenditure), since there is such wide variation in the size of projects. For example the proportion of aid expenditure which falls below AusAID's minimum overall quality level would seem pertinent information.

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<sup>14</sup> These ratings are for all aid activities. The ratings for contracted aid delivery were very similar at 82% and 76% for 1999–2000 and 2000–2001, respectively.

80. In addition to the activity rating system, AusAID undertakes some quality assurance reviews. A review of project implementation assessed the overall quality of sampled activities as 'good', with 74% rated 'satisfactory overall'. The review identified contractor performance as a strength, with the sustainability of aid outcomes as the weakest area. Separate analyses by AusAID of a sample of contractor reports identified humanitarian and emergency assistance as the most difficult area in which to achieve quality. Quality outcomes were also considered difficult to attain in some countries/regions.

### **Contractor performance**

81. Effective contractor performance is a key determinant of successful aid outcomes, with the quality of in-country team leadership and strength of team motivation being major contributors to success. The ANAO analysed data collected on contractor performance for the activity quality rating system and found that contractor performance was rated 'satisfactory overall' or higher for about 87% of contracted activities in 1999–2000 and 2000–2001.

82. In addition, the ANAO's in-country fieldwork and site visits indicated that contractor team leadership and staff were generally of a good quality. Project teams demonstrated a strong commitment to achieving project objectives and a clear appreciation of the challenges in delivering aid in sometimes difficult development situations. Teams generally had a pro-active, practical approach to problem-solving and relationship management.

### **Use of lessons learned**

83. International aid organisations operate in a high-risk and complex environment, where mistakes and failure to learn lessons can be costly and lead to sub-optimal development outcomes. It is therefore recognised better practice to seek to harness, and use, key lessons from aid delivery.

84. AusAID has an extensive range of information holdings which contain lessons learned relevant to contracted aid activities, including a lessons learned database. However, the database is currently of very limited value: it has not been updated since 1998; has poor coverage of lessons for some key result areas; is mainly sourced from evaluation and review studies, and staff make very little use of the system. In addition, although project completion reports are a rich source of lessons learned, the relevant information is not entered on the database, and there is a high rate of misplacement of the reports.

85. Strengthened arrangements for the management of lessons learned are likely to require a more systematic approach to the identification, capture, management and presentation of relevant information. Given the important role that contractors play in designing and delivering projects, it is desirable that contractors have appropriate access to lessons learned.

# Recommendations

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Set out below are the ANAO's recommendations aimed at improving AusAID contract management. Report paragraph references and abbreviated AusAID responses are also included. More detailed responses are shown in the body of the report. The ANAO considers that AusAID should give priority to Recommendations 1, 3, 4 and 9.

## Recommendation

### No. 1

#### Para 2.8

#### Contract management guidelines

The ANAO recommends that AusAID:

- identify clearly those elements of AusGUIDE that are mandatory; and
- provide advance notice to contractors of changed reporting requirements and the related reasons.

*AusAID response:* Agreed.

## Recommendation

### No. 2

#### Para 2.18

#### Contract management roles and responsibilities

The ANAO recommends that AusAID articulate the contract management roles and responsibilities of desks and posts and provide these to contractors. Roles and responsibilities could be tailored to the particular needs of countries or individual contracts, and regularly reviewed to accommodate changing circumstances.

*AusAID response:* Agreed.

## Recommendation

### No. 3

#### Para 2.32

#### Retaining knowledge

The ANAO recommends that AusAID monitor the effectiveness of measures taken to reduce the impact of high desk officer turnover on contract management.

*AusAID response:* Agreed.

## Recommendation

### No. 4

#### Para 3.21

#### Risk management

The ANAO recommends that AusAID strengthen its risk management approach by:

- implementing systematic risk management training across AusAID;
- ensuring that contracts identify the party with primary responsibility for managing each significant risk; and
- requiring contractors to report at appropriate and specified intervals on both emerging risks and those originally identified.

*AusAID response:* Agreed.

**Recommendation  
No. 5  
Para 5.36**

**Contract variations**

The ANAO recommends that AusAID assess the risks of contractors undertaking work without a formal variation being in place and consider means of managing this situation in a more systematic manner.

*AusAID response:* Agreed.

**Recommendation  
No. 6  
Para 5.57**

**Assessing contractor  
performance**

The ANAO recommends that AusAID build upon the benefits of its new contractor performance assessment scheme by extending it to other contractors where cost-effective to do so, and collecting more quantitative information on performance.

*AusAID response:* Agreed.

**Recommendation  
No. 7  
Para 6.17**

**AusAID's contracting  
approach**

The ANAO recommends that AusAID review its contract provisions to articulate its intended behaviour, as appropriate, but without weakening the Commonwealth's position.

*AusAID response:* Agreed.

**Recommendation  
No. 8  
Para 6.28**

**Building on AusAID's  
contracting approach**

The ANAO recommends that AusAID build on its existing contracting approach by developing a more structured, post-award partnering approach that could be employed for appropriate, larger and more complex projects that AusAID delivers.

*AusAID response:* Agreed.

**Recommendation  
No. 9  
Para 7.27**

**Assessing and  
reporting aid  
outcomes**

The ANAO recommends that AusAID strengthen its assessment and reporting of the quality of aid outcomes, by:

- collecting performance information on activities of the country and regional aid program exempt from the rating scheme, where it is appropriate and cost-effective to do so;
- undertaking and recording quality ratings for all activities covered by the rating system;
- undertaking quality assurance of the reliability of quality ratings; and
- including in its reports to the Parliament a wider range of appropriate information on quality ratings for example, where meaningful, for key result areas and countries/regions, and explaining significant data limitations applying to reported aid quality ratings or the underlying assessments.

*AusAID response:* Agreed.

**Recommendation  
No. 10  
Para 7.55**

**Capturing lessons  
learned**

The ANAO recommends that AusAID develop an information management strategy that captures key lessons learned from the management and delivery of aid activities and enables AusAID staff and, where appropriate, contractors to readily access and use the information to improve the quality of aid activities.

*AusAID response:* Agreed.



# **Audit Findings and Conclusions**



# 1. Introduction

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*This chapter provides an overview of AusAID's aid program and the role of commercial contracts in aid delivery. It also outlines the audit approach.*

## Overseas aid

**1.1** The Australian Agency for International Development (AusAID) is responsible for the management of the Australian Government's overseas aid program. In 2001–2002, the Australian Government will provide \$1.57 billion in overseas aid through AusAID.

**1.2** This aid promotes Australia's fundamental national interests in regional peace, stability and prosperity and is often delivered in dynamic and high-risk environments. For example, in 2000–2001, conflict in the Pacific, economic and political transition in Indonesia, and the nation building efforts in East Timor required an intensive aid response. The aid program also played a key role in facilitating peace and security in the Solomon Islands, Fiji and Bougainville.

**1.3** Papua New Guinea, Pacific island countries and the poorest regions of East Asia are the areas of highest aid priority, with assistance concentrated in key areas such as agriculture, health and education. Aid is delivered through a number of major programs, with each program comprising a range of individual aid activities that have specified outcomes and outputs.

## The role of commercial contracts in delivering aid

**1.4** AusAID estimates that Australian<sup>15</sup> firms and individuals under contract to AusAID deliver around 90% of Australia's bilateral aid program, which accounts for some 60% of the overseas aid program. Contracted Australian expertise is used at all stages from project feasibility, design, and implementation, to review and evaluation.

**1.5** A relatively small number of contractors deliver the bulk of overseas aid.<sup>16</sup> For example, in 2000–2001 the largest contractor was delivering aid through 27 separate contracts with a total value of \$354 million; the second largest had 20 contracts worth \$209 million.

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<sup>15</sup> To tender for AusAID contracts organisations must be carrying on business in Australia or New Zealand (under the *Australia New Zealand Closer Economic Relations Trade Agreement* New Zealand companies are treated equally). Organisations must also have headquarters and associated facilities in Australia or New Zealand.

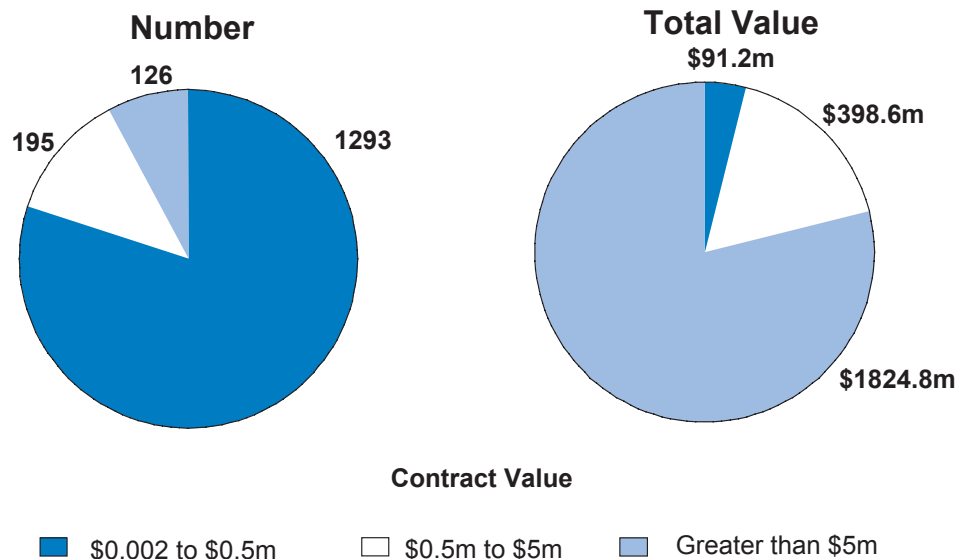
<sup>16</sup> Notwithstanding the significance of a small number of contractors in delivering aid, at any one time AusAID may engage more than 300 contractors.

1.6 During 2000–2001, AusAID managed more than 1600 commercial contracts with a total contract value of approximately \$2.3 billion. These contracts vary widely in purpose, complexity and scope. At one end of the spectrum are many short-term, relatively simple, consultancies. Such consultancies can involve pre-feasibility studies; development of full project designs; or the provision of technical advice to AusAID. At the other end of the spectrum, there are complex, multi-million dollar construction and institutional strengthening projects. These major contracts were the focus of the audit.

1.7 As Figure 1.1 demonstrates, the diversity of contracts is reflected in substantial variation in contract value. While the bulk of contracts are for less than \$500 000, those for over \$5 million account for some 79% of total contract expenditure. Appendix 1 provides further information on the number and value of contracts.

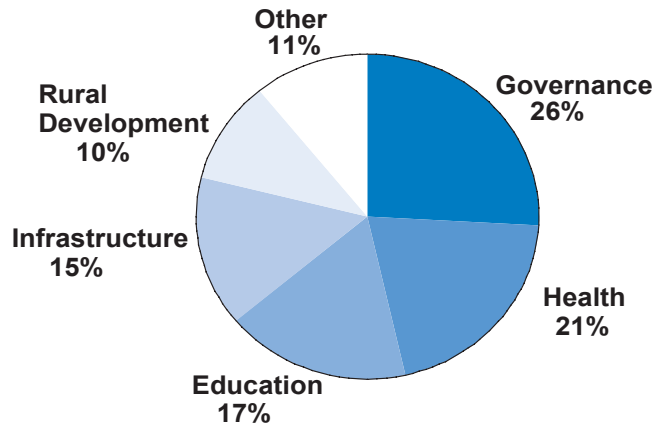
**Figure 1.1**

**Number and total value of commercial contracts in 2000–2001**



Source: AusAID data

1.8 The monetary value of overseas aid delivered by contractors in 2000-2001 is shown in Figure 1.2. Governance and health are the largest sectors, accounting for just under half of such aid, reflecting the fundamental role that these sectors play in promoting sustainable development.

**Figure 1.2****Contract value by key sectors 2000–2001**

Source: AusAID

1.9 One well known example of a major contracted project was the building of the My Thuan Bridge over the Tien Giang River in Viet Nam. This \$60 million project was opened in May 2000 and linked Ho Chi Minh City to the Mekong Delta region, assisting the social, economic and cultural development of the region. The largest project identified in this audit is outlined in Figure 1.3.

### Figure 1.3

#### Royal Papua New Guinea Constabulary Development Project

In 1985 Papua New Guinea asked Australia to undertake a study to assess the development needs of the Royal Papua New Guinea Constabulary (RPNGC). The study recommended a training and development program using Australian technical assistance.

Phase One of the project commenced in 1988 and concentrated on the RPNGC's administration, personnel management and training. A joint review towards the end of Phase One in 1992 recommended that the Project be extended into a second five-year phase.

Phase Two of the RPNGC Development Project commenced in January 1993 and, following an extension, was completed in February 2000 at a cost of \$85.7 million. The Project involved the deployment of 53 long-term advisers in 12 locations across 18 functional areas of the RPNGC.

Phase Two's goal was to improve the capability of the RPNGC to preserve peace and good order and to maintain and enforce the law in an impartial and objective manner. The major components of the project were to:

- achieve accountability for the delivery of basic police services/project implementation;
- achieve effective and sustainable systems, procedures and methods based on a commitment to professional and community policing principles;
- achieve effective and sustainable professional training for RPNGC;
- achieve competent and sustainable financial management, administration and management services;
- achieve competent and sustainable personnel management;
- progressively improve information technology and services; and
- improve the effective use and performance of scientific services.

In March 1998 a team reviewed the Phase One and Phase Two projects and assessed the need for future assistance. While it found that considerable improvements had been made by the RPNGC, it also determined that it would take time for them to be fully translated into improved RPNGC effectiveness—a long term commitment would be required to overcome the problems facing the RPNGC and to achieve sustainable improvements. Phase Three of the Project commenced in March 2000 and will involve \$55.3 million over five years.

Source: ANAO summary of AusAID information

## Contractual and other relationships in the delivery of overseas aid

1.10 The management and delivery of aid through Australian contractors is not a straightforward contractual relationship between two parties. It involves relationships with a number of key stakeholders, including:

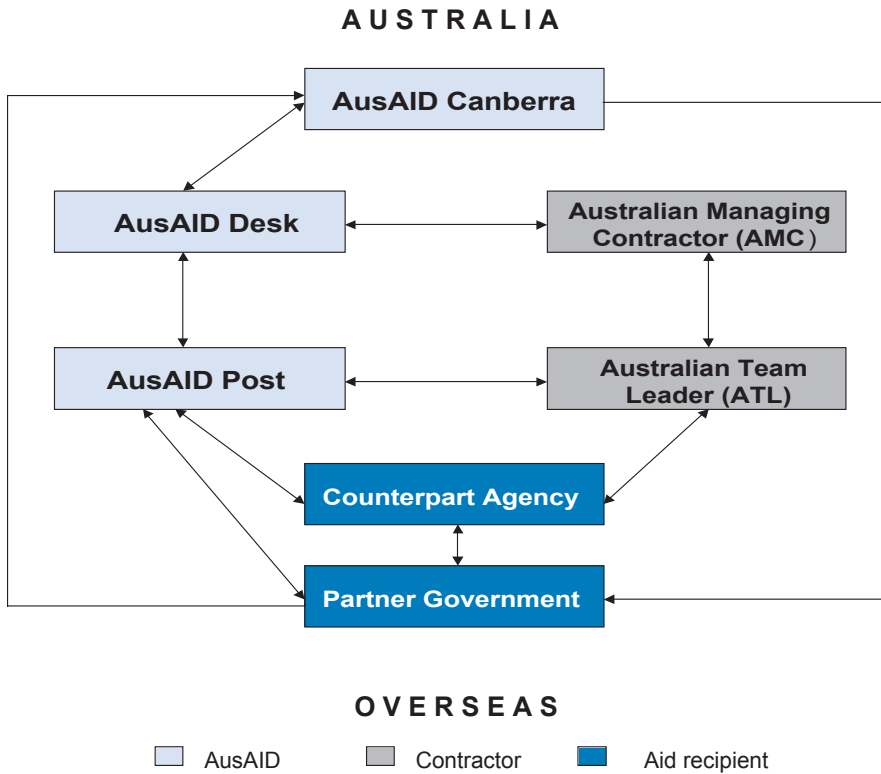
- the *partner government*—the government of the country receiving the aid;
- the *counterpart agency*—the department or agency of the partner government that the contractor works with or within on a day-to-day basis when delivering an aid project;
- the *Australian Managing Contractor (AMC)*—typically a large Australian company, partnership or consortium which is contracted to AusAID to deliver the aid project. The AMC often sub-contracts to obtain the additional expertise required to implement aid activities;
- the *Australian Team Leader (ATL)*—an individual employed or contracted by the AMC to deliver the project on the ground in the recipient country;
- the *desk*—an AusAID officer(s) stationed in Canberra who has primary responsibility for managing the aid project from feasibility study to evaluation; and
- the *post*—an AusAID officer(s) stationed in the recipient country who monitors project delivery on a day-to-day basis.

1.11 Typically, the more complex and high value contracts are let to an *AMC*, which appoints an *ATL* and team to implement the project on its behalf. During implementation, the AusAID *desk* in Canberra manages the contract and liaises with the *AMC* in Australia. The AusAID *post* monitors project delivery and liaises with the *ATL* and *partner government* in-country.

1.12 AusAID has organised itself to reflect these relationships, as illustrated in Figure 1.4.

**Figure 1.4**

**Key players and main lines of communication in contracting out overseas aid**



Source: ANAO analysis

## AusAID's strategic direction

**1.13** In recent years AusAID has undergone substantial change due to external and internal reviews. In 1997 an independent review of Australia's overseas aid program<sup>17</sup> led to a number of substantial changes aimed at improving the quality of the program. These changes included the establishment of a Program Quality Group and other organisational changes and a strengthening of the contract management function. A subsequent review by the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development<sup>18</sup> found that AusAID's new systems and processes placed Australia at the top end of management practices in DAC Member aid agencies.

<sup>17</sup> The review—*One Clear Objective: poverty reduction through sustainable development*—was undertaken by a Committee headed by Mr Paul Simons.

<sup>18</sup> *Development Co-operation Review—Australia*, Organisation for Economic Cooperation and Development, December 1999.



**1.14** AusAID recently undertook a wide-ranging internal review of its strategic direction that led to the release of the AusAID Strategic Plan: *Improving Effectiveness in a Changing Environment* in December 2001. The objective of the Strategic Plan is to improve the aid program's impact and effectiveness by strengthening AusAID's analytical capacity and focussing its efforts more strategically. The three main areas of change involve:

- an increased emphasis on program quality;
- an enhanced policy and analytical capacity; and
- strengthened people management and corporate systems.

**1.15** The Strategic Plan will be largely implemented by early 2003 and will require change to most aspects of agency work. A number of the initiatives flowing from the Plan relate to improving contract management in areas identified in this audit as warranting attention. The relevant initiatives from the Plan are discussed in the specific chapters of this report.

## The audit

### Audit objective and criteria

**1.16** The overall objective of the audit was to assess AusAID's management of commercial contracts to deliver Australia's overseas aid program. To this end, the audit examined whether:

- there are sound supporting structures for contract management;
- AusAID effectively manages risks;
- contracts clearly define deliverables;
- services are delivered and payments are made in accordance with the contract;
- there are appropriate arrangements to manage contractor performance;
- strategies appropriately assess and allocate risk between AusAID and contractors; and
- contracts deliver the desired aid outcomes.

**1.17** The criteria for the audit were derived from recognised good practice for contract management and from benchmarks in previous ANAO audits and parliamentary committee reports and, in particular, from the ANAO's Better Practice Guide on *Contract Management*.<sup>19</sup> The criteria are summarised in Appendix 2.

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<sup>19</sup> ANAO Better Practice Guide on *Contract Management*, February 2001.

**1.18** The audit focused on the management of contracts after they had been signed, rather than the tendering processes leading to a contract being put in place. The audit did not cover funding of voluntary non-government organisations or Australian Development Scholarship contracts. However, these have been the subject of recent audit reports.<sup>20</sup>

## **Audit methodology**

**1.19** The audit was conducted in accordance with ANAO auditing standards. The cost of the audit to report tabling was \$385 000.

**1.20** Audit fieldwork was undertaken in AusAID Canberra, as well as in overseas posts in Papua New Guinea, Viet Nam and Vanuatu. The ANAO interviewed officers and reviewed files, documentation and management information systems. The ANAO examined in depth the management of 14 randomly selected contracts worth \$272 million. Aspects of a further 12 contracts worth \$182 million were reviewed during visits to overseas posts. The ANAO also undertook on-site visits to a number of aid projects.

**1.21** The ANAO held discussions and interviews with AMCs;<sup>21</sup> their ATLs implementing projects in-country; and some partner government and counterpart agencies.

**1.22** *Currie & Brown* was engaged to provide specialist contract management expertise.<sup>22</sup> As well, an AusAID officer assisted the audit team during fieldwork.

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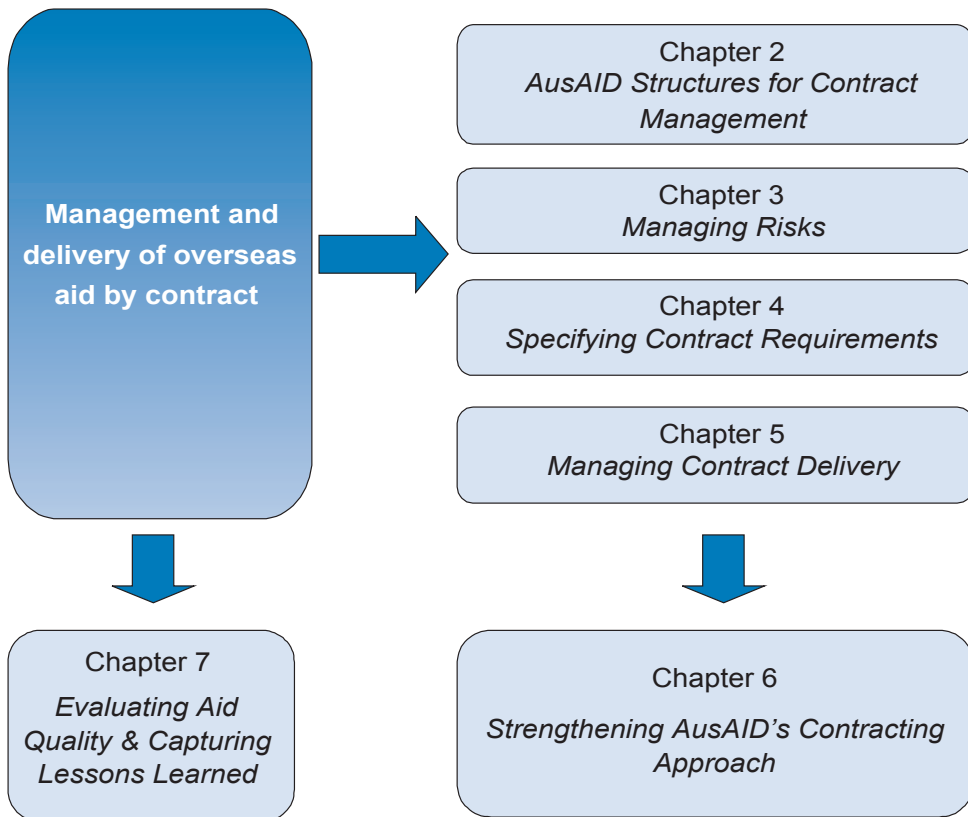
<sup>20</sup> ANAO Audit Report No.18 1998–99 *Accounting for Aid—The Management of Funding to Non-Government Organisations-Follow Up Audit* and ANAO Audit Report No.15 of 1999–2000 *Management of the Australian Development Scholarships Scheme*.

<sup>21</sup> Including the Private Sector Contractors Group (PSCG), which meets regularly with AusAID to discuss matters of mutual concern.

<sup>22</sup> *Currie & Brown (Australia) Pty Ltd* also assisted the ANAO in the development of the Better Practice Guide on *Contract Management*, ANAO, February 2001.

## Report structure

**Figure 1.5**  
Structure of the report



## 2. AusAID Structures for Contract Management

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*This chapter examines the supporting structures for contract management and related accountability issues.*

### Introduction

**2.1** The key role of contractors in delivering Australia's overseas aid means that sound contract management is critical to meeting AusAID's aid objectives. This is a complex task, since AusAID manages a diverse portfolio of contracts which are spread across many different countries with different cultures and administrative and governance structures; provide many different types of aid; and which range from small, short duration tasks to long term multi-million dollar projects.

**2.2** In these circumstances, a systematic and structured approach to contract management makes it more likely that contract management practices, risk management and resources/skills are appropriate for the task to be managed. It also provides assurance that minimum corporate standards, including legal requirements, are met. Accordingly, the ANAO examined the extent to which AusAID had in place contract management policies, procedures and supporting structures. The areas examined further in this chapter, and desirable enhancements, are summarised in Table 2.1.

**Table 2.1**  
**Strengthening structures for contract management**

Area	Desirable enhancement
<b><i>Clearly articulated guidance and standards</i></b>	Distinguish clearly those elements of AusGUIDE that are mandatory from those that are optional (2.6).
<b><i>Clear roles and responsibilities</i></b>	Articulate the respective roles and responsibilities of desks and posts (2.17).
<b><i>Ensuring contract management staff have appropriate skills and knowledge</i></b>	Monitor the effectiveness of measures taken to reduce the impact of high desk officer turnover on the quality of contract management (2.31).
<b><i>Supporting management information systems</i></b>	Address shortcomings in the new management system (2.37).
<b><i>Appropriate accountability arrangements</i></b>	While AusAID gazettes all initial contracts, contract variations are not gazetted (2.45).
<b><i>Sound liaison arrangements with overseas governments and stakeholders</i></b>	Broadly, current relationships are positive and satisfactory (2.55).

Source: ANAO analysis

## Guidance and standards

2.3 The need for contract management guidance is met by AusGUIDE, which is AusAID's key reference for contract managers. AusGUIDE is updated regularly and is available to staff on AusAID's intranet and on CD-ROM. It provides basic guidelines and analytical tools for staff involved in the preparation, implementation, monitoring and evaluation of aid projects (AusGUIDE is outlined at Appendix 3). AusGUIDE also provides information for stakeholders such as contractors and counterpart agency staff, and is available on AusAID's website. The ANAO found that AusGUIDE is seen as a valuable tool by AusAID staff and contractors.

2.4 AusGUIDE guidance is not mandatory. That is, apart from some basic risk management and accountability procedures, it does not set minimum standards or requirements. AusAID advised that this is because the design and delivery of development assistance is a complex task that requires flexibility, and often innovation, in approach.

2.5 AusAID officers consider that the ability to interpret and adapt AusGUIDE for their specific purposes is valuable. However, the ANAO found that this has led to a variety of approaches to managing, monitoring and reviewing, and

reporting on, contract implementation and contractor performance. These differences were often considerable, had an impact on the contractor, and were often attributable to the preferences of individual officers rather than the specific features of the contract/project. The impact on contractors was emphasised by their view that the lack of prescription leads to variable contract management across AusAID, particularly in relation to requirements for contractor reporting.<sup>23</sup> One contractor referred to four different monthly report formats being required for the same project in two years, reflecting the personal preferences of successive desk officers.

**2.6** There would be substantial merit in clearly distinguishing those elements of AusGUIDE which are mandatory from those that are optional. This would permit appropriate flexibility in approach, as desired by AusAID, whilst facilitating a common understanding between AusAID and contractors of minimum requirements. It would also facilitate a more consistent approach across AusAID and help desk officers who change projects to familiarise themselves with their new responsibilities.<sup>24</sup>

**2.7** The ANAO suggests that the provision of advance notice to contractors of altered reporting requirements and the reasons for the alteration would also assist in limiting changes to those that are necessary for good contract management by requiring contract managers to set out the reasons for the change.

## **Recommendation No. 1**

**2.8** The ANAO recommends that AusAID:

- identify clearly those elements of AusGUIDE that are mandatory; and
- provide advance notice to contractors of changed reporting requirements and the related reasons.

### *AusAID response*

**2.9** Agreed.

- AusAID notes that key steps fundamental to quality are already mandatory such as use of independent appraisal of significant activities; consistency with Financial Management Accountability provisions and now, under the Strategic Plan, mandatory documentation of peer review assessment at critical decision points. But AusAID agrees that the mandatory nature of key steps fundamental to quality should be made more explicit in all future editions of AusGUIDE.

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<sup>23</sup> Although AusGUIDE provides basic templates for most contractor reports, desk officers adapt the templates to suit their projects' particular needs or their own preferences.

<sup>24</sup> The impact of turnover of desk officers on contract management practices is discussed at Figure 2.2.

In the interim, AusAID has produced a document for AusAID managers which explicitly highlights the key mandatory requirements, while preserving the proper exercising of judgement on the other. AusAID will be making this document available to contractors.

- AusAID is trialling new general contractor reporting arrangements through its Activity Monitoring Brief (AMB) system. This provides a standardised and more streamlined format for reporting, but which still retains the capacity to increase the detail and/or frequency of reporting depending on activity performance and progress. The potential of the system to be introduced as a standard reporting provision will be evaluated, and industry consulted, with a view to introducing the system in parallel with the devolution to in-country management.

## Contract management roles and responsibilities

**2.10** Contracting responsibilities are split between two service groups and between Canberra and the overseas post.<sup>25</sup> Figure 2.1 broadly summarises these roles and responsibilities. Although Figure 2.1 describes a variety of contract management roles between these areas, the formally appointed contract manager is the desk officer (see 1.10). The ANAO found that contract managers are appropriately appointed for each contract.<sup>26</sup>

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<sup>25</sup> Some 64 Australia-based staff (at 23 overseas offices), supported by some 216 locally contracted staff (at 36 locations) perform a variety of aid-related tasks, including contract monitoring.

<sup>26</sup> When contract management is in transition, as a result of desk officers changing, a senior officer provides adequate cover.

**Figure 2.1**  
**Contracting roles and responsibilities**



Source: ANAO summary of AusAID information



**2.11** The respective roles and responsibilities of desks and posts are set out only in broad terms in AusAID guidance, leading to different approaches across desks and posts. This sometimes results in duplication of effort, particularly in relation to the monitoring of activities, and confusing or conflicting advice to contractors, undermining the quality of communication between posts, desks and contractors.

**2.12** This lack of clarity in some contract management roles can be compounded by the different relationship styles that emerge in desks' and posts' dealings with contractors. Posts deal with the Australian Team Leader (ATL) on a day-to-day basis; they therefore tend to become more understanding of the operational environment in-country, and the practical problems in delivering the aid project. Desks, being more remote, are more focussed on formal contractual and financial imperatives.

**2.13** The following problems observed by the ANAO are typical of those that arise:

- a post approved the recruitment of a member to the contractor's team; however, the desk subsequently overrode this approval; and
- a contractor had to provide regular reports to AusAID on a project but received conflicting directions from the desk and post on the required report format.

**2.14** Some AusAID staff expressed the view that, while the different approaches and overlap in roles can result in disagreement, it also provides a useful 'check and balance'. Indeed, until recently, guidance has referred to posts and desks taking on the roles of 'good guys' and 'bad guys' in their relationships.<sup>27</sup>

**2.15** Notwithstanding these views, the current approaches clearly lead to inconsistent contract management and conflicting advice. Apart from the internal costs of duplication, this creates the risk that inefficiencies in the contractual relationship are passed on in the contract price or affect the progress of the aid project. There is also the risk that contractors may be able to exploit different AusAID views and role confusion, to their advantage.

## **AusAID is planning to shift activity management and monitoring in-country**

**2.16** AusAID's Strategic Plan has identified the need to clarify contracting roles and responsibilities and to shift activity management and monitoring in-country, sometimes outside of the post. This is expected to substantially address the

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<sup>27</sup> In December 2001 AusAID advised that it would remove the 'good/bad guys' analogy from its guidance.

desk/post relationship issue, whilst enhancing field-level decision making and responsiveness, and enabling desk officers to focus on more strategic matters. Implementation is planned by March 2003.

2.17 These reforms have the potential to substantially reduce the problems identified in this audit. However, past experience suggests that the new arrangements would benefit from being documented on a contract or country basis to provide the necessary assurance that desk and post officers have, and act upon, a common understanding of their roles and responsibilities. Providing a copy of the document to the contractor would enable the contractor to approach the appropriate officer for advice and assistance.

## Recommendation No. 2

2.18 The ANAO recommends that AusAID articulate the contract management roles and responsibilities of desks and posts and provide these to contractors. Roles and responsibilities could be tailored to the particular needs of countries or individual contracts, and regularly reviewed to accommodate changing circumstances.

### *AusAID response*

2.19 Agreed.

As the ANAO notes, the reforms inherent in the AusAID Strategic Plan—and especially the significant move to in-country, devolved, activity management—have the potential to substantially reduce duplication. The move co-locates responsibility for monitoring and contract/activity management, thereby improving both the effectiveness, and efficiency, of decision making and monitoring. These intentions have been formally discussed with contractors. The AusAID Executive has already approved the framework setting out the respective roles and responsibilities of desks and posts in general. Each program area is now documenting the respective roles and responsibilities of desk and post using the opportunity to review work practices within its own detailed business case. This information will be provided to contractors—and partner governments and other key stakeholders—once approved. Further consultations with contractors will establish any specific arrangements required for particular contracts.

## Contract management skills and knowledge

### Structured training and skills development

**2.20** In its report on *Australian Government Procurement*, the JCPAA concluded that:

Training and education can help to influence the attitudes and approaches of purchasing officers as well as give them a skill base to efficiently and effectively conduct their purchasing responsibilities.

In respect to training and education of purchasing officers, the Commonwealth does not have a systematic approach.<sup>28</sup>

**2.21** In its subsequent report on *Contract Management in the Australian Public Service*, the JCPAA noted that:

Contract managers in performing their tasks must have knowledge and skills ranging from interpersonal, communication, negotiation, project management and legal.<sup>29</sup>

**2.22** The ANAO found that AusAID attaches priority to contract management skill development. Contract management training is provided to all relevant Australian staff and monitored by management. The ANAO found that this training covers appropriate aspects of contract management, and is rated highly by participants (a satisfaction rate of 90% in 2000–2001).

**2.23** The ANAO found that posts also monitor the skills and training requirements of locally contracted staff overseas. These staff have undertaken a month long training course in Canberra, or are scheduled to do so in the future.

### Retaining knowledge—the impact of staff turnover

**2.24** AusAID has a high rate of staff mobility. In 1999 AusAID estimated that the average time a desk officer spent in one position was 10 months and a senior contract manager 14 months. The high turnover was evident in much of the sample of contracts examined by the ANAO. For example, one contract involved seven desk officers in 26 months; another involved four desk officers in three and a half years.

**2.25** This rate of turnover arises because of the high internal mobility of AusAID staff rather than separations from the agency, which may largely be beyond AusAID's control. Internal staff movements occur for a number of reasons including overseas postings, internal transfer and promotions.

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<sup>28</sup> JCPAA Report 369, *Australian Government Procurement*, June 1999, p. xxiii.

<sup>29</sup> JCPAA Report 379, *Contract Management in the Australian Public Service*, October 2000, p. 89.

**2.26** The ANAO found considerable concern, both within AusAID and from contractors, about the impact of the high rate of desk officer turnover. Some of the consequences observed in this audit are summarised at Figure 2.2.

### Figure 2.2

#### Some consequences of desk officer turnover for contract management

- Unfamiliarity with a project, affecting speed and quality of decision-making (e.g. in approving reports, making payments and approving variations).
- Contractors investing time and effort in frequent briefing of new desk officers.
- Inconsistent standards and approaches in dealings with contractors (e.g. see 2.5 above).
- Contractors benefiting from lack of corporate memory (e.g. by raising previously rejected issues).
- The cost of aid delivery increasing as a result of internal inefficiencies or from the risk of additional costs to contractors being passed on to the Commonwealth.

Source: ANAO analysis

**2.27** The high desk officer turnover, and its impact, has been a long-standing issue for AusAID. It has sought to address this by taking some measures in recent years to reduce staff mobility.<sup>30</sup> AusAID is also intending to develop indicators to monitor the rate of internal mobility and staff retention. However, turnover remained high at the time of this audit, and the measures taken in the past have yet to be assessed for effectiveness.

**2.28** Effective filing procedures and handover arrangements to incoming desk officers would partly help to mitigate the impact of high turnover. However, the ANAO found that handovers of project/contract knowledge to incoming desk officers were often not effective. This is reinforced by AusAID's 2001 Staff Survey, which revealed that half of the respondents did not believe that there were procedures to transfer knowledge when moving to or from a role.

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<sup>30</sup> Measures include a (discretionary) arrangement aimed at preventing transfers prior to staff serving 18 months in their current position, and an arrangement to allow promotion within the current work area where staff have gained promotion elsewhere.

**2.29** Filing systems also had shortcomings. Inconsistencies in the naming of contract files make it difficult for incoming desk officers to locate all relevant files. The ANAO also found that searching the records management database by keyword or project title did not ensure that relevant project files were identified.

**2.30** AusAID's Strategic Plan and related initiatives foreshadow the development of means to address staff mobility. These are likely to include new procedures to ensure more effective handovers, such as briefing notes and handover meetings, and new record management tools to support consistent classification and titling of files.

**2.31** The actions recently taken, or proposed, by AusAID have the potential to reduce the level and consequences of high staff mobility. However, it is clear from the evidence in this audit that high desk officer turnover is having an adverse ongoing impact on the quality of contract management. The effectiveness of AusAID's measures in addressing this matter therefore warrants continuing assessment.

## Recommendation No. 3

**2.32** The ANAO recommends that AusAID monitor the effectiveness of measures taken to reduce the impact of high desk officer turnover on contract management.

### *AusAID response*

**2.33** Agreed.

AusAID is a relatively small agency but, due to the variety of operational requirements for short-term and long-term postings overseas, has relatively high levels of internal staff turnover. This cannot easily be avoided but AusAID agrees that the consequences of such turnover need to be managed well.

AusAID introduced new requirements for managing staff turnover in February 2002. These provide a systematic but efficient approach to managing key aspects of staff handovers, including standard processes for handover of contract management matters. The procedures involve a formal meeting of the relevant AusAID staff together with, wherever possible, the contractor's Project Director; and written confirmation by Directors in AusAID that the handover procedure has been completed. AusAID will review the effectiveness of these measures by the end of 2002 and make any necessary adjustments in the context of the AusAID People Management Strategy.

AusAID also anticipates that the devolution to in-country management under the Strategic Plan will help reduce the problems of staff turnover because postings are for fixed periods of two to three years.

## Management information

**2.34** The Activity Management System (AMS) is a computerised management information system that records the status of each project. It has the facility to monitor payments and total project expenditure; check that the financial limit of a contract is not exceeded; and report on project status/progress.

**2.35** However, AMS has a number of limitations as a management information tool. A 1998 ANAO report<sup>31</sup> found that data was often inaccurate and/or incomplete. The ANAO found in this audit that AMS data completeness has improved. However, there remain deficiencies in the accuracy and timeliness of data. For example:

- 15% of contracts were not entered on AMS until after the contract had been signed, notwithstanding the requirement to enter contracts as soon as a contractor has been selected and negotiation commenced (a similar problem is identified at 5.26); and
- during 2000–2001 desk and post officers were required to prepare project status reports known as *Activity Monitoring Briefs (AMBs)* at regular intervals<sup>32</sup> during the year through the AMS. These reports highlight any problems or issues with project implementation. However, the ANAO found that of the 183 AMBs expected to be prepared in that year, only 97 (53%) had actually been prepared.

**2.36** Users of the AMS consider that the system is user-unfriendly and cumbersome, with officers often keeping separate records. Desk officers generally did not find AMS to be a useful day-to-day project management tool, and its reliability as a project management-reporting tool was, accordingly, considered questionable.

**2.37** AusAID has recognised, and is seeking to address, the shortcomings of AMS. It has contracted for a replacement system using a more user-friendly web-based application. AusAID expects the new system—to be known as *Aidworks*—to be fully implemented by late 2002.

## Accountability arrangements

**2.38** The contracting out of key Commonwealth outputs requires an appropriate accountability framework, including the maintenance of a contract register; the appropriate use of access and confidentiality clauses; the timely gazettal of contracts; and the reporting to the Parliament of results achieved.

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<sup>31</sup> ANAO Audit Report No.18 1998–99 *Accounting for Aid—The Management of Funding to Non-Government Organisations-Follow Up Audit*.

<sup>32</sup> The intervals vary from project to project depending on the project risk.

## Contract register and documentation

2.39 In its report *Contract Management in the Australian Public Service*, the JCPAA recommended:

that all agencies establish and maintain an effective contract register.<sup>33</sup>

2.40 The ANAO found that AusAID does maintain a contract register, with unique identifiers, through the Activity Management System (AMS). Notwithstanding data limitations mentioned above, the AMS adequately records relevant contract details such as the name of the contractor, value of the contract, and description of the contract.

2.41 AusAID also requires that the original contracts be held centrally in the records management unit. The ANAO found that all original contracts examined by the ANAO complied with this policy. The requirement with respect to the central holding of variations could be clarified for those concerned.

2.42 AusAID requires that officers keep records of all communications with contractors. This is partly because of the high turnover it experiences amongst desk officers (see 2.24) and to address potential legal implications. In practice, desks and posts keep records only of key communications with contractors. This appeared to be adequate, although there would be merit in AusAID clarifying its guidance.

## Contract gazettal

2.43 The *Commonwealth Procurement Guidelines* require that details of contracts and contract amendments valued in excess of \$2000 be published in the *Gazette* within six weeks of contract signing. This is to ensure that public procurement is open and transparent and that agencies are accountable for their purchasing decisions.

2.44 AusAID gazettes all initial contracts. However, this is not always timely. Some 12% of contracts signed over an 11-month period were not gazetted within six weeks of the contract sign date.<sup>34</sup> AusAID advised that late gazettals are monitored and reported to the Executive, and that AusAID's planned replacement for its Activity Management System (*Aidworks*) is likely to have a module to enable managers to access compliance information for their areas of responsibility.

2.45 The ANAO found that contract variations have not been gazetted as required. AusAID has only recently become aware of the need to do so. AusAID

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<sup>33</sup> JCPAA Report 379, *Contract Management in the Australian Public Service*, October 2000, p. 43.

<sup>34</sup> Of 787 contracts signed between 1 July 2000 and 19 May 2001, all were gazetted. 88% (694) were gazetted within six weeks of the contract sign date.

advised that the main reason for non-gazetted variations is a deficiency in the Gazette Publishing System (GaPs). AusAID has advised the Department of Finance and Administration, which is responsible for GaPs, and requested that it be addressed.

## **Access to contractors' premises**

**2.46** Under section 33 of the *Auditor-General Act 1997*, the Auditor-General may, at all reasonable times, enter and remain on any premises occupied by the Commonwealth, a Commonwealth authority or Commonwealth company. The Auditor-General's powers, however, do not extend to accessing the premises of government contractors to inspect contract documentation.

**2.47** In its report *Contract Management in the Australian Public Service*, the JCPAA reaffirmed:

... the need for the Auditor-General to have access to contractors' premises...<sup>35</sup>

**2.48** Most of the contracts examined in depth in this audit did not contain a clause explicitly providing for Auditor-General access to the contractor's premises. However, AusAID has recently developed a new suite of contracts that do contain specific clauses that provide for such access. Use of the new suite of contracts should ensure that, in future, contracts contain appropriate access clauses, strengthening accountability and aiding contract management by AusAID.

## **Confidentiality provisions in contracts**

**2.49** The Senate made an Order on 20 June 2001 that, among other things, requires all agencies under the *Financial Management and Accountability Act 1997* to list contracts over \$100 000 on the Internet and indicate whether those contracts contain clauses requiring the parties to maintain confidentiality of any contract provisions or whether any provisions were regarded by the parties as confidential.

**2.50** The ANAO recently tabled a report addressing agency compliance with this Order.<sup>36</sup> This reported that AusAID had placed a listing of its contracts over \$100 000 on the Internet. AusAID also advised that its contracts did not contain any provisions that were regarded as confidential. The ANAO's examination of contracts in this audit confirmed that none in the sample had provisions that would prevent AusAID from disclosing such information.

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<sup>35</sup> JCPAA Report 379, *Contract Management in the Australian Public Service*, October 2000, p. 55.

<sup>36</sup> ANAO Report No.33 of 2001–02 *Senate Order of 20 June 2001 (February 2002)*.



2.51 AusAID's current suite of contracts contains standard confidentiality clauses that prevent disclosure by the contractor of 'AusAID Confidential Information'<sup>37</sup>. They also contain clauses that permit AusAID to disclose information to other agencies, Ministers and to the Parliament, including to Parliamentary Committees or Inquiries.

2.52 The ANAO concluded that these provisions facilitate public accountability.

## Reporting to the Parliament of results achieved

2.53 This is addressed at paragraphs 7.22-25.

## Communication arrangements with overseas stakeholders

2.54 Good communication and liaison with overseas governments and stakeholders is an important element of the overall management of contracted aid projects. This is particularly the case as partner governments, counterpart agencies and communities are not formally included in the contractual arrangements.

2.55 The ANAO found that relationships between contractors, partner governments and AusAID are generally positive and satisfactory. Counterpart agencies tend to deal directly with the post as their immediate contact point. This is supported by formal arrangements for regular project monitoring and review through, for example, Project Coordination Committee meetings.<sup>38</sup> In addition, AusAID generally provides pre-departure and on-arrival briefings for contractors to assist in their understanding of contractual requirements and overseas conditions.

2.56 The ANAO met with a range of counterpart agencies in the countries visited, and found them to be satisfied overall with the approach and responsiveness of contractors and of AusAID posts.

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<sup>37</sup> AusAID Confidential Information is defined in the contracts to mean, among other things, 'the terms of the Contract'.

<sup>38</sup> The Project Coordination Committee meeting is the key forum for discussing high-level management and implementation issues about the project. The post, the contractor, the partner government agency and sometimes the project beneficiaries attend the PCC meeting. Meetings are held six-monthly or more frequently for larger projects.

## 3. Managing Risks

*This chapter examines AusAID's arrangements for managing contract-related risks.*

### Aid is often delivered in a high-risk environment

3.1 The delivery of development aid overseas is inherently risky, involving multiple relationships, complex contractual arrangements and challenging development problems. The working environment is difficult with external factors ranging from differences in business ethics, procedures and practices to environmental disasters, civil unrest and war. Figure 3.1 illustrates some of the challenges.

#### Figure 3.1

##### The provision of assistance to the Royal Papua New Guinea Constabulary (RPNGC)

Providing assistance to the RPNGC involves inherent risks. It has the potential of placing Australian technical advisers in physical danger and involves the risk that Australia will be seen in a negative light if the RPNGC does not perform with integrity.

Notwithstanding the associated risks, strengthened governance—involving law and order—is critical to the future development of PNG.

Source: AusAID

3.2 It is neither possible nor desirable to eliminate all this risk. Risk is implicit in all that AusAID does and therefore needs to be managed well. This chapter addresses AusAID's management of this risk, in particular its:

- management of risk through bilateral relationships;
- project risk management processes; and
- risk monitoring and review.

### Management of risk through bilateral relationships

3.3 The bilateral aid program for each country is developed under an umbrella agreement<sup>39</sup> that sets out the respective responsibilities of both the Australian Government and the '*partner government*'. Subsidiary agreements are generally used to detail the specific obligations and inputs of each government in relation

<sup>39</sup> This agreement is normally in the form of a Memorandum of Understanding (MOU).

to the implementation of individual projects. The implementation of individual projects is normally assisted by a partner government agency (the ‘*counterpart agency*’).

**3.4** The capacity of the partner government to support a project during and after implementation varies by country and, within the country, by counterpart agency. Partner government commitment and capacity can also change unpredictably and substantially during a project’s life. This is an intrinsic and unavoidable risk common to all international aid agencies.

**3.5** Although the partner government is not a party to the contract between AusAID and the contractor, its inputs—usually in the form of staffing and office accommodation—can be critical in terms of achieving project objectives and outcomes. Some of the difficulties that can arise are illustrated in Figure 3.2.

### Figure 3.2

#### Some difficulties that can arise in working with partner governments

- Changes in partner government priorities or circumstances, leading to a loss of counterpart agency commitment to, and ownership of, the project.
- Inability of the counterpart agency to provide adequate staff and resources (such as accommodation and equipment).
- Loss of key staff in the counterpart agency—often those who have received training under the project.
- Slow and cumbersome approval and administrative processes within a counterpart agency.

Source: ANAO summary of AusAID information

**3.6** Consultation with partner governments is therefore important to ensure that potential risks are identified and managed. AusAID policy is that partner governments and other relevant stakeholders, such as beneficiaries, are consulted on, and participate in, risk identification and management.

**3.7** The ANAO found evidence of partner government input into project design and implementation documents for most of the contracts that it examined. Consultation with the partner government at the design stage was confirmed by overseas visits. Consultation continued during project implementation through regular Project Coordination Committee (PCC) meetings (see 2.55) with contractors and AusAID. These meetings are the key forums for discussing, among other things, emerging issues and risks.

## Risk management processes

3.8 AusAID has provided staff with a range of guidance on its risk management policy, principles and practices. The guidance is based on Australian risk management standards<sup>40</sup> and is supported by practical examples and checklists.

3.9 Broadly, AusAID's approach requires the project design team to develop a *risk matrix* setting out key information such as the nature of the risk, its likelihood and consequence and the proposed risk treatment. Once the contract to implement the project is awarded, the contractor is required to update the risk matrix and prepare a *risk management plan*. The plan describes the risk management measures needed to reduce and control the identified risks and the ongoing monitoring and reporting arrangements.

3.10 Overall, these processes and the overarching guidance provide a sound framework for managing project-related risk. The processes are consistent with the ANAO's Better Practice Guide on *Contract Management*.

## Risk management training

3.11 Notwithstanding the processes that AusAID has in place to manage project risk, there is limited risk management training offered for key contract management staff, which has the potential to limit the effectiveness of these processes. Although some training courses such as AusAID's induction program and its program for locally contracted staff include brief coverage of risk issues there has been no in-depth systematic risk management training undertaken across AusAID since 1995.

3.12 The high-risk business environment in which AusAID operates and the fact that AusAID itself identified the need for such training more than two years ago<sup>41</sup> warrants AusAID giving the development and delivery of such training a priority.

## Identifying risk management responsibilities in contracts

3.13 Prior to 1999, few AusAID contracts specified or allocated risks, or identified how they were to be managed.<sup>42</sup> However, recent contracts examined

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<sup>40</sup> *Risk Management—Australian/New Zealand Standard, AS/NZS 4360:1999*, Standards Australia/Standards New Zealand, April 1999.

<sup>41</sup> AusAID Circular No 29 of 8 November 1999 issued AusAID's updated risk management policy and foreshadowed the commencement of related training courses in February 2000. Risk management training was piloted in early 2001, but this training was considered unsuitable and was abandoned.

<sup>42</sup> While not specifically referring to 'risk', most pre 1999 contracts in the sample did comply with AusAID's requirement for contractors to identify 'problems and issues' and contractors did report on actions proposed and taken to minimise the risk or impact of the event occurring.

by the ANAO do specify and identify how risk is to be managed by the contractor. For example, one contract required the contractor to acknowledge the inherent risks involved in performing its obligations under the contract and to proactively manage those risks and take all steps to minimise their occurrence. AusAID's current proforma for major services and construction contracts now contains standard clauses that require the contractor to manage those risks that are its responsibility, in accordance with an attached risk management plan.

**3.14** However, the ANAO found that the risk management plans for recent contracts examined in the audit actually identified a number of parties as having joint responsibility for some risks. They included the partner government and counterpart agencies, which are not parties to the actual contract.

**3.15** While there are degrees of sharing of risk, this practice creates the risk of uncertainty over who has primary responsibility for managing the risk. The identification of the party with *primary* responsibility for the management of each *significant* risk would lessen the likelihood of those risks being overlooked.

## Risk monitoring and review

### Monitoring and review of risks by contractors

**3.16** AusAID requires the contractor to manage the risks in the risk management plan, and to provide regular reporting and updated assessments to AusAID against the plan. The reports are to include an assessment of emerging issues and strategies to deal with them.

**3.17** The ANAO found that the initial risk assessments required at the project design stage were undertaken in accordance with the risk management guidelines, and identified the consequences and likelihood of risks occurring. Also, contractors update the initial risk management matrices and develop risk management plans during the early implementation stage.

**3.18** The ANAO found that there was monitoring and reporting by contractors of *emerging risks*, which were discussed with AusAID. However, contractor reporting of emerging risks normally involved exception reporting, rather than a systematic reassessment of the *original risks* identified in the initial risk matrix. Only one quarter of the (large) projects examined in the audit had systematically revised risk assessments. Better practice requires risks and the effectiveness of controls to be monitored over time in the event that changing circumstances alter risk priorities or weaken the operation of controls.

**3.19** AusAID advised that its more recent contract proforma provide for contractors to update the risk management plan, which should overcome this

concern. The ANAO agrees but notes that the new proforma does not specify a time but rather provides for the contractor to update the risk management plan 'as required'. The specification of a definite timeframe for updates, such as annually, would strengthen this arrangement.

## Conclusion

3.20 AusAID has established processes and guidance that provides a sound framework for managing project related risk. There are, however, a number of areas that require strengthening in order for AusAID to get full benefit from its risk management framework. These involve the development of systematic risk management training, identifying the party with primary responsibility for the management of each significant risk and the specification of a definite timeframe for risk management plan updates by contractors.

## Recommendation No. 4

3.21 The ANAO recommends that AusAID strengthen its risk management approach by:

- implementing systematic risk management training across AusAID;
- ensuring that contracts identify the party with primary responsibility for managing each significant risk; and
- requiring contractors to report at appropriate and specified intervals on both emerging risks and those originally identified.

### *AusAID response*

3.22 Agreed.

- AusAID's risk management training commences with its induction program and is thereafter an integral component of the more detailed training provided on managing the activity cycle. AusAID is currently expanding its risk management framework, based on the findings of an external review undertaken in 2001. This expanded framework includes the integration of risk assessment and management as a standard feature of Branch business planning. Future training requirements have been identified as part of an expanded risk framework already in preparation. The revised framework will be completed by August 2002 and a training strategy to address these issues will be delivered during 2002-2003 within the constraints of existing resources. It is recognised that this will need to include more systematic training in risk management.
- AusAID already requires that risk management be addressed at the project design stage: the Project Design Document normally includes a risk matrix

where relevant risks are identified and assessed. However AusAID will henceforth require activity design missions to more clearly and explicitly allocate the primary responsibility for each significant risk, and this will then be subsequently reflected in the scopes of services of implementation contracts.

- Standard clauses in AusAID's implementation contracts already require contractors 'to maintain and update the risk management plan regularly to ensure they adequately reflect project risks at all times' and that risk management strategies are updated. Similar requirements are contained in AusGUIDE. Further, contracts also require immediate notification of any actual or anticipated risks and/or problems which could have a significant impact on the project. While AusAID believes the identification of *emerging* risks is generally handled well, it agrees there is a case for contractors undertaking a more consistent reassessment of *original* risks during the review of the Annual Plan.

# 4. Specifying Contract Requirements

*This chapter examines the development and specification of project design, deliverables and milestones for AusAID contracts.*

## Introduction

4.1 AusAID has extensive processes for defining its requirements from contracted aid. These are summarised in Figure 4.1.

### Figure 4.1

#### Key AusAID processes for defining contract requirements

**Project Design Document (PDD):** A feasibility stage is undertaken for a proposed project, from which a PDD is prepared. This sets out the design intended for project implementation and analysis to support the design. The PDD is agreed with the partner government and is a key document in project approval, tendering and contract negotiation. During implementation, the PDD is the basic reference document for the annual plan prepared by the contractor. The PDD contains a detailed *logframe matrix*.

**Logframe matrix:** The logframe matrix contains a statement about how the project will address the identified development problem. It divides the project into components with identifiable outputs. It also contains a methodology for measuring the achievement of the project outputs, including indicators to verify achievement of progress, and the means of verification. The PDD and logframe matrix are used in developing a *scope of services*.

**Scope of services (SOS):** The scope of services is an attachment to the contract terms and conditions, which defines the deliverables. The SOS also includes performance standards such as quality and timeliness, the financial limitation, and a milestone (payment) schedule.

Source: ANAO summary of AusAID information

4.2 Good design and specification of contract requirements through these processes is critical to successful aid outcomes. This chapter examines some of the central aspects of this process, including project design, deliverables, and identified milestones.

4.3 The process of defining deliverables—which need to be specified in terms of time, cost, quantity and/or quality standards—commences with project design.



## Project design

### Design process

4.4 AusAID has a systematic approach to designing aid projects involving three stages: a project identification and initial assessment stage, a project feasibility / design stage (project design is normally contracted out to the private sector) and an appraisal and approval process. The resulting PDD and related design documents are critical to successful outcomes for the project. They need to address the development need but also be practical in terms of implementation, since they are influential documents throughout the life of a contract.

4.5 AusAID requires project design teams to consider a wide range of matters, including sustainability, institutional capacity building, Australian and partner government policies, including gender and the environment. In addition, there is an increasing move, particularly in PNG, to sector wide approaches that tend to be large and complex by their nature. These factors can contribute to complexity of design. This is a significant risk to manage, since overly complex or ambitious designs can result in complex contracts and scope of services (SOS), often with excessive milestones and reporting requirements. They are also more likely to require contract variation (discussed at 5.22) as some contract deliverables may not be fully achievable within the planned timetable.

4.6 The ANAO found variable quality of design work, with sometimes overly ambitious design, and some designs assuming an unrealistic level of counterpart agency capacity. This was a frequent concern of contractors and was evident in some of the ANAO sample—some project designs were large, complex, and full of jargon. Over complexity in some of these designs has been acknowledged by AusAID as contributing to difficulties in implementing the projects, and has been identified by internal AusAID review as needing attention.<sup>43</sup>

4.7 AusAID's Strategic Plan has identified the need to improve design quality and reduce complexity. It intends to implement a number of measures to strengthen design work, with a focus on designs being more flexible (see Figure 4.2) and less prescriptive, with clear and realistic objectives, and more focussed on key outcomes and outputs. Measures include:

- AusAID staff playing a more active design role, including leading design teams as appropriate;
- identifying existing design expertise within AusAID and developing options for making this more widely available across the agency; and

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<sup>43</sup> A recent internal review reported that 'Over-ambitious objectives occurred in about 26% of projects which invariably pointed to a reduced chance of success.'

- developing a training program on management and quality assurance of the design process by September 2002.

4.8 These initiatives are also expected to reduce the number of unplanned variations to contracts (discussed further at 5.27).

## Figure 4.2

### More flexible design approaches under trial

- A *phased* approach—involves a pre-project phase, comprising the short-term delivery of inputs with the design to be developed over a longer period, and an implementation phase.
- A *rolling design* approach—milestones and key activities are set for only the first year, with review and agreement for the next year.
- A *design and implement* approach—the contractor responsible for the initial design also implements the project if the design is accepted.

Source: AusAID

## Partner involvement

4.9 As noted in Figure 4.1, agreement with the partner government is an important part of the design process. Successful engagement of the partner government at this stage is a recognised success factor in obtaining their commitment to the project and to providing counterpart agency inputs. The ANAO found that this involvement generally occurs, but that it was of variable effectiveness.

4.10 Difficulties were commonly attributable to the capacity of the partner government to sufficiently comprehend often complex project documents, particularly those written in English. A clear and simple explanation of the design and the translation of key elements such as executive summaries would assist ownership where English is not a recognised language of the partner country. This does happen on some occasions.<sup>44</sup> However, the current approach is not sufficiently systematic to ensure that it takes place where it will add value. ANAO believes that this area would benefit from an ongoing management focus to ensure that translations are undertaken where they are likely to add value.

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<sup>44</sup> As well as translating key project documents AusAID sometimes run workshops to encourage partner government ownership and understanding.

## Deliverables

4.11 Contract deliverables are generally expressed as one, or a combination of, the following:

- outputs, such as the construction of a building or bridge;
- activities that produce outputs, such as the delivery of a training program; or
- inputs required to produce an output, for example, the procurement, distribution and installation of equipment.

4.12 Figure 4.3 illustrates the deliverables for one aid contract.

**Figure 4.3**

### Example of deliverables in an AusAID contract

<p>The purpose of the project is to assist PNG raise the quality and relevance of teacher education. One component of the project is infrastructure support. There are 27 deliverables associated with just one element of the infrastructure support component—involving the refurbishment of a dormitory. A sample of these is set out below.</p>	
Item (deliverable)	Description
<b>Roofing</b>	Replace existing sheeting with specified sheeting.
<b>Install guttering and downpipes</b>	Remove existing guttering and downpipes and dispose offsite. Install new guttering and downpipes.
<b>Exterior wall</b>	Resurface existing external walls (sand and two coats of external paint).
<b>Internal wall</b>	Strip walls, sugar soap clean and repaint (interior trim paint).
<b>Security grills</b>	Install painted metal security grills over all windows. Remove any existing security grills and take off site.
<b>Timber floor</b>	Resurface timber (sand and two coats of polyurethane).
<b>Doors—refurbish</b>	Repair, patch and paint frame and door.
<b>Ceilings</b>	Sugar soap clean and repaint (two coats).

Source: AusAID data

4.13 The ANAO found that deliverables were generally clearly defined in AusAID's commercial contracts. They were well described, quantifiable and unambiguous. The contracts examined (apart from one) contained detailed information on the goods and services to be delivered by the contractor, with the SOS setting out:

- a description of each project component, including its objective;
- specific outputs and milestones for each component; and
- service quality, quantity and timeliness.

4.14 Contractors interviewed generally confirmed this finding.

## Milestones

4.15 Contract milestones are events that are selected by AusAID to signify that certain project deliverables or outputs have been completed or achieved. They are usually a trigger for contract payments. Effective use of milestones is an important element of contract management, assisting in managing financial risk and the risk to desired outcomes by facilitating a shared understanding with the contractor of requirements for payment to be made. Good contract milestones are clearly specified; sufficient in number to enable effective monitoring; and verifiable.

### Clarity of milestones

4.16 The ANAO found that a milestone schedule had been developed for most contracts examined in the sample.<sup>45</sup> The schedules contained some, or all, of:

- payment milestones, including value of the payment;
- a summary of the work to be undertaken, cross-referenced to the PDD;
- a means of verification by AusAID; and
- a target date for the completion of the milestone.

4.17 Milestones were generally set out in terms of *time*, *cost* and *quantity* in the milestone schedule. Information on service *quality* was usually set out in the associated deliverables. Infrastructure contracts contained more detail on *quality*, referring to relevant industry standards for the project. Those contracts that did not identify *quality* standards specified 'recommended equipment' to be procured or used by the contractor in delivering a milestone.

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<sup>45</sup> While two contracts examined did not specify milestones the contracts defined detailed outputs for the project and clearly set out payment arrangements in the *Basis of Payment* attached to the contract.

**4.18** Milestones were also generally achievable. For example, milestones were specific in requiring contractors to produce reports (including monthly reports, six monthly reports and annual plans), provide training, prepare minutes from meetings, run workshops, produce course outlines or compile surveys. These outputs were usually within the contractor's control.

**4.19** The ANAO concluded that the specification of milestones was satisfactory, a view generally confirmed by contractors interviewed.

## Number of milestones

**4.20** Contracts need to have sufficient milestones to enable effective monitoring of contractor progress. At the same time, it is desirable that milestones are meaningful and reflect important project outputs. These aims can point in opposite directions, requiring consideration of the balance between them.

**4.21** The ANAO found that there was wide variation in the number of milestones employed in (often similar) contracts. Some contracts contained excessive numbers of milestones. One extreme example involved the contractor meeting 114 milestones over the two-year life of a \$3 million project. This can lead to micro management by AusAID desk officers and continuous, repetitive reporting by contractors which is of little benefit to AusAID. This occurrence was observed by the ANAO in a number of cases and also remarked upon by contractors.

**4.22** This risk is recognised by AusAID, which uses the term 'milestone madness' to describe the use of an excessive number of milestones in some of its contracts<sup>46</sup>.

**4.23** The ANAO also observed some better practice examples, involving some four or five milestones a year. On the whole, the better practice examples were more recent contracts, indicating some success by AusAID in addressing 'milestone madness' over the last 18 months. This results from a number of initiatives following its November 2000 review, including conducting workshops with all AusAID branches and by identifying *12 Steps to Simplifying Contracts*, which includes a strong focus on minimising the number of contract milestones.

**4.24** AusAID's moves in this direction have been aided by its contract simplification process, which has involved moving away from *outputs* based contracts to *hybrid* contracts. The latter contracts have more significant and meaningful activity milestones reflecting critical outcomes or outputs of the activity (see Appendix 4).

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<sup>46</sup> In November 2000, AusAID reviewed the use of milestones and found that for some contracts milestones had become an end in themselves, requiring the contractor to produce endless reports leading to the project's strategic focus being significantly diluted and of little value to counterpart agencies.

**4.25** AusAID has commenced monitoring the effectiveness of its efforts to reduce contract milestones. It advised that, between April and December 2001, 31 contracts were signed valued at \$3 million or more; of these, half were hybrid contracts and three-quarters had been actively reviewed by AusAID's Contract Services Group to reduce the number of milestones used.

### **Verifying milestone achievement**

**4.26** The ease with which milestones can be verified often depends upon the nature of a project. It can be relatively straightforward in a construction project, for example checking that a concrete pylon has been poured. It is generally more difficult for institutional strengthening projects, for example, in ascertaining whether a contractor has succeeded in meeting a requirement to transfer skills to a counterpart agency.

**4.27** The ANAO found that AusAID had established, and set out in the contract, the means of verifying progress for most of the projects examined. However, AusAID did have difficulty in verifying progress for some projects. For example, one institutional strengthening project did not initially have a regime for AusAID to verify the quality of outputs against identified milestones, with AusAID dependent on the contractor to report that it had achieved the required outputs. The desk officer subsequently developed ad hoc arrangements for verifying outputs claimed.

## 5. Managing Contract Delivery

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*This chapter examines management of contract delivery, including monitoring and payment arrangements, contract variations and contractor performance.*

### Introduction

5.1 Ongoing management of AusAID contracts involves a range of processes and procedures, as discussed below, including:

- monitoring of progress, largely through reporting by contractors;
- verification of service delivery;
- management of contract variations;
- dispute resolution;
- payment arrangements; and
- contractor performance assessment.

### Monitoring and progress reporting

5.2 Project monitoring is generally undertaken at two levels. In-country monitoring by posts of project implementation and the collection and formal reporting of information by contractors.

### Monitoring in-country

5.3 Contracts specify a formal arrangement for regular project monitoring and review through, for example, regular Project Coordination Committee (PCC) meetings (see 2.55). In addition, the key in-country relationship to support project monitoring is that between the post and the contractor's Australian Team Leader (ATL). The ANAO found that the working relationships between posts and ATLs were effective, with posts keeping in regular contact with ATLs by telephone, e-mail or personal visit. For example, one post organised monthly meetings with all ATLs to provide a forum for the exchange of views. On the whole, ATLs considered communications with posts, and their responsiveness in facilitating or resolving problems, to be satisfactory.

5.4 Some ATLs did observe that some (Australian-based) desk officers visited projects only infrequently and were concerned that these officers did not have a sufficient knowledge base on which to make important project decisions. While

noting these comments, the ANAO recognises that AusAID has to balance the benefits of more regular visits with the associated opportunity and financial costs.

5.5 In addition, the ANAO notes that AusAID's plan to shift activity management and monitoring in-country is likely to substantially address these concerns by enhancing field-level decision making (see 2.16).

## **Contractor reporting**

5.6 Effective monitoring of contract service delivery requires a reporting regime that aligns with the nature and complexity of the contract being managed.<sup>47</sup> The arrangements for aid contract reporting focus on reports by the ATLs. ATLs produce a range of reports for AusAID (usually through the AMC) and the counterpart agency and the Project Coordination Committee.<sup>48</sup> The reports for AusAID include achievements against milestones; (usually) monthly reports<sup>49</sup> on achievements against the annual plan and on any emerging problems; six monthly reports; and annual reports.

5.7 Traditionally, regular formal (written) contractor reporting has facilitated progress payments and kept the desk officer informed of implementation progress and difficulties. While the post increasingly relies on more informal communication with the ATL (i.e. telephone, e-mail and meetings) to keep up-to-date on project implementation and to brief the desk officer, formal reporting has often continued at a high level.

5.8 It is recognised by all parties concerned in these reporting arrangements that they are often excessive. Excessive contractor reporting was also a prominent feature of contracts examined in this audit (see illustration). It results in ongoing and time-consuming reporting, often requiring a large proportion of an ATL's time. One ATL estimated that he would spend just over 60% of his time writing reports over a two-year period.

5.9 Reports can also be quite large. For example, one milestone report examined contained over 60 pages<sup>50</sup>. This was one of more than 45 milestone reports to be produced in just over two years.

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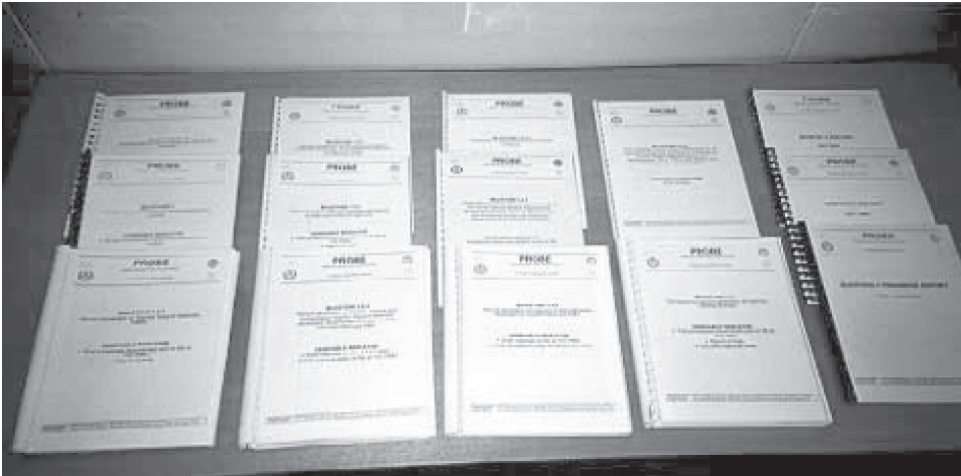
<sup>47</sup> The ANAO's Better Practice Guide on *Contract Management*, February 2001, p. 52.

<sup>48</sup> ATLs may also be required by the AMC to produce reports specifically for their management purposes.

<sup>49</sup> Some projects only require quarterly reports, although monthly reports have been a requirement for most projects.

<sup>50</sup> This level of reporting was not uncommon, although towards one end of the spectrum of practices observed.





*Contractors prepare a range of reports for AusAID. These are some of the reports that were prepared for one project.*

**5.10** ATL's advised that this level of reporting significantly reduces the time available to them to transfer skills to the counterpart agency, often a key aspect of the project. There is also an impact on project cost, for example, in management costs. As well, AMC's advised that they take account of reporting commitments in pricing tenders.

**5.11** Current volumes of reporting also affect the management approach of desks and posts. On the one hand, the ANAO found that it results in AusAID not reading many of the general (non-milestone) reports sent to them. On the other hand, there is a risk that in dealing with the volume of reports, AusAID becomes insufficiently strategic and risk based in its monitoring.

**5.12** AusAID has been seeking to address these concerns. Measures underway, or commenced during the audit, include:

- a 'contract simplification' process, involving reduced reporting for new and some existing contracts with effect from April 2001; and
- increased use of hybrid contracts, which have fewer milestones (see Appendix 4).

**5.13** While the ANAO found many examples of excessive reporting during the audit, AusAID has recently signalled a more strategic focus for the agency<sup>51</sup> and during 2001 commenced implementation of a range of practical measures to reduce contractor reporting. The effectiveness of these measures would benefit from an ongoing management focus.

<sup>51</sup> AusAID's Strategic Plan sets out a more strategic approach for the agency, which includes avoiding micro managing projects.

## Verification of service delivery

### Verification of milestone attainment

**5.14** Contract monitoring is the responsibility of both the post and the desk (see Figure 2.1). The post advises on project progress; the desk monitors expenditure against contract milestones. The post and desk must agree on the quality of a report, where it is a specified contract output, before a payment can be made.

**5.15** The ANAO found that, for the most part, AusAID appropriately verified the achievement of contract milestones through the use of a variety of approaches including site visits, reliance on reports from Technical Advisory Groups (TAGs—see 5.17 below) or reports from the contractor (backed up with some spot-checking).<sup>52</sup> The approach depended on a range of factors, including post proximity to the project, the identified project risk factor, the technical nature of the project and post resources.

**5.16** All but one of 14 contracts examined during the audit contained evidence of work undertaken by AusAID to verify milestone attainment. (Two of these were construction projects that relied on an engineer to verify milestone attainment.) There was no documented evidence of verification taking place for the last contract; however, the desk officer advised that verification had occurred but that it had not been documented.

### Technical verification

**5.17** Technical Advisory Groups (TAGs) are an important part of AusAID's approach to monitoring and verifying contracted aid activities. TAGs are small teams contracted by AusAID to provide independent technical advice on specific aspects of an activity. They have a key role in undertaking technical assessments where AusAID staff would not be expected to have the necessary knowledge.

**5.18** The ANAO found that TAG assessments are widely accepted as being technically competent. However, the number, and use, of TAGs has grown substantially in recent times, with increasing reliance being placed on them for more basic monitoring of inputs, outputs, risks and emerging problems. The result is that they sometimes duplicate post monitoring responsibilities.

**5.19** In addition, the growth in the use of TAGs has led to inconsistent approaches across AusAID, and has led to ATLS expressing concerns that TAGs are sometimes unnecessarily intrusive, leading to extension and complication of the reporting and verification process (for example desks referring contractor

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<sup>52</sup> Surveys and workshops were also used to monitor project progress.

reports to TAGs for comment). This has sometimes delayed milestone payments to contractors.

**5.20** It is clearly appropriate that AusAID obtains sufficient verification of delivery of the technical aspects of a project. However, it is important that this be undertaken on a risk-managed basis to avoid duplication of post monitoring, unnecessary delays and intrusion. This in turn needs a greater degree of structure and guidance on use of TAGs than has so far been the case.

**5.21** AusAID has responded to these concerns, particularly the consequential late payment, by reminding staff that such payment delays should not be unacceptably long. It is also seeking, following consultations with contractors and an internal AusAID workshop, to ensure a more consistent approach across AusAID to the use of TAGs. At the time of the audit, one measure being considered was a shift in responsibility for TAG appointments to the post. This measure is to be considered in the context of the implementation of the Strategic Plan.

## Contract variations

**5.22** The challenging environment in which aid is delivered and lengthy implementation times often results in delays in, or changes to, project implementation (see Figure 5.1). These changes are often beyond the control of both AusAID and the contractor and commonly involve alterations to the scope of services, basis of payment or term of a contract.

### Figure 5.1

#### Typical project changes leading to contract variation

- Project evolution, including agreed extensions of activities to similar areas.
- Risks eventuating from changed circumstances, resulting in additional costs.
- The provision of 'bridging' contractual cover between different project phases.
- Poor initial design, including inappropriate or overly ambitious designs (see 4.5).
- Partner government contributions being delayed or not meeting expectations (e.g. in project approval or provision of funding, staff, land, facilities, etc).
- Other reasons beyond the control of stakeholders, such as inclement weather or interruptions to power supplies.

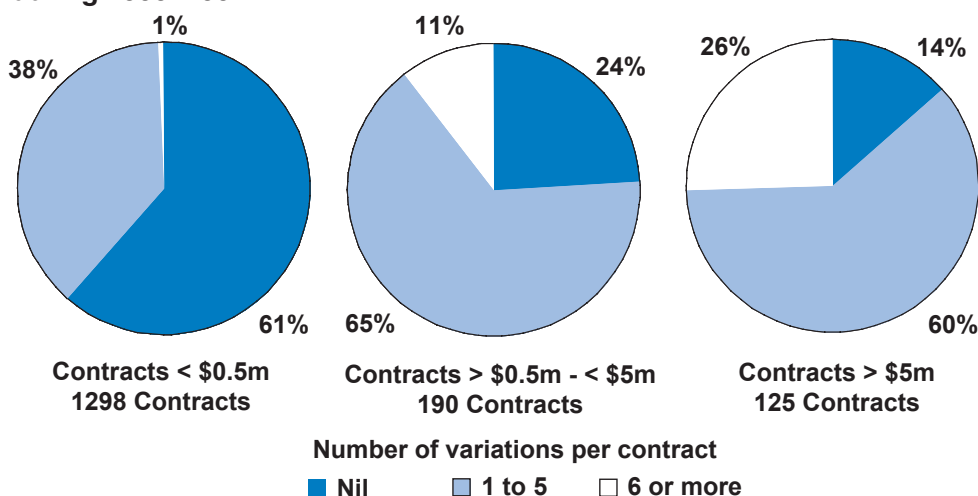
Source: ANAO analysis

5.23 Contract variations normally occur in the context of the annual plan, which is prepared by contractors (by 31 March each year) and approved by AusAID. The first annual plan is important as it allows the contractor to review the project design and suggest changes. However, AusAID expects that significant changes<sup>53</sup> to the overall project design would be rare in the first project year.

5.24 The ANAO analysed all contracts in force<sup>54</sup> during 2000–2001 and found that about half had been varied at least once. (As many will continue into future years it is likely that there will be further variations during their life.) As Figure 5.2 demonstrates, the likelihood of variation increases with the value of the contract.

**Figure 5.2**

**Frequency of contract variations for commercial contracts in force during 2000–2001**



Source: ANAO AMS database analysis

5.25 The ANAO also found that for those contracts that had been varied, on average, there were about three variations for each contract valued between \$500 000 and \$5 million and four variations for contracts over \$5 million.<sup>55</sup> The above data needs to be interpreted with some caution as some projects evolve over time due to planned phasing or extensions of activities to similar areas (see Figure 5.1) rather than delays or cost overruns.

<sup>53</sup> Significant changes involve changes to budget allocations or a substantial change to a component; for example an addition, deletion or substantial modification to one or more major outputs.

<sup>54</sup> Contracts that were 'in force' during 2000–2001 includes contracts that were ongoing, commenced during 2000–2001 or were completed in that year.

<sup>55</sup> As this is an average to date, by the time the contracts are completed the average may increase due to further variations.

**5.26** Further analysis of a small sample of contracts indicated that more than 60% of the variations had a financial impact. About 40% of those variations with a financial impact involved an increase in the cost of the project of more than 25%. The impact of the variations could not be assessed due to inaccurate and unreliable information in the AMS.<sup>56</sup>

### **Contract variations sometimes result from design difficulties**

**5.27** The ANAO found it common practice for a contract to be signed with both the contractor and AusAID aware that a variation would be required at an early opportunity. This occurs as a result of changed requirements since the initial design work was undertaken and due to poor initial design.

**5.28** AusAID's recent Strategic Plan has identified the need for more flexible designs that are less prescriptive and more focussed on key outcomes and outputs. This builds upon work that AusAID has undertaken to trial more flexible design approaches (see 4.7). These provide greater scope for innovation and responsiveness to evolving circumstances, and appear to offer the prospect of fewer variations resulting from design limitations.

**5.29** Given the significant impact of contract variations on contract management the success of these initiatives in better managing contract variations warrants evaluation in due course.

### **Contractors undertake additional work pending formal contract variation**

**5.30** The changing project needs discussed above, the cyclical way in which variations are submitted and approved, and the time that may be involved in formally approving variations,<sup>57</sup> means that contractors are sometimes undertaking work additional to that provided for in the existing contract without a formal variation to the contract. There was clear evidence of this in cases examined by the ANAO, and contractors confirmed this occurs, including spending substantial amounts of their own funds without a formal variation to the existing contract.

**5.31** In some of these cases, contractors received letters of comfort but in others only oral commitments were given. This preparedness to undertake work pending formal variation reflected the reasonable level of trust observed by the

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<sup>56</sup> From a sample of 35 projects, eight projects were still current in the AMS and had not been varied to extend the timing of the project even though the expected finish date was well past.

<sup>57</sup> Delays in approving contract variations were raised by a number of ATIs and desk officers and had been identified as an issue by internal audit in 1999. A meeting between the PSCG and AusAID in July 2001 noted that improvements in timeliness had been made.

ANAO between AusAID and contractors. However, the ANAO also observed some discomfort amongst contractors concerning the informality of the way this ongoing issue was managed.

5.32 Some desks do employ 'work-arounds'. For example, one desk uses a requisition arrangement, whereby the desk might instruct the contractor to purchase say, motor vehicles, and then provide reimbursement. This has the disadvantage that these costs are not attributed to the contract or gazetted.

5.33 The ANAO considers that it would be prudent for AusAID to assess the risks arising from this situation as well as the means of managing it more formally and effectively, including assessing current practices for appropriateness and identifying better practice.

## Conclusion

5.34 More flexible design approaches, including those currently being trialed, offer the prospect of addressing one of the major causes of variations. However, the challenging environment in which AusAID operates means that there will be a continuing need to have robust contract variation arrangements.

5.35 The ANAO therefore considers that it would be appropriate for AusAID to assess some of its current practices for managing work undertaken without a formal variation being in place.

## Recommendation No. 5

5.36 The ANAO recommends that AusAID assess the risks of contractors undertaking work without a formal variation being in place and consider means of managing this situation in a more systematic manner.

### *AusAID response*

5.37 Agreed.

The ANAO notes that there is a reasonable level of trust that has been built up between contractors and AusAID. While this reflects well on all parties, AusAID does not regard it as good contract management practice for contractors to undertake additional work to that specified in a contract without a formal variation.

AusAID is therefore managing the issue of contract variations in a number of ways. First, while there will always be a need for contract variations to reflect changing circumstances, AusAID is seeking to reduce the need for, and number of, contract variations that arise in the first place. For example, the move under the Strategic Plan towards less prescriptive, more strategic, and more flexible

project designs should reduce the frequency of contract variations, although it needs to be recognised that the move to ‘rolling designs’ will still require a level of inherent variation.

Second, AusAID will put more emphasis on the activity annual plan as the most efficient and appropriate mechanism for considering essential contract variations.

Third, major AusAID contracts now incorporate a formal variation order mechanism that enables relatively simple variations to be undertaken in a very efficient manner. For example, personnel on the project site can now be substituted through a simple variation order, rather than a formal contract amendment.

Fourth, AusAID issued policy guidelines in 2001 which enable staff to provide a written assurance to a contractor agreeing on the scope of additional work and to the level of inputs whilst a formal variation is processed.

## Dispute resolution

**5.38** AusAID’s contracts contain clauses on dispute resolution and arbitration. Parties are to use best endeavours to agree on a process for resolving a dispute prior to resorting to arbitration.

**5.39** The ANAO found, as previously discussed, that AusAID and contractors on the whole maintain good working relationships, with posts responsive in facilitating or resolving problems that arise during project implementation.<sup>58</sup> Accordingly, formal disputation between AusAID and contractors is low. ANAO examination of AusAID management information revealed that only four of more than 1650 contracts were identified as being in dispute in 2000–2001.

## Payment arrangements

### Payments are appropriately approved

**5.40** Before a payment may be made, a Certifying Official must ensure that the payment is appropriate, and then approve it.<sup>59</sup> The ANAO found that AusAID had appropriate processes for approving payments and that these were appropriately followed and payments certified for the contracts examined in this audit.

**5.41** AusAID’s contracts provide for payment to be made within 30 days of acceptance of a milestone report or, in the case of reimbursables, within 30 days

<sup>58</sup> AusAID’s practical approach to problem resolution and its tendency to invoke the contract only as a last resort is further discussed in Chapter 6.

<sup>59</sup> The Certifying Official must ensure that: a properly rendered tax invoice has been received; the correct amount is being claimed and has not already been paid; and assess whether relevant contractual requirements have been met. The Certifying Official must not also have provided any of the approvals under the contract.

of receipt of a properly rendered invoice. The ANAO found that delays in the payment of invoices have occurred in the past and recently raised with AusAID by contractors. AusAID has largely addressed these concerns, and payments now appear to be timely.

## **Invoicing requirements have been inconsistent**

5.42 Sound contract payment practice incorporates agreed arrangements and standards for:

- the format and timing of invoices;
- a minimum level of information to be included in invoices; and
- checking to be undertaken before an invoice is to be paid.<sup>60</sup>

5.43 As noted in Chapter 2, desk officer turnover can result in inconsistent standards and approaches in dealing with contractors (Figure 2.2). The ANAO found that invoicing requirements vary widely from desk to desk and can change for the same contract with a change of desk officer. Indeed, contractors reported instances of incoming desk officers rejecting an established format and requiring a greater level of supporting detail on achievements against specific project components. Variable reporting requirements were also a particular issue for AMCs preparing invoices for several desk officers because of multiple contracts. Contractors noted that this resulted in increased costs, which were then passed on to AusAID.

5.44 AusAID advised the ANAO that it had only recently become aware of this issue and would be clarifying instructions to Certifying Officials and developing a procedure circular for desk officers to simplify invoicing requirements for future contracts.

## **Foreign exchange risk management**

5.45 The management of foreign exchange risk exposures in AusAID's bilateral aid program was addressed in ANAO Report No.45 of 1999–2000, *Commonwealth Foreign Exchange Risk Management Practices*.<sup>61</sup> It found that, while AusAID faced a significant foreign exchange exposure it had not explicitly quantified its extent or identified the degree to which it had increased cost volatility and reduced or increased contract costs.

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<sup>60</sup> ANAO Better Practice Guide on *Contract Management*, February 2001, p. 63.

<sup>61</sup> The Minister for Finance and Administration announced on 28 May 2002 that the Government had decided to revise its foreign exchange risk management policy. The revised policy retains the requirement for agencies to individually manage their forex risk but agencies will no longer be permitted to hedge, except in special circumstances. Forex gains will be returned to the budget while agencies will be supplemented for any forex losses.



**5.46** AusAID advised that it has made progress in addressing a number of key issues in this regard, including the development of a clear statement of foreign exchange risk management objectives; the identification of a need for its new Aidworks system (see 2.37) to quantify the exposure; and the establishment of a risk management committee whose responsibilities would include consideration of foreign exchange risk management policies and strategies.

## Assessing contractor performance

**5.47** Contractor performance is critical to project success and directly affects the impact and quality of the aid program. In its 1999 submission to the JCPAA inquiry into contract management<sup>62</sup> AusAID identified improvements in contractor performance and the management of performance problems as being priority areas for AusAID contracting over the next few years.

**5.48** Assessment and feedback on contractor performance occur through two channels. Firstly, and most immediately, through the direct contract management relationship between the contractor and the AusAID desk officer. Secondly, through AusAID schemes to assess the overall performance of contractors with multiple contracts.

## Regular contract management feedback

**5.49** AusAID desk officers monitor contractor performance through the regular reporting and monitoring regimes discussed in the rest of this chapter. The desk officers are expected to provide performance feedback to contractors regularly and in writing, in accordance with AusAID policy and guidance.

**5.50** However, evidence from audit examination and advice from contractors indicated that this policy is not consistently implemented. Some contractors received feedback from the relevant desk officers, others did not (in the latter cases there was particular concern that they may not be made appropriately aware of perceived poor performance). Whether feedback occurred depended on the management approach of the individual AusAID officer. Feedback that was received tended to be ad hoc and perceived as negative with a focus on performance problems. Contractors also advised that they sometimes received conflicting advice from different desks.

**5.51** The ANAO concluded that the provision of day-to-day feedback to contractors would benefit from greater regularity and more consistency across AusAID. This would be worth consideration in the context of the formal assessment scheme (see below).

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<sup>62</sup> JCPAA Report 379 *Contract Management in the Australian Public Service*, October 2000.

## The new contractor performance assessment scheme for major contractors is a positive innovation

5.52 In late 2000 AusAID introduced a new scheme to assess the performance of major contractors with multiple contracts, replacing earlier arrangements. Key features of the scheme are outlined in Figure 5.3.

### Figure 5.3

#### Outline of Contractor Performance Assessment Scheme

The scheme links past contractor performance with the contractor's capacity to win future contracts. It is coordinated by the Contract Services Group (CSG). The CSG collects comments on contractor strengths and weaknesses from the desk, post (through the desk) and other internal and external sources. Comments are collected and grouped under four assessment criteria used for the tender assessment process: organisation capacity; approach; personnel; and project management.

This information is conveyed to the contractor by CSG in a formal performance discussion. The contractor is given six months to take any remedial action considered appropriate before the process is repeated. Following a second meeting, a formal one-page summary is prepared and provided to the Technical Assessment Panel (TAP)<sup>63</sup> when the contractor next bids for an AusAID contract, along with a commentary by the contractor. Guidelines have been developed to assist the TAP chair in the use of the information.

The scheme has initially focussed on seven major contractors that account for about half of total contract value. AusAID intends to include two further large contractors by December 2002.

Source: ANAO summary of AusAID information

5.53 The ANAO observed a number of performance assessment discussions and interviewed participants in the new arrangements. The ANAO found that the scheme is an improvement on previous arrangements. As well as the linking of past performance to future contracts, strengths include:

- feedback direct to senior AMC management;
- documentation of comments and actions, which are subsequently reviewed;

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<sup>63</sup> The Technical Assessment Panel (TAP) is used to rank contractor bids on the basis of technical merit. They comprise a non-voting chair (normally the contract manager) and three to five non-voting members, depending on the complexity of the project.

- contractors having the opportunity to respond and to take remedial action before the assessment is provided to the TAP; and
- assessment undertaken in a non-adversarial manner.

5.54 Contractors generally see the scheme as a constructive initiative. Evidence indicates that AMCs were acting, or planning to act on, identified shortcomings. For example, one AMC developed a series of six-monthly action plans through which it was able to monitor and improve its performance. AusAID advised that the relevant desks had reported significant improvements in performance of some AMCs as a result of feedback.

5.55 AusAID envisages that the scheme will evolve further over time in consultation with contractors and depending on the outcomes achieved. To assist this evolutionary process the ANAO identified elements of the new scheme that would benefit from strengthening. In particular, the process relies on views presented by desk officers rather than an assessment against specific key performance indicators or targets. A *Contractor Performance Assessment Report* template has been developed by the CSG that allows desks to check one of ten boxes ranging from 'Best Practice' to 'Weak' against each assessment criteria. However, use of the template by desks is optional and those collected by the CSG are not aggregated numerically. More consistent use of this template and the collection of more *quantitative* information on performance<sup>64</sup> would complement the process-focussed *qualitative* information currently collected.

5.56 Other potential enhancements that warrant consideration include:

- expanding the scheme to cover a wider range of contractors, having regard to cost-effectiveness considerations;<sup>65</sup>
- clarifying how the TAP process is to be equalised for new contractors or those not assessed;<sup>66</sup> and
- ensuring that desks/posts maintain sufficient documentation to support their feedback to CSG.<sup>67</sup>

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<sup>64</sup> While the PSCG initially indicated a preference for a weighted scoring (formula) approach, it subsequently agreed to review the operation of the current system after a reasonable period of operation.

<sup>65</sup> Limited expansion to those contractors with contracts totalling over \$10 million would result in about 12 more contractors being assessed, in addition to the nine expected to be covered by the end of 2002.

<sup>66</sup> Contractors that have not undergone a performance assessment may be advantaged or disadvantaged in a TAP process. For example, a non-assessed contractor may have similar weaknesses to one that has been assessed.

<sup>67</sup> The ANAO found that some desks/posts did not maintain sufficient documentation to support the contractor performance comments that they had provided to CSG. Among other things, this might hamper an incoming desk officer's ability to become familiar with contractor shortcomings.

## Recommendation No. 6

5.57 The ANAO recommends that AusAID build upon the benefits of its new contractor performance assessment scheme by extending it to other contractors where cost-effective to do so, and collecting more quantitative information on performance.

### *AusAID response*

5.58 Agreed.

AusAID—and no doubt the contractors—would welcome incorporation of even greater rigour and quantification into the system. There are opportunities for doing so that are relevant and not disproportionately expensive in resource terms. AusAID will review, with contractors, the incorporation of more rigorous and quantitative information in its contractor performance system.

Extending the contractor performance system to other contractors—including design teams—is a priority for AusAID but this will need to be done within existing resource constraints.

## 6. Strengthening AusAID's Contracting Approach

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*This chapter examines AusAID's contracting approach and identifies areas where it could be strengthened.*

### AusAID's contracting approach

#### The contract relationship continuum

6.1 The ANAO's Better Practice Guide on *Contract Management* identifies four different relationship types—viz: traditional, cooperative, partnering and alliancing—which form a contract relationship continuum.

6.2 Historically, relationships between purchasers and providers have been described as traditional and have been shaped by legal and contractual obligations. The relationships tend to be centred around the contract, ad hoc and at arm's length with each party pursuing its own objectives. The traditional approach is most beneficial where the scope of services can be accurately defined; the potential for changes in scope during the contract period is low; and the risk of failure of the service is also low. This approach tends to be the basis of most contracts entered into by the Commonwealth.

6.3 The three other approaches involve varying degrees of cooperation and trust (further discussed at Appendix 5):

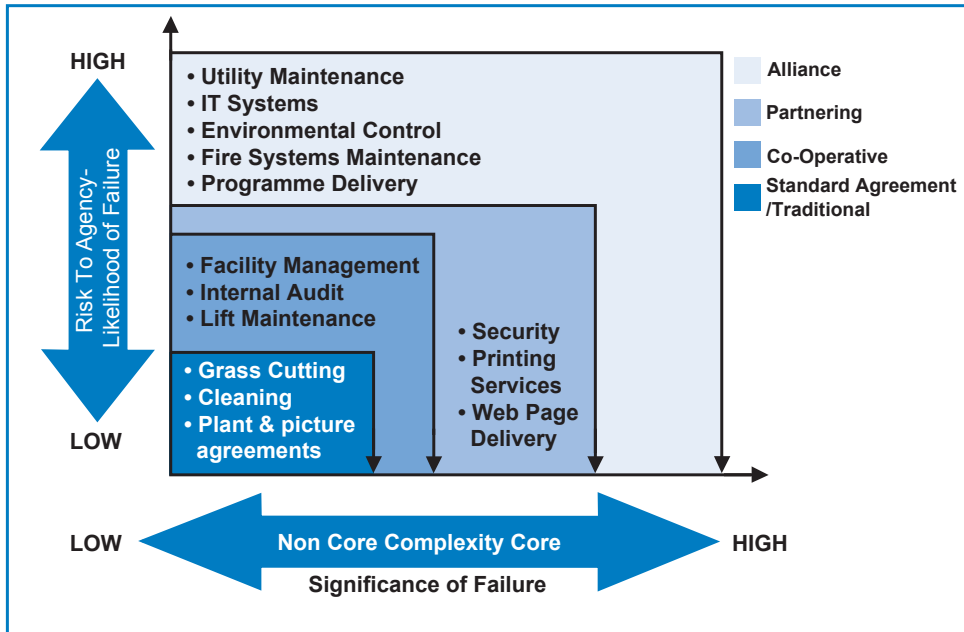
- *Cooperative*—incorporates some of the key elements of partnering such as improving communication and obtaining commitment at a senior level but does not extend to some of the higher ideals within partnering such as the sharing of risks;
- *Partnering*—a more formalised process that establishes a moral agreement and includes some sharing of risks, aligning objectives and a structured approach to communication, issue resolution and evaluation of project performance; and
- *Alliancing*—takes the partnering concept a step further and involves a shared risk reward regime that links remuneration to achieving exceptional performance in the delivery of services.

6.4 The nature of the risk, the complexity of the service, and whether the service is considered to be core or non-core to the organisation, will very often determine the relationship style as set out in Figure 6.1. Another consideration

is that the more cooperative approaches can involve higher levels of risk to the organisation and require more sophisticated and intensive management arrangements.

**Figure 6.1**

**Contract risk and service complexity as determinants of relationship style**



Source: ANAO's Better Practice Guide on *Contract Management*

**AusAID employs a range of contracting approaches**

6.5 AusAID advised that its contracting approach involves a combination of:

- conventional contract provisions;
- payment structures that encourage the achievement of deliverables;
- active monitoring of outputs and deliverables; and
- consultation between AusAID, the AMC and partner governments to resolve problems, with litigation used only as a last resort.

6.6 This approach involves a range of contracts (small value, intermediate and large) which AusAID applies according to the nature of the activity.<sup>68</sup> For

<sup>68</sup> AusAID's current suite of contracts was introduced progressively from April 2000 following a major review and was, in part, a response to some past contractor failings.

example, construction projects use the FIDIC contract,<sup>69</sup> while a range of purpose built contracts are used for the provision of services.

**6.7** AusAID's contracting approach has evolved in response to its experience in managing them for successful outcomes. Contracts initially had a focus on *inputs*; this later changed to a focus on *outputs*. Output contracts remain AusAID's preferred approach for small value activities and for major construction activities where the outputs and outcomes can be clearly defined.

**6.8** However, AusAID now often uses *hybrid* contracts for major services (see Appendix 4)<sup>70</sup>—and especially for activities such as institutional strengthening and capacity building—where development impact is a combination of some strategic, higher level, tangible outputs, supported and reinforced by flexible delivery of inputs (such as training, procurement, or technical assistance). This mix of outputs and inputs is reflected in hybrid contract provisions and payment regimes. In particular, the hybrid approach involves a move away from the production of numerous, and sometimes mechanical, milestone reports which were required for output contracts. Instead payments are linked to essential project inputs and the achievement of fewer, but more significant and strategic, milestones.<sup>71</sup>

**6.9** AusAID has advised that hybrid contracts are usually most useful when addressing capacity building and institutional strengthening needs, because the payment structure is more closely tailored to the actual interventions and outcomes. It considers that an additional, but subsidiary benefit, is that hybrids provide a more predictable and assured cash flow to contractors and encourage new contractors to tender for projects.

## **AusAID's actual contracting approach is not well reflected in its formal contract provisions**

**6.10** Better practice provides that risk should be allocated to the party best able to manage it or bear the consequences. The likelihood of risks occurring in the delivery of overseas aid is magnified by the inherent instability of the political, economic and social structure of some recipient countries and the long time frames often involved in project delivery. In this environment there are unique considerations that make some risks hard to manage by either party.

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<sup>69</sup> A standard set of contract conditions for construction projects developed by the Fédération Internationale des Ingénieurs-Conseils (F.I.D.I.C.).

<sup>70</sup> Hybrid contracts for major services were formally introduced in May 2001.

<sup>71</sup> Essentially this involves reimbursements of 60–70% of input costs, made in arrears on a monthly or quarterly basis. The remaining payments, largely representing AMC profits and overhead costs, are linked to the achievement of significant activity milestones.

**6.11** In seeking to protect the Commonwealth's interests, AusAID's major construction and service contracts provide for the selective use of penalty clauses that cover a *reduction in fees for non-performance* and *liquidated damages* for a delay in project completion caused by the contractor. They also provide for the selective use of *unconditional financial undertakings* and *performance guarantees*. AusAID has advised that there have been circumstances where projects have been delayed by factors within the control of the contractor, rather than the partner government. In these cases, AusAID's use of provisions to reduce payments or apply penalties has protected the Commonwealth's position.

**6.12** However, AusAID operates in an environment where partner government commitment and the provision of counterpart staff and resources are common risks (see 3.5) that are often beyond the capacity of the contractor to influence. In seeking to address this issue AusAID's standard contracts contain *extension of time* provisions for circumstances that arise and are beyond the contractor's reasonable control.

**6.13** In between the two extremes is a substantial grey area where it is not possible to precisely attribute causes of delay.<sup>72</sup> AusAID has sought to address this issue in the past by seeking to transfer at least some of the third party risk to the contractor. This involved the inclusion of a contract provision—in force at the time of the audit<sup>73</sup>—whereby *the Contractor agrees to provide the Services in as flexible a manner as possible to take account of Third Party Issues within the Fees*.

**6.14** In reality, when problems arise during project implementation AusAID adopts a practical approach to their resolution, acknowledging that some risks are beyond the contractor's control, and seeks resolution through cooperative discussion. Indeed, while not forgoing its rights under the contract, AusAID tends to invoke the contract only as a last resort, as evidenced by the low level of disputation noted at 5.39. Project delays caused by partner governments not being able to meet expectations are often managed by contract variation (see Figure 5.1).

**6.15** However, AusAID's tendency toward a cooperative and practical approach to resolving implementation problems is not reflected in its contract provisions. There is a risk, as acknowledged by AusAID, that existing provisions may deter new contractors from tendering and may impact adversely on price for very complex, high-risk projects. There would be merit in the contracts reflecting AusAID's intended behaviour but without weakening the Commonwealth's position.

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<sup>72</sup> A complicating factor is that some external factors can be influenced by contractor behaviour. For example, contracted technical advisers can play a role in building effective relationships and encouraging partner government ownership but the quality and effectiveness of the technical advisers in this role is difficult to quantify or verify.

<sup>73</sup> AusAID advised that this provision is being phased out of its service contracts from January 2002.



**6.16** This might be accommodated by the development of provisions to be used, as appropriate, articulating AusAID's intended approach to contract management. These provisions could include the identification of roles in relation to the project, a joint approach to resolving problems, a communication framework to include kick-off meetings and reviews, a commitment to a cooperative exchange of information and the establishment of targets for improvement. This might also involve AusAID articulating in the contract what contractors can expect of AusAID, for example, in relation to the timely payment of invoices.

## Recommendation No. 7

**6.17** The ANAO recommends that AusAID review its contract provisions to articulate its intended behaviour, as appropriate, but without weakening the Commonwealth's position.

### *AusAID response*

**6.18** Agreed.

AusAID's contracts were systematically and comprehensively reviewed in 1999 using high-level external legal advice. The result of the review was that AusAID's contracts have been made more consistent, contemporary, and legally defensible, thereby safeguarding the Commonwealth's interest.

But AusAID agrees with the ANAO finding that AusAID's 'tendency toward a cooperative and practical approach to resolving implementation problems is not reflected in its contract provisions'. Such a disconnect between contractual provisions and actual practice is, of course, not unique to AusAID. But AusAID sees the benefits in better aligning the language and provisions of its contracts with its intended practice, while still preserving more formal legal remedies and penalties when needed.

AusAID has commenced work on a statement of general principles which articulates what parties to the contract may reasonably expect of each other—including a constructive, speedy, effective and efficient approach to problem solving—but which do not weaken the Commonwealth's position. AusAID will consult with contractors on this statement of principles, as well as obtaining legal advice. Once finalised, the text will be included as a preface to all AusAID major contracts.

## Building on AusAID's contracting approach

### AusAID is expanding its range of contracting choices

6.19 AusAID recognises that there is no single contracting approach appropriate for every type of aid activity, with factors such as risk, complexity, value, the degree of flexibility needed and the amount of management input required being key considerations. AusAID is committed to an ongoing process of renewal and improvement across the agency and recognises that sound contracting strategies are a key means to ensure effective implementation of its aid programs.

6.20 As part of this ongoing process, AusAID's Strategic Plan proposes an expansion in the range of contracting choices, with key contracting models—including hybrids, managing contractor models and 'relationship contracting' (including alliance contracting)—enhanced or developed. Supporting guidelines and documentation for these approaches are to be developed for contract managers by July 2002.

6.21 Relationship contracting brings with it both potential gains on appropriate projects and also risk, being a complex undertaking that needs careful planning and execution. In this context, AusAID advised that it is committed to undertaking a trial of alliance contracting and is actively seeking to identify a suitable activity.

6.22 The rest of this chapter explores the opportunities for further enhancements on an incremental basis to AusAID's existing contractual arrangements by more formally adapting the principles of cooperation and collaboration to those arrangements.

### Development of selective structured partnering would be beneficial

6.23 As noted above, for the more complex and high-risk contracts AusAID's actual relationship approach reflects features normally found in a cooperative/partnering approach. For example:

- kick-off meetings to brief the contract team on mobilisation, monitoring, reporting and documentation requirements and Project Coordination Committee meetings to review progress and discuss issues;
- joint problem solving—the ANAO found that posts, in particular, often adopt a cooperative approach to resolving difficulties that arise during project implementation;
- a reluctance to enforce penalties and a low level of disputation; and
- a consultative arrangement with the PSCG and other key stakeholders.

**6.24** The ANAO's view is that AusAID's tendering approach, which involves the assessment of tenders on both technical merit and price,<sup>74</sup> provides a good foundation for cooperative/partnering relationships. The focus on technical merit will generally ensure that the contractor with the best team, experience and processes is selected. These elements are important where the success of the project depends on the quality of the relationship with the contractor.

**6.25** These existing tendering/contracting features provide the basis for developing a more formal, structured and systematic partnering approach for some of the larger, more complex projects that AusAID delivers. Such an approach offers a number of benefits for AusAID including greater assurance that an appropriate relationship is employed for appropriate projects. This already occurs informally for some projects, but inconsistent contract management approaches identified in other chapters limits its effectiveness.

**6.26** A more consistent approach across the agency would also help contractors better understand what is required of them. The development of a structured approach to resolving issues is also likely to assist AusAID where the project risk is hard to define and the requirements are difficult to specify and likely to result in contract variation. Figure 6.2 suggests the type of projects that might benefit from a more structured partnering approach.

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<sup>74</sup> This normally involves a weighting of 80% technical merit and 20% price.

## Figure 6.2

### Projects that might benefit from a more structured partnering approach

- larger and more complex projects;<sup>75</sup>
- those likely to encounter implementation difficulties arising from counterpart agency problems<sup>76</sup> or otherwise likely to require some redesign during implementation;<sup>77</sup>
- those likely to involve risks that are difficult to identify at the tendering stage;
- projects difficult to scope and price;
- projects in need of a fast track approach, with the normal selection process bypassed and price negotiated;
- projects heavily dependent on contractor input for success;<sup>78</sup> and / or
- those that require innovative approaches.

Source: ANAO analysis

#### 6.27 Building on its current approach might involve AusAID:

- flagging an intention in the tender documentation to both award the contract on the basis of merit and then adopt a post-award partnering approach with the preferred bidder;<sup>79</sup>
- ensuring that contract provisions articulate its intended post-award behaviour (see Recommendation 7 above);
- developing procedures and guidelines to ensure that desks, posts and contractors share a common understanding;
- developing training for relevant contract management staff;
- enhancing kick-off meetings so that they cover a wider range of issues—e.g. developing a structured approach to resolving issues before resorting to disputation clauses; identifying roles and responsibilities of AusAID

<sup>75</sup> Large and complex designs are discussed in Chapter 4. *Specifying Contract Requirements*.

<sup>76</sup> Partner government difficulties are discussed in Chapter 3. *Managing Risks* and Chapter 5. *Managing Contract Delivery*.

<sup>77</sup> Design weaknesses are discussed in Chapter 4. *Specifying Contract Requirements*.

<sup>78</sup> The importance of contractors to project success is discussed in Chapter 7. *Evaluating Aid Quality and Capturing Lessons Learned*.

<sup>79</sup> In the United Kingdom, the public sector has used a 'post-award partnering' approach which accommodates the need for an openly competitive process of selecting contractors. In essence, the agency follows its normal purchasing procedures but signals in the tender documents that it would like the relationship to be of a partnering nature when the contractor is selected. When the contractor is selected the parties follow the partnering process.

and the contractor; identifying potential problems and ways of overcoming those problems; and discussing risks and how they are to be managed—and, at least initially, using a third party facilitator; and

- monitoring and reviewing kick-off meeting outcomes as appropriate.

## Recommendation No. 8

**6.28** The ANAO recommends that AusAID build on its existing contracting approach by developing a more structured, post-award partnering approach that could be employed for appropriate, larger and more complex projects that AusAID delivers.

### *AusAID response*

**6.29** Agreed.

AusAID agrees that this approach should be developed for appropriate larger and more complex projects where the benefits are commensurate with the resources required.

The ANAO has correctly noted that for the more complex and high-risk contracts AusAID's actual relationship approach already reflects features normally found in a cooperative/partnering approach (whilst nevertheless preserving a professional, arms length, and accountable division of responsibilities that does not blur roles).

And several of the contracting reforms envisaged under the Strategic Plan facilitate this further. For example, the movement to shorter, higher level, and more strategic 'concept designs' gives contractors greater freedom and opportunity to be creative and innovative—but within a strategic framework established for the activity by the partner government, and AusAID on behalf of the Australian Government. Expanding and encouraging the 'best for activity' contracting models should also better align interests of all parties. And the move to more devolved in-country management of activities can facilitate quicker, more responsive, and more appropriate decision making between AusAID, contractor, and other key stakeholders.

## 7. Evaluating Aid Quality and Capturing Lessons Learned

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*This chapter examines how AusAID measures the quality of aid outcomes; results achieved for aid activities; contractor performance; and how it harnesses and uses lessons learned.*


### AusAID's quality rating system for aid activities

#### Introduction

**7.1** Australia's overseas aid is concentrated in ten key result areas<sup>80</sup> and delivered through a number of major component programs, including the country and regional program. Each program, in turn, comprises a range of individual aid activities that have specified outputs and outcomes. Most activities, particularly in the country and regional program, are managed and delivered by contractors. Some aid activities involve multiple contracts to implement.

**7.2** Assessing the performance and quality of aid activities is recognised as a challenging task by the international aid community. This is because donor agencies, such as AusAID, work in many different countries and sectors. As well, activities often focus on issues such as capacity building, policy reform and good governance, which are difficult to measure. Obtaining reliable performance information on outcomes is, however, critical to managing aid programs for value for money, including sustainability of outcomes.

**7.3** To address this need, AusAID has developed a sophisticated assessment system introduced in July 1999.<sup>81</sup> This involves desk and post officers preparing project status reports known as *Activity Monitoring Briefs (AMBs)* at regular intervals during the year through the Activity Management System.<sup>82</sup>

**7.4** AusAID's system involves an assessment of the quality of individual aid activities by the officers using a five-point rating system (see  7.1). The

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<sup>80</sup> Key result areas comprise: build effective partnerships; deliver Australia's aid program with excellence; promote effective governance; increase access to and quality of education; improve health; improve agriculture and rural development; provide essential infrastructure; deliver humanitarian and emergency assistance; maximise environmental sustainability; and promote gender equity.

<sup>81</sup> The rating scheme was revised in August 2001. Changes included a reduction in the use of quantitative ratings scales, with a reliance on the use of more qualitative assessments (identification of strengths and weaknesses) based on desk and post officers' judgement.

<sup>82</sup> In addition to assessing the aid quality they also highlight any problems or issues with project implementation.

rating ‘satisfactory overall’ is the lowest score that satisfies AusAID requirements. It represents an activity that has some minor weaknesses as well as strengths, but where the weaknesses are not severe enough to threaten the activity.

**Figure 7.1**

**AusAID rating system for the assessment of aid quality**

Weak	Marginally Satisfactory	Satisfactory Overall	Fully Satisfactory	Best Practice
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Source: AusAID

7.5 In arriving at an overall quality rating for an activity, desk and post officers address four key quality attributes (Figure 7.2). The ‘be professionally managed’ component is particularly pertinent for contracted aid activities as it includes an overall assessment of the performance of all contractors involved in delivering the activity. This aspect is looked at later in the chapter.

**Figure 7.2**

**Four quality attributes of good aid activities**

<b>Good aid activities should:</b>	Have appropriate objectives and design	Achieve their objectives	Be professionally managed	Have sustainable outcomes
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Source: AusAID

7.6 The achievement of the overall aid objective is assessed by aggregating ratings for individual activities. A quality target of 75% of activities assessed as ‘satisfactory overall’ or higher has been adopted by the agency as the key performance measure for the country and regional program and for the overall aid program.

7.7 The results from this activity rating system are now an important element of AusAID’s performance reporting to senior management and the AusAID Executive. However, the ANAO noted that AusAID management was provided with limited supporting analysis of the aid quality ratings for 2000–2001. Given the pivotal role of the ratings for performance assessment, there would be merit in extending analysis to provide greater insight. For example, to address the distribution of ratings, rather than an average, and comparing ratings with the previous year.<sup>83</sup>

<sup>83</sup> While the Executive was provided with overall quality results for 2000–2001 compared with the previous year, there was no comparison made for individual countries or key result areas.

7.8 Development and implementation of AusAID's aid quality rating system are considerable achievements. The World Bank and the United Kingdom's aid agency had earlier developed similar performance rating systems, using the same quality target of 75%.

7.9 The ANAO considers that, overall, the activity rating system provides a sound basis upon which to assess the quality of aid outcomes. It addresses important issues such as the likely sustainability of outcomes; it has flexibility, such as the ability for narrative comments on performance to be recorded; and it records the overall quality rating for each activity, as well as separate ratings for the four quality attributes.

7.10 However, there are some aspects of the system that warrant enhancement, in order to improve the performance information available to AusAID, the Parliament and other stakeholders. These are discussed below.

### **One third of aid activities are not rated**

7.11 The ANAO estimates that about 30% of aid activities in the country and regional program are exempted from the requirement to be rated. Such activities include project feasibility studies, design missions and monitoring activities undertaken by Technical Advisory Groups.

7.12 These activities are not, by themselves, expected to produce sustainable benefits and are often relatively small in financial terms. While the standard rating system may not be appropriate in these circumstances, AusAID does not have performance data for much of the 'exempt' activities.

7.13 AusAID acknowledges that it needs to collect more performance data on 'exempt' activities and has work underway in this area. For example, it is considering applying its contractor performance assessment scheme (see 5.52)—which links past performance to winning future contracts—to design mission contractors.

7.14 The regular collection of performance information on exempt activities, where it is appropriate and cost-effective to do so, would enhance AusAID's accountability for the aid quality of a broader range of activities of the country and regional aid program.

### **Required ratings are not completed for many aid activities**

7.15 AusAID has a target that ratings are to be completed and recorded for at least 90% of activities that require rating (i.e. are not exempt). This target has not been achieved to date, with the ANAO calculating completion rates of 85% for 1999–2000 and 79% for 2000–2001. This weakens confidence in the validity



of the performance data. The ANAO estimates that activities for which required ratings were not completed represented some \$90 million in aid expenditure in 1999–2000.

**7.16** The incomplete use of the rating system appears to be related to negative views by desk officers of the value of Activity Monitoring Briefs, which are used to record the activity ratings. Changes made to activity monitoring and management reporting arrangements in August 2001 are intended to address these concerns. At the time of audit, the effectiveness of these changes had not been assessed.

### **Ratings of many aid activities appear to be unreliable**

**7.17** The ratings of aid quality are ‘self-assessments’ made by posts and desks as part of their management of individual aid activities. As such, there is substantial subjectivity, and a risk of over-optimism. AusAID advises that its approach in relying on the judgement of officers to make performance assessments is consistent with that of other members of the Development Assistance Committee of the Organisation for Economic Cooperation and Development.

**7.18** The results of a 1999 quality assurance review confirmed the risk of over-optimism. The review rated 40% of activities sampled as lower than the ratings given by desks and posts (10% were rated higher). The ANAO estimates that if these results applied generally in 1999–2000, the overall aid quality measure would have been 64% of activities rated ‘satisfactory overall’ or higher, compared with the 84% reported by desks and posts. At this level, aid quality would be below the 75% performance target.

**7.19** AusAID introduced reforms in August 2001 to better inform the assessment. In particular, the new rating system will involve the desk and post making the assessment having regard to input from a greater range of AusAID staff, the partner government, the AMC and the contractor.

**7.20** At the time of audit there had been no further quality assurance checks to address whether rating reliability and objectivity had improved since the 1999 sample, or as a result of the 2001 reforms. In addition, AusAID deferred consideration of annual random sample checks until it has more experience with the new rating system.

**7.21** As these ratings are central to assessing the outcomes of Australia’s overseas aid, it would seem appropriate to undertake some quality assurance activity regarding the robustness and defensibility of future performance ratings.

## Reporting to the Parliament

7.22 AusAID's 2000–2001 Annual Report reported on the second year of operation of the agency's new performance information framework. It included an assessment of the performance of the overall aid program and, among other things, stated that AusAID achieved the performance target of 75% for the country and regional component.

7.23 The Annual Report did not expand upon this information with quantitative information. For example, it did not identify the quantum of the rating or provide quality ratings for any individual country program or key result area. AusAID advised that data quality concerns (see 7.18) had contributed to its decision not to publish such information.

7.24 Transparency and public accountability would be enhanced by the future release of a wider range of appropriate information on quality ratings for example, where meaningful, for key result areas and specific countries/regions. The availability of such data is discussed below at 7.33.

7.25 The 2000–2001 Annual Report did not express qualification regarding the rating data, although the previous year's report did (it acknowledged data limitations and indicated an intention to refine the ratings). It would also increase transparency to explain more clearly any data quality limitations applying to the ratings or the underlying assessments that AusAID reports to the Parliament.

## Conclusion

7.26 The quality rating system provides AusAID with a sound basis on which to assess the quality of aid outcomes. However, there are a number of aspects of the assessment and reporting process that require strengthening to improve the reliability of, and confidence in, the rating system and to enhance the public reporting of quality ratings for the aid program.

## Recommendation No. 9

7.27 The ANAO recommends that AusAID strengthen its assessment and reporting of the quality of aid outcomes, by:

- collecting performance information on activities of the country and regional aid program exempt from the rating scheme, where it is appropriate and cost-effective to do so;
- undertaking and recording quality ratings for all activities covered by the rating system;

- undertaking quality assurance of the reliability of quality ratings; and
- including in its reports to the Parliament a wider range of appropriate information on quality ratings for example, where meaningful, for key result areas and countries/regions, and explaining significant data limitations applying to reported aid quality ratings or the underlying assessments.

### *AusAID response*

#### 7.28 Agreed.

- Exempt activities comprise only about 10% of country and regional program expenditure.
- Measures to improve the completion and collation of ratings are being implemented in the development of the new Aidworks project management system.
- This is an area that challenges all aid agencies. While AusAID has been recognised as being in the vanguard of donors in this area, AusAID also recognises that continuing improvement is needed to strengthen the validity and reliability of AMB assessments.
- AusAID agrees with the need to set out the limitations of data derived from rating systems. Those limitations need to be taken into account in considering the appropriate analysis and disaggregation of the data. AusAID is committed to continuing improvement in its performance information systems, illustrated by a new AMB system introduced in 2001. Broader reporting of performance information will be determined in a review of the Performance Information Framework to be undertaken in 2002.

## Aid performance outcomes

### Aid activity ratings

7.29 Table 7.1 summarises the quality ratings for the country and regional aid program in 1999–2000 and 2000–2001. The overall country and regional aid ratings for both years exceeded AusAID’s overall quality target of 75% of activities rated ‘satisfactory overall’ or higher (although the caveats above regarding data reliability are pertinent to this conclusion). As Table 7.1 shows, most of these activities were rated as ‘satisfactory overall’, rather than as ‘fully satisfactory’ or ‘best practice’.

**Table 7.1****Quality ratings for the country and regional program<sup>84</sup>**

<i>Overall country and regional program</i>	<i>1999–2000</i>	<i>2000–2001</i>
<b>Aid activities rated ‘satisfactory overall’ or higher #</b>	<b>84%</b>	<b>77%</b>
Comprising:		
• Best Practice	0%	0.3%
• Fully Satisfactory	23.2%	12.4%
• Satisfactory Overall	61.0%	63.9%
• Marginally Satisfactory	13.9%	20.0%
• Weak	1.9%	3.3%

Source: AusAID data

# These ratings are for all aid activities. The ratings for contracted aid delivery were very similar at 82% and 76% for 1999–2000 and 2000–2001, respectively.

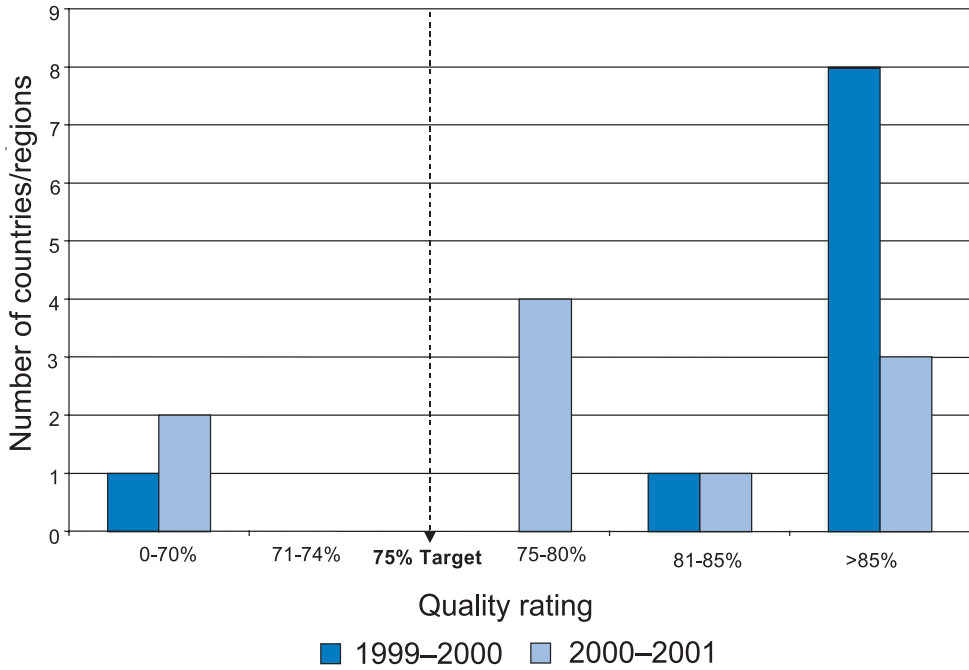
**7.30** AusAID advises that the decline in the overall quality rating reflected an ‘unduly positive’ rating of aid activities by desk and post officers in the first year rather than a decline in aid quality, although it did not marshal hard evidence to support this view. According to this view, the 2000–2001 ratings are likely to be more reliable as an indicator of aid quality.

**7.31** As previously discussed, AusAID has an overall quality target of 75%. AusAID has advised that as this is an overall target it expects that some countries and sectors will be above and below the target from year to year. This variation in quality reflects, for example, the different development challenges and risks associated with aid delivery to a diverse range of countries.

**7.32** In this context, Figures 7.3 and 7.4 indicate, from the range of results, that the quality ratings recorded for aid activities in some countries and key result areas were well below the overall quality target, particularly in the latest year for which data is available 2000–2001. The key result areas of environment, governance and health were all below the 75% overall quality target.

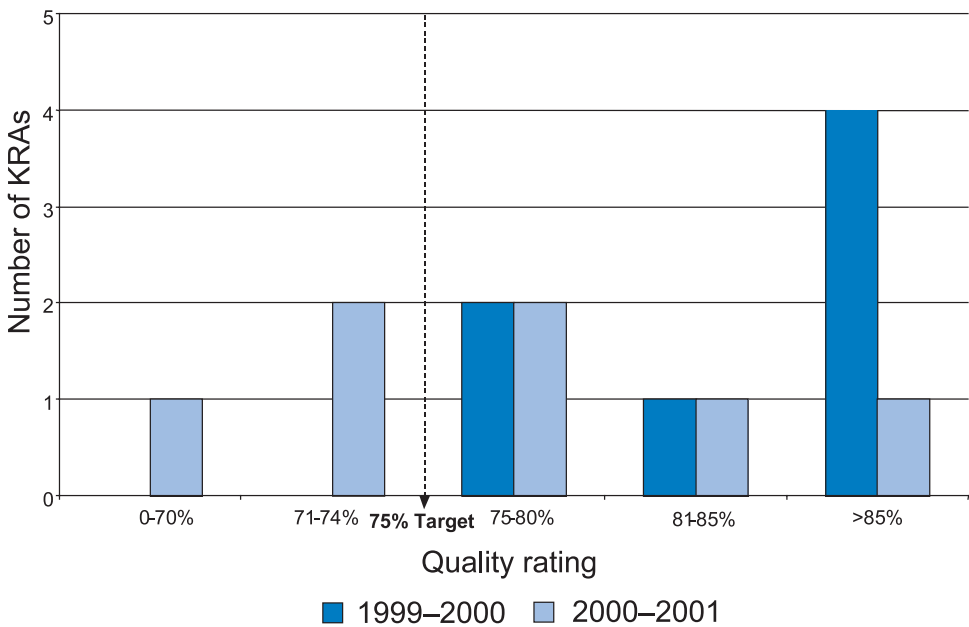
<sup>84</sup> These results should be interpreted with some caution, since they are subject to the data limitations discussed at 7.17–21. Specifically, there is evidence that the ratings are overly optimistic.

**Figure 7.3**  
Quality ratings for the countries/regions



Source: AusAID data

**Figure 7.4**  
Quality ratings for key result areas



Source: AusAID data

7.33 AusAID does not have data readily available, which provides further dimensions to the quality assessment. The ANAO considers that there would be merit in widening the analyses prepared from the system. For example, the measurement of aid quality in terms of the percentage of *expenditure* (in addition to *activities*) rated 'satisfactory overall' or higher would be very worthwhile information. Given the wide variation in size of activities it may actually give a clearer indication of quality of *outcomes*.

## Quality assurance reviews

7.34 An AusAID quality assurance unit undertakes quality assurance reviews aimed at improving the quality of activity design and implementation. Two of the reviews have addressed the quality of activities of the country and regional aid program: one focussed on the preparation stage; the other on the implementation stage.

7.35 Both reviews reported that the overall quality of the sampled activities was 'good'. Some 85% of activities at the preparation stage were rated 'satisfactory overall'. However the review at the implementation stage rated 74% of activities as 'satisfactory overall'. The implementation review also noted that extrapolation of its results would represent annual country aid program expenditure of \$80 million having serious weaknesses requiring attention.<sup>85</sup>

7.36 This latter review also identified contractor performance, partner government support and the strategic use of TAGs as activity strengths. It reported that the weakest area was the sustainability of aid outcomes; activity monitoring and reporting by post and desk officers were also weak areas.

## Project completion reports and other evaluations

7.37 Contractors are required to assess the quality and effectiveness of aid activities at the end of each major project by preparing *project completion reports*. The ANAO examined a sample of recent reports and found that contractors generally reported that activities achieved planned outputs and intended outcomes.

7.38 AusAID recently reviewed 57 aid activities totalling \$299 million and concluded that the majority of the aid activities were 'satisfactory overall' or higher in terms of AusAID quality ratings. The report identified the quality of projects as high in some sectors; viz, health, education, agriculture and rural

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<sup>85</sup> The implementation review was based on a sample of 20 projects of a total population of 146 eligible bilateral projects in implementation. 26% of the sampled projects were rated 'marginally satisfactory'. Extrapolated to the population, 38 projects (\$80 million of aid expenditure) then being implemented had serious weaknesses.

development; with humanitarian and emergency assistance the most difficult area in which to achieve quality. The report also indicated that results were difficult to attain in some countries/regions.

## Contractor performance and its contribution to aid outcomes

**7.39** Effective contractor performance is a key determinant of successful aid outcomes, with the quality of in-country team leadership and strength of team motivation being major contributors to success.<sup>86</sup> Accordingly, the ANAO assessed the available sources of information on the performance of contractors, specifically AusAID activity quality rating data; quality assurance results; and ANAO audit examination, including sampled contracts and field observation.

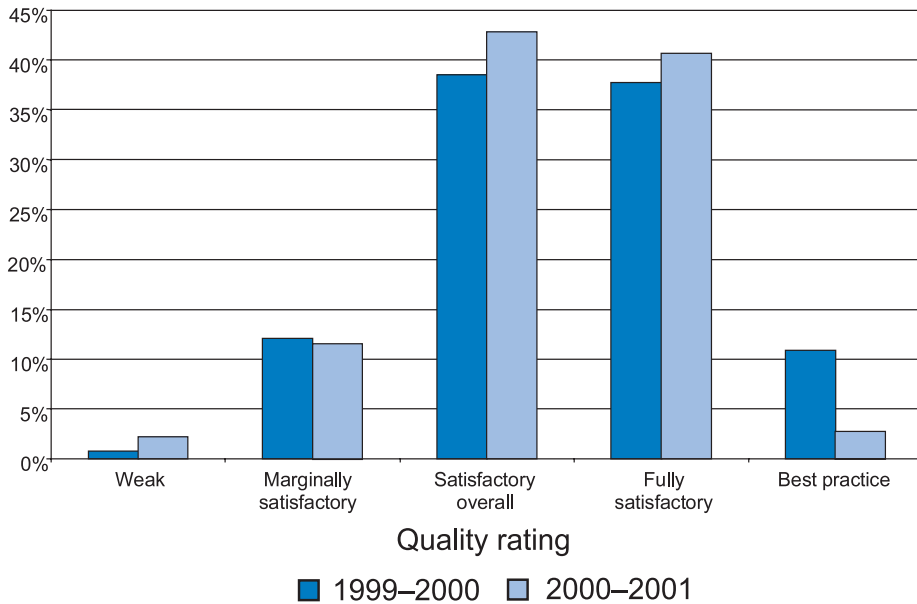
**7.40** As noted in 7.5, in arriving at an overall quality rating for an activity, desk and post officers address four key quality attributes, one of which is 'be professionally managed'. This component includes an overall assessment of the performance of all contractors involved in delivering the activity. (The contractor performance assessment scheme discussed in Chapter 5 focuses on an assessment of the strengths and weaknesses of seven major contractors with multiple AusAID contracts.)

**7.41** The ANAO extracted this data on contractor performance from AusAID's database. The data on contractor performance is summarised in Figure 7.5. Contractor performance was rated 'satisfactory overall' or higher for about 87% of contracted activities for both 1999–2000 and 2000–2001. This included 38% and 41% respectively rated as 'fully satisfactory'.

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<sup>86</sup> A 1999 AusAID quality assurance review of activities at implementation stage found that contractor performance and partner government support were strongly linked to likely project success, particularly sustainability. High quality in-country team leadership and strong team motivation were identified as major contributors to success.

**Figure 7.5**  
**Quality ratings of contractor performance**



Source: AusAID data

**7.42** AusAID advised that the value of this information in assessing contractor performance is limited due to a lack of reliability.<sup>87</sup> However, the ANAO considers that the information is useful in giving an indicative overall assessment of contractor performance in the absence of other sources of quantitative information, particularly as it is a by-product of the overall quality rating system.<sup>88</sup>

**7.43** The AusAID quality assurance review that looked at implementation (see 7.34 above) found that contractor performance was one of the main strengths of the aid activities examined. In this regard, project team motivation; commitment to project implementation; working relationships with the counterpart agency; and communication with the post were all highly rated. Lower rated areas tended to be outside of the control of contractors—such as partner government maintenance of inputs. The review did not address key areas of contractor performance such as project management (especially in Australia), quality assurance, and performance reporting.

<sup>87</sup> AusAID believes that the ‘simple rating scale’ used for contractor performance in the quality rating system has limitations, as it does not assist in identifying means of improving the aid activity. AusAID has recently replaced the rating scale for contractors with an assessment of strengths and weaknesses.

<sup>88</sup> The ANAO found that AusAID contractor performance ratings of about 87% for each year were broadly comparable with performance results reported by AusAID for all aid activities (see Table 7.1). The 87% rating relates to contractor performance, whereas the figures in Table 7.1 relate to the whole aid activity, which would involve other factors such as design and partner government involvement. The note to Table 7.1 identifies the ratings for contracted aid delivery as being 82% and 76% for 1999–2000 and 2000–2001, respectively.



**7.44** The ANAO in-country fieldwork and site visits indicated that contractor team leadership and staff was generally of a good quality. Project teams demonstrated a strong commitment to achieving project objectives and a clear appreciation of the substantial challenges in delivering aid in sometimes difficult development situations. Teams generally had a pro-active, practical approach to problem solving and awareness of the importance of good working relations with other stakeholders. As noted at 2.55 and 5.3, the ANAO found that relationships between contractors, partner governments and AusAID to be generally positive and satisfactory.

**7.45** The ANAO concluded, on the basis of the above evidence, that the performance of contractors in managing and delivering aid activities is generally good.

**7.46** As mentioned at 5.52, AusAID's new contractor performance assessment scheme has only recently been introduced and has initially focussed on seven major contractors. As discussed in Chapter 5, the ANAO considers that greater emphasis on quantitative measures of performance would assist AusAID in assessing the performance of contractors.

## Identification and use of lessons learned from aid delivery

**7.47** International aid organisations operate in a high-risk and complex environment, where mistakes and failure to learn lessons can be costly and lead to sub-optimal development outcomes. It is therefore recognised better practice to seek to harness, and use, key lessons from aid delivery as a valuable means of expanding collective knowledge of how to increase the likelihood of success of development assistance and of cost-effective aid management.

**7.48** AusAID has an extensive range of information holdings which contain lessons learned relevant to contracted aid activities. These include: project completion reports prepared by contractors; quality assurance studies; evaluations and reviews of aid activities; and technical advisory reports (some of which is available on the AusAID intranet).

**7.49** AusAID recognises the value of capturing and using this information. It established a lessons learned database in 1997 to be the main repository of lessons learned from aid activities. However, the database is currently of very limited value. It is out of date and staff make very little use of the system. The database has not been updated since 1998. Further, the database has been mainly sourced from evaluation and review studies, rather than from direct project experience (e.g. project completion reports). It has poor coverage of lessons for some key

result areas, including the governance and health sectors, and was not designed to cover contract management and contractor performance issues.<sup>89</sup>

**7.50** One particularly valuable source of information, which is not well harnessed by current arrangements, are project completion reports prepared by contractors (see 7.37). Contractors are required to identify and report on lessons learned in these reports. The ANAO found that contractors meet this requirement and have reported some useful lessons from their experience in delivering contracts.

**7.51** However, this information is poorly managed. AusAID does not have a consolidated listing of the large number of project completion reports it receives; the relevant information is not entered on the lessons learned database or any other knowledge sharing system; and there is a high rate of misplacement of these reports (as well as the independent technical advisory reports on aid projects). There is equally poor management of lessons from the routine reporting by, and management of, contractors during the course of a contract.

**7.52** At the time of the audit, efforts to manage lessons learned were still somewhat fragmented. For example, the establishment of two additional lessons learned databases on contract management and on activity management was proceeding in an ad hoc manner. Some summary references of general lessons on the intranet also have not been refreshed for more than a year.

**7.53** The ANAO concluded that AusAID does not have an adequate corporate framework for the management of lessons learned information. Strengthened arrangements are likely to require a more systematic approach to the identification and capture of relevant information, effective management of information holdings, and clear and structured presentation of lessons learned in a user-friendly format. Given the important role that contractors play in designing and delivering projects, it is desirable that contractors have appropriate access to lessons learned.

**7.54** The ANAO notes in this context that AusAID's Strategic Plan includes a commitment to strengthen corporate systems for storing and accessing key business information.

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<sup>89</sup> Some preparatory work was undertaken to upgrade the database, but a consultancy study advised against further development of the system as a separate database.

## Recommendation No. 10

7.55 The ANAO recommends that AusAID develop an information management strategy that captures key lessons learned from the management and delivery of aid activities and enables AusAID staff and, where appropriate, contractors to readily access and use the information to improve the quality of aid activities.

### *AusAID response*

7.56 Agreed.

This area is an ongoing challenge for all aid donors. And AusAID has recognised the importance of this issue, especially in the context of the Strategic Plan. A new approach to the capture and sharing of lessons has been developed within AusAID and is currently being trialed. The system incorporates more diverse and comprehensive information, with an improved search engine, and links to other components of AusAID's knowledge resources, such as a portfolio of good practice examples.

AusAID will also ensure that such information is more effectively utilized. A major change in AusAID practice is a strong emphasis on the peer review process. This will institutionalise the need for activity managers to analyse and report on lessons learned when proposing and assessing new activities. As well as the electronic information system for sharing lessons, the strengthened peer review process means that relevant expertise and knowledge is brought to bear through the involvement of relevant individuals in the assessment process.

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Canberra ACT  
20 June 2002



P. J. Barrett  
Auditor-General



# Appendices



## Appendix 1

## Number and value of commercial contracts in 2000–2001

Value		Contracts		Total value	
\$		Number	%	\$m	%
2 000 ->	74 999	943	58.4	24.9	1.1
75 000 ->	149 999	179	11.1	18.8	0.8
150 000 ->	499 999	171	10.6	47.5	2.1
500 000 ->	999 999	57	3.5	39.7	1.7
1 000 000 ->	1 999 999	55	3.4	76.9	3.3
2 000 000 ->	2 999 999	33	2.0	86.3	3.7
3 000 000 ->	4 999 999	50	3.1	195.7	8.5
5 000 000 ->	9 999 999	66	4.1	466.8	20.2
10 000 000 ->	19 999 999	38	2.3	539.5	23.3
20 000 000 ->	29 999 999	11	0.7	271.4	11.7
30 000 000 ->	39 999 999	4	0.3	152.3	6.6
40 000 000 ->	49 999 999	3	0.2	130.2	5.6
50 000 000 ->		4	0.3	264.6	11.4
<b>Totals</b>		<b>1614</b>	<b>100.0</b>	<b>2314.6</b>	<b>100.0</b>

Source: AusAID data

## Appendix 2

### Audit criteria

1. Are contract management roles and responsibilities within AusAID clearly defined and well understood?
2. Do AusAID contract management staff have appropriate skills and training?
3. Do AusAID information systems support contract management by providing accurate and up-to-date data, e.g. relating to contractor progress, contract amendments, financial details?
4. Are contract managers appointed for each contract?
5. Does AusAID systematically identify, assess, treat, monitor and review for action as necessary risks?
6. Is the good or service to be delivered clearly specified in the contract?
7. Do contracts specify assessable milestones?
8. Are services delivered in accordance with the contract?
9. Are payments made in accordance with the contract?
10. Are variations documented and ongoing communications maintained with the contractor?
11. Does AusAID have appropriate arrangements in place to manage contractor performance?
12. Does AusAID evaluate the risk and service complexity involved in each contract in determining the most appropriate contracting strategy?
13. Does AusAID evaluate contract outcomes and do those outcomes support program objectives? Does AusAID capture lessons learned?



## Appendix 3

### AusGUIDE

1. AusGUIDE is AusAID's key reference for contract managers. It provides basic guidelines and analytical tools for staff involved in the preparation and implementation of projects. It also provides information for other stakeholders such as contractors and counterpart agency staff.
2. AusGUIDE is updated regularly and is available on AusAID's intranet and website and in CD-ROM format.
3. AusGUIDE consists of two parts:
  - the main documentation on key issues, procedures and processes involved in project management; and
  - guidelines that provide more detailed information on the procedures involved in the management of projects.
4. The main document is divided into six sections:
  - Activity Cycle Overview
  - Stage 1: Identification and initial assessment
  - Stage 2: Project preparation
  - Stage 3: Appraisal
  - Stage 4: Mobilisation, Implementation and Monitoring
  - Stage 5: Completion and Evaluation
5. The Activity Cycle Overview provides an overview of the Activity Cycle and summaries of the key decision points, alternative pathways for moving through the cycle, documentation requirements, contracting principles and core analytical tools. The remainder of the document covers each of the main stages of the Activity Cycle in more detail.
6. Referenced within each section are a number of additional documents, which provide source materials and more detailed guidance on undertaking specific tasks. These subsidiary documents are grouped into three main categories:
  - attachments to each section which provide further guidance on how to complete a task (e.g. checklists, suggested report formats and proformas for approvals);

- detailed guidelines on how to prepare specific documents (e.g. project design documents or project completion reports) and how to use specific analytical tools (e.g. logical framework approach and risk analysis); and
- policy documents and operational guidelines (e.g. quality assurance).

Source: AusAID

## Appendix 4

### The development of hybrid contracts in AusAID

1. Prior to July 1994, AusAID's major contracts were generally awarded following a tender process that relied exclusively on a technical assessment of proposals. Contracts were largely *inputs* based; that is, contractors were largely reimbursed for expenditure incurred.
2. In 1994, following a major review of its purchasing, significant changes to contractor selection procedures were made, including the introduction of price into the selection process. Associated with the introduction of price was a move towards *output* based contracts. The move from inputs to outputs did not involve a review of contract conditions but rather a change to the basis of payment; contractors were paid for the outputs produced.
3. In 1999 AusAID made a number of changes to its contractor selection procedures. A major change involved a reduced emphasis on price. At the same time AusAID commenced a review of contract documentation. The aim of the review was to clarify the documentation and consolidate changes that had occurred by accretion over a period of years. The review was overtaken to some degree by AusAID and contractor concerns about the excessive focus on milestones.
4. In particular, major outputs based contracts, which relied solely on milestones as the payment mechanism, were considered onerous for both AusAID and the contractor; they required substantial resources that could be better directed towards the actual achievement of project outcomes rather than the production, verification and acceptance of numerous, and sometimes mechanical, milestone reports.
5. In early 2001<sup>90</sup> these concerns led to the expanded use by AusAID of *hybrid* contracts as the preferred model for major services contracts. (Output contracts remain AusAID's preferred approach for small value activities and for major construction activities where the outputs and outcomes can be clearly defined.)
6. Essentially, hybrid contracts enable about 60–70% of contractual payments to be made (in arrears on a monthly or quarterly basis) for essential project inputs (e.g. contractor personnel and housing costs) provided by the contractor. The remaining 30–40% of payments (i.e. largely representing the contractor's profit and overhead costs), is linked to the achievement of fewer, but more significant and strategic, activity milestones. AusAID and contractors expect

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<sup>90</sup> Hybrid contracts for major services were formally introduced in May 2001.

that this will provide a more predictable and assured cash flow and encourage new contractors to tender for projects.

7. AusAID advised that of the 31 contracts valued at \$3 million or more that were signed between April and December 2001, half were hybrid contracts.

Source: AusAID

## Appendix 5

### Relationship types—key features, benefits and risks

<p><b>Traditional</b>—Historically, relationships between purchasers and providers have been described as traditional and have been shaped by legal and contractual obligations. The relationships tend to be centered around the contract, ad hoc and at arm’s length with each party pursuing its own objectives and, in some cases, with contractors seeking to maximise costs. This traditional approach creates a strong compliance/control relationship that relies on extensive checking and verification of the service delivered against the contract. It can also create a tendency toward an ‘adversarial culture’. However, there are many circumstances where a traditional type of relationship is appropriate. A traditional relationship is most beneficial where the scope of services can be accurately defined; the potential for changes in scope during the contract period is low; and the risk of failure of the service is also low.</p>
<p><b>Non-traditional</b>—The three non-traditional approaches involve varying degrees of cooperation and trust and are set out below.</p> <p><i>Cooperative:</i></p> <p>A cooperative arrangement is often the first step for some organisations and incorporates some of the key elements of partnering such as improving communication and obtaining commitment at a senior level but does not extend to some of the higher ideals within partnering such as the sharing of risks.</p>
<p><i>Partnering:</i></p> <p>Partnering is more of a formalised process that establishes a moral agreement, which binds key stakeholders to act in the best interest of each other. Key elements of partnering include some sharing of risks, aligning objectives and a structured approach to communication, issue resolution and evaluation of project performance rather than the performance of individuals but does not include the alliance concept of linking remuneration to performance. Partnering therefore for the majority of organisations is just a better way of doing business.</p>

*continued on next page*

*Alliancing:*

A 'true' alliance arrangement takes the partnering concept a step further and involves a shared risk/reward regime that links remuneration to achieving exceptional performance in the delivery of services. An alliance incorporates the elements of partnering but generally has an 'open-book' approach to all financial matters and a combined client and contractor team. In general, the higher the risk of failure, the greater the complexity of the task involved and the more the project outcomes are going to improve from the input of the contractor the more likely it is that the organisation will benefit from developing an alliance relationship with the contractor.

**Potential benefits from non-traditional relationships**

A number of potential benefits are associated with non-traditional relationships, including:

- significant performance improvements and savings in baseline costs. Examples include:
  - 20% productivity increase and 9% cost decrease (1997 figures) (Institute of Outsourcing (USA)); and
  - 2–10% saving when using a partnering type arrangement on an individual project—(*Trusting the Team—The Best Practice Guide to Partnering in Construction*—Centre for Strategic Studies in Construction—The University of Reading, UK).
- encouraging innovation in a positive way;
- achieving breakthrough performance in areas such as timeframe, safety and the environment; and
- providing flexibility to change the scope of work or services, re-allocate resources if required and develop alternative solutions to problems.

### Potential risks of non-traditional relationships

Non-traditional relationships can fail due to a number of factors, including:

- a poorly structured process;
- a poor attitude of client personnel;
- a lack of understanding of the relationship by client personnel, resulting in the traditional approach continuing to be employed;
- a lack of involvement by all key stakeholders;
- a reluctance by the contractor to disclose actual costs where an 'open book' approach is adopted in an alliance relationship;
- a lack of clear understanding of the client business, project objectives, and possibly other stakeholder objectives;
- the non-availability of quality personnel; and
- a lack of commitment by either party, either at a senior level or throughout the organisation.

Other risks include:

- the level of achievement may be less than anticipated resulting in a perception of failure;
- a dilution of contractual obligations. A party may, under the 'spirit of the relationship', try to dilute its contractual obligations. A party may also seek to take advantage of the relationship;
- a change of senior personnel, affecting commitment;
- sabotage by personnel who are not committed to the process;
- possible probity issues;
- a relationship that becomes too comfortable and non competitive; and
- a lack of maintenance of confidentiality and the security of data.

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