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Balancing Accountability and Efficiency in a More Competitive Public Sector Environment

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Pat Barrett
Auditor-General for Australia
I. INTRODUCTION

I am pleased to be invited to present at this conference which has the theme of "Achieving Excellence and Managing for Results". This forum provides an opportunity to explore and discuss some important issues associated with the management and operation of government agencies and businesses at a time of significant transformation of the public sector and the delivery of public services.

As with many other democracies, Australian governments have been focussing increasingly on achieving a better performing public sector and less costly, more tailored or better focussed and higher quality services to citizens. This has not only involved adapting, or adopting, private sector methods and techniques but also direct participation by the private sector in providing public services, even so-called and traditionally regarded core services such as policy advice and determination of entitlements. Such changes are often described as the privatisation or commercialisation of the public sector.

Privatisation and/or commercialisation of public services is occurring in Australia on a significant scale. Privatisation in Australia involves three principal contexts:

- the opening up to competition of areas previously reserved to government, such as telecommunications;
- contracting out by public sector entities to private sector suppliers of goods and services in areas such as employment services and information technology; and
- the transfer of some $A50 billion in Commonwealth assets or business to private sector owners.

While the increasingly business-like approach of the public sector is welcome, it is important to recognise that the provision of public services involves rather more than simply achieving the lowest price or concepts of profit or shareholder value. Public service agencies must strive to maximise overall ‘value for money’ for citizens which requires consideration of issues other than production costs, such as client satisfaction, the public interest, fair play, honesty, justice and equity. It also requires proper accountability for the stewardship of public resources, including asset management and use of techniques such as activity-based and life-cycle costing, as in the private sector.

I contend that public sector managers, at all levels, have to deal with a different nature and level of risks in the more contestable environment confronting most of us than they have had to do in the past. The new challenges include market-testing, competitive tendering and contracting out, all of which may be considered to present opportunities for, as well as risks to, a public service that has traditionally been said to be risk averse. These new elements are central to improved business performance and accountability in the current program of reforms to the public sector. While I will be largely canvassing issues bearing on this changing risk profile, I will also draw on some of the initiatives my Office is taking to enhance risk management practices and improve accountability within the context of this rapidly changing environment.
The concept of accountability is not exclusive to the public sector. No one doubts, for example, that the boards of private sector corporations are accountable to their shareholders who want a return on their investment. It is the nature and extent of that accountability which public sector commentators would contend distinguishes the two sectors. Of note is that the adoption or adaptation of private sector approaches, methods and techniques in public service delivery, has highlighted trade-offs between the nature and level of accountability and private sector cost efficiency. On this issue, it has been noted in Australia that:

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

Accordingly, the essential issue, as it often is in public administration, is to achieve an appropriate balance which can vary in differing circumstances. Achieving such a balance becomes even more of an imperative when the converging private and public sectors not only focus on the similarities of issues and even responses that confront managers, but more sharply contrasts differences between the two sectors.

Public sector commentators would contend that it is the nature and extent of accountability which distinguishes the two sectors. This is reflected in the following observation:

Ethical behaviour is one of the principal means by which accountability is maintained in the public sector. Indeed, political and administrative accountability depend on the observance of ethical standards and ethical relations between individuals or between institutions.'

At the risk of stating the obvious, the public sector operates, first and foremost, in a political climate which is values-oriented as witnessed by constant references to the ‘public interest’, which has always been difficult to define or measure in any generally agreed fashion, except that it is very real to the Parliament and public servants as well as to the ordinary citizen. In short, everyone seems to know when they do not have it. Our public service values are contained in the Public Service Act 1999 (Section 10). As well, a code of conduct, based on these values, is contained in Section 13, with provisions to deal with breaches in Section 15.

Public servants, at least, must understand the pervasive and often decisive influence of ‘politics’, as opposed to ‘markets’, both on public policy and administration. This means that public sector agencies must balance complex political, social and
economic objectives, which subject them to a different set of external constraints and influences than those experienced in the private sector. Consequently, there is an issue of trade-offs between the nature and level of accountability and private sector cost efficiency, particularly in the delivery of public services and in the accountability regime itself. This is a reality we as public servants, meaning all who are employed in the public sector, should never ignore. However, decisions about such trade-offs are basically ones for the Parliament and/or Government to make thus providing guidance to decision-makers, whether in the public or private sector, and not leaving it to the latter by default.

Audit mandate

Australia has a federal system of government with parliamentary institutions based, in part, on the Westminster model. The relationships between the Commonwealth (or Federal) level of Government and the eight State and Territory governments are established by the Australian Constitution and have been shaped over the years by a combination of constitutional amendment, judicial interpretation and political accommodation. Each level of government has its own accountability regime that operates independently of the others and includes an Auditor-General. Thus, as the Auditor-General for the Federal Government, I have no mandate to examine the activities of State or Territory entities. To date, I have only undertaken contemporaneous audits with some State Auditors-General.

My responsibilities as Auditor-General are outlined in the *Auditor-General Act 1997* and in a range of entity-specific legislation. The legislative arrangements for the appointment of the Auditor-General and the establishment of the Australian National Audit Office (ANAO) mean that I am, by statute, independent of the political environment. The results of audits are reported to the Parliament, thus providing the Parliament and the community with an important source of information about the way public resources are being administered. The mandate of my Office is to undertake audits of:

- financial statements, which provide an essential independent attestation of the financial statements of public sector entities and, in so doing, provide an independent and objective assurance to all parties on the financial stewardship of the public sector and on the financial systems which support it; and

- performance audits, which evaluate the economy, efficiency and effectiveness of the management of public sector entities by, for example, examining and assessing the use of resources, information systems, performance measures, monitoring systems and legal compliance.

Performance audits often extend to the identification of better practice models which may be included as a part of the performance audit report or may be produced separately as a best practice guide. They also include financial control and administration audits of public sector agencies and programs which are designed to address the gap between financial statement audits and performance audits by identifying best practice in areas such as procurement, accounts processing, performance measures and indicators, travel and related expenses. Essentially such audits focus on those core activities that are vital for good management, including the
provision of guidelines, instructions, monitoring practices, systems development, values and ethical checklists and complementary audit trails.

Within the audit mandate, I have complete discretion in the selection of areas subject to performance audit and in the timing of audits. I take account of the audit priorities of the Parliament through advice from the Parliamentary Committee of Public Accounts and Audit (JCPAA). Given the size and complexity of agencies, it is normally impracticable to attempt to assess overall performance of agencies. Performance audits are normally directed towards specific functions and operations of an agency. The ANAO’s mandate does not extend to examining matters of Government policy per se: the setting of policy objectives is the prerogative of Government. I am empowered to examine how well government programs and policies are administered and whether they are meeting stated policy objectives.

I have taken the view that my Office’s core business is as the public audit practice for all agencies that are budget dependent. Our non-core business therefore broadly covers entities that are not in the budget sector. This distinction is based on the fact that my Office derives its public sector expertise and comparative advantage from its virtual day-to-day involvement in nearly all Commonwealth entities. It also reflects the principle that the Auditor-General does not deliver just one audit but a total audit service both at whole-of-government and individual agency levels.

The role of Auditors-General

While there are variations in the mandate, focus and operating arrangements across countries, the fundamental role of Auditors-General or their equivalents in democratic systems of government is substantially the same. That role is to provide the elected representatives of the community (the Parliament) with an independent, apolitical and objective assessment of the way the government of the day is administering their electoral mandate and using resources approved by democratic processes, albeit in differing governance frameworks.

In most, if not all, systems of government, the concept of accountability is of fundamental importance to governance. By accountability I mean a direct authority relationship within which one party accounts to a person or body for the performance of tasks or functions conferred, or able to be conferred, by that person or body.

In my view, Auditors-General are an essential element in the accountability process by providing that unique blend of independence, objectivity and professionalism to the work they do. Indeed, the four national audit agencies making up the Public Audit Forum in the United Kingdom consider that:

‘... there are three fundamental principles which underpin public audit:

- the independence of public sector auditors from the organisations being audited;
- the wide scope of public audit that is covering the audit of financial statements, legislatively (or legality), propriety (or probity) and value for money; and
• the ability of public auditors to make the results of these audits available to the public, and to democratically elected representatives."

Corresponding with the public sector changes over time, the role of the Auditor-General and the place of auditing in democratic government has also changed. In today’s environment, our role includes providing independent assurance on the overall performance and accountability of the public sector in delivering the government’s programs and services and implementing effectively a wide range of public sector reforms. And I cannot overstate the importance of the independence of the Auditor-General in those respects. As the public and private sectors converge; as the management environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have all the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them.

I would argue that the role of Auditors-General is more important to effective, accountable and democratic governance today than at any time in the past. I would also suggest that, as we move into the future, and as the pace of change remains unabated, this trend will not decline, rather it is likely to increase as the roles and responsibilities of the public and private sectors converge and, perhaps, the differences between the two become more apparent than real. As the British Prime Minister, Tony Blair, has observed in relation to the current environment:

‘Distinctions between services delivered by the public and private sectors are breaking down in many areas, opening the way to new ideas, partnerships and opportunities for devising and delivering what the public wants’.5

and

‘People want effective government.’6

These developments have given rise to a focus on what constitutes ‘core’ public sector activities as opposed to ‘non-core’ ones. That is, what are those functions which can, and should, only be performed and delivered by government. Clearly, the size of the core is shrinking as evidenced by outsourcing and privatising in areas which, hitherto, were considered traditional public sector activities. Just how small the core can become is open to debate. But even areas where the public sector has traditionally held a monopoly, such as the provision of policy advice, are becoming increasingly open to competition. For some years now, considerations of public versus private provision of services have been largely at the margin, virtually on a case-by-case basis. A broader issue is what is the sustainable critical mass necessary to retain a credible and effective public sector as part of sound democratic governance in the longer term.

Having made the decision to privatise (by whatever means) activities previously undertaken by the public sector, important issues need to be addressed concerning the ongoing administration of the public interest, including proper accountability for public resources. This is the primary focus of my paper, examining some of the more
significant accountability and audit issues in circumstances of sale of the public’s ownership interest as well as the greater involvement of the private sector in the delivery of public services and the commensurate interest in contract management. These issues need to be seen in the context of the changing governance environment and the increasing attention required to our organisation’s corporate governance framework.

I will finish with a discussion about the changing public sector framework and a perceived need for improving networking within the public sector, as well as with the private sector, for greater responsiveness, competitiveness and overall performance in a more global environment rather than simply concentrating on greater private sector involvement with a more market oriented focus.

II. GOVERNANCE ENVIRONMENT

Public sector managers, at all levels, have to deal with a different nature and level of risks in the more contestable environment confronting most of us than they have had to do in the past. Managing the risks associated with the increased involvement of the private sector in the delivery of government services, in particular the delivery of services through contract arrangements, will require the development and/or enhancement of a range of skills across the public sector and will be a key accountability requirement of public sector managers. The identification, assessment, prioritisation, monitoring/review and treatment of risks have to be an integral part of an effective, operational and strategic management approach at all levels of an organisation.

In Australia, recent changes to financial and industrial legislation have seen a shift from central agency control to a framework of devolved authority with enhanced responsibility and accountability being demanded of public sector agencies and statutory bodies. These changes are intended to allow the Australian Public Service to better manage and respond to new challenges brought about by the changing environment. The legislation provides opportunities for enhanced performance and accountability in the Australian Public Service but can also involve greater management risks, particularly in an environment of devolved authority. It has also undoubtedly heightened the Australian Public Service’s awareness of good corporate governance, an issue I will address in detail later.

One important aspect of Australia’s new financial management legislation is that it broadly reflects a basic distinction between core agencies of Government and non-core bodies controlled by Government. The split reflects, inter alia, a general acceptance that some activities should only be performed under the close and direct control of the Executive, whereas others by their very nature require a degree of independence from the Executive.

The dichotomy between ‘core’ and ‘non-core’ Government activities is an issue that will continue to receive considerable attention as the Australian Public Service strives to maximise efficiency and effectiveness of service delivery. As a result, the size of the core public service is shrinking as even areas that were once considered traditional public sector activities, such as employment services and the provision of policy
advice, are increasingly being subject to privatisation, outsourcing and competition. Just how small the core can become without jeopardising the public interest is still open to debate. The Australian Prime Minister has observed that:

‘... no matter how radical anyone’s view is about the role of government in the twenty-first century, I believe there will always be an irreducible minimum of public service functions’.8

The new financial legislation illustrates how significantly the Australian Public Service management framework has changed in the last decade. Voluminous and detailed rules and prescriptions have been largely replaced by principles based legislation which clearly places the responsibility for the efficient, effective and ethical management of public sector organisations in the hands of Chief Executive Officers (CEOs) and directors of boards. Together with a new Public Service Act 1999 and the more principles-based legislation relating to workplace arrangements (which has deregulated and decentralised the Australian Public Service people management framework), this overall package of legislation is intended to provide managers with increased flexibility, including the elimination of unnecessary bureaucratic processes, to respond to the challenges of the evolving Australian Public Service operating environment and improve the performance of their organisations. The emphasis is now very much on personal responsibility starting at the level of the CEO.9 Greater management flexibility and commensurate increases in personal accountability are the hallmarks of the ongoing public sector reform movement.

From my perspective, greater responsibility and flexibility in decision-making needs to be matched by at least a commensurate focus on strengthening the associated accountability arrangements to ensure that decisions are appropriately made and that those people making decisions can be properly called to account should the question arise. To provide such assurance, public sector entities need to have robust corporate governance arrangements including sound financial management and other suitable control structures in place as well as providing meaningful performance information.

Not surprisingly, the increased emphasis on personal responsibilities and accountabilities has focussed attention on personal sign-offs to the CEO, and so on to other organisation levels often as part of the normal hierarchical delegations for particular areas of responsibility by particular individuals, including for financial performance. But, I would like to point out, it is not the action of personal sign-off that creates the assurance. It is what underlines (or what underpins) the sign-off that is important, including endorsement of that framework and its acceptance by those who rely on it. Instructions (such as Chief Executive Instructions), operational guidance and user-friendly information systems are essential in this respect and part of what makes corporate governance work. Therefore, the exercise of responsibility and associated sign-offs, in relation to an organisation’s stakeholders, are seen as central to good corporate governance with its agreed objectives, strategies and performance measures.

Devolution of authority has also increased the emphasis on the individual organisation (whether this is a government agency, an authority or a corporation) with less central control being provided by central agencies such as Treasury and/or Finance. This means that a variety of tasks with traditional corporate governance attributes which
were previously undertaken by central agencies and particular specialist groups, are now the responsibility of individual entities.

I would suggest that devolution of authority and accountability to agency heads, together with contracting out and contestability, has significantly increased the risk profile of agencies. As agencies increasingly have recourse to private sector contractors, some of whom in turn employ sub-contractors, to perform what were once considered core public sector activities, the ‘golden thread’ of accountability that binds the Australian Public Service does become strained. At the very least, it engenders a higher level of uncertainty as the line of responsibility is extended. The public sector must manage the risks inherent in this new environment if it is to achieve the levels of performance required and satisfy whatever accountability requirements have been determined.

The considerable diminution of central controls and direction has also undoubtedly reinforced the need for good corporate governance in individual agencies and entities. Corporate governance provides the vehicle to integrate conformance and performance imperatives. Organisations are now responsible for their own oversight and need to develop and implement appropriate accountability and performance structures to assist them measure their achievement against strategic objectives. Any coordination of activities or sharing of experiences are matters for individual agencies to arrange between themselves. Further reduced central oversight and coordination is problematical as agencies recognise that some interrelationships, such as ‘shared outcomes’, are indicative of the need for broader corporate governance arrangements across agencies. Realistically, the latter will obviously take some time to accomplish. This is something I address later in relation to the suggestion that we may be moving, to some extent at least, from market-based bureaucracies to more networked bureaucracies which includes private sector providers of public services.

From my Office’s perspective, reduced central oversight has meant a broadening of our approach to auditing which once focussed largely on compliance and conformance, to a more pro-active involvement with agencies and entities with the goal of adding real value to public administration. In this regard we have moved from a traditional ‘gotcha’ mentality, usually associated with auditors, to one where we seek to assist organisations to better manage their functions (business), thereby improving their performance as well as providing the necessary assurance to stakeholders. That is, we seek WIN-WIN outcomes or results. For example, our better practice guides are designed to assist organisations test their own systems and where applicable, improve their practice and performance in line with recognised principles of better practice. Any more substantial move to continuous auditing would also enhance both internal and external management performance.

I would like to stress that we are not trying to supplant the role of central agencies or fill a perceived gap as a business strategy. Indeed, on a number of our better practice guides, we have worked positively with other interested central and line agencies. Nevertheless, it needs to be recognised that, in a devolved authority environment and with the vacation of the traditional monitoring review and overseeing roles by central agencies, gaps have emerged in the information available to managers to help them to make sound and informed decisions. Given
our across-the-service perspective, we are well placed to fill at least some of those gaps as part of our contribution to improving public administration.

It is important to understand that the introduction of new ways of delivering public services does not obviate or limit the need for accountability simply because of the market discipline induced by competition. To the contrary, in a more contestable environment which is highlighted by less direct relationships and greater decision-making flexibility, it is essential that we maintain and enhance our accountability, improve our performance, and find new and better ways of delivering public services while meeting ethical and professional standards. Increasingly, those ways are dependent on information technology and communication systems which bring their own control problems as well as significant opportunities for a more responsive and efficient public service.

Globalisation and the governance environment

Over the past three decades, globalisation, which can be defined as the rapid progress towards creating a single world market, has changed the economic landscape of the world. The movement towards a single market has been accompanied by dramatic government reforms, with the view to improving international competitiveness of the private sector. Examples of the type of reforms are the deregulation of financial sectors, floating of exchange rates, pursuit of free trade, and reform of tax systems. Australia has been one of the countries to embrace such changes. The public sector has also been subject to a range of reforms partly to reduce the costs to business.10

Throughout the move to globalisation, new technology has been revolutionising the telecommunications sector dramatically increasing the speed of communication. As well, new and innovative networks have been developed for the rapid transfer of all types of information. These changes have made distances between, for example, buyers and sellers virtually irrelevant.

In Australia, over the past 50 years, multinational companies have been an important part of the economy. They have invested heavily in capital and technology as well as providing valuable experience, as shown by the mining and automobile sectors.11 There is also the associated increase in employment and wages (though there are exceptions) that accompany these investments.12 However, in a recent edition of The Economist, the editorial pointed out that:

> ‘the ten biggest industrial multinationals each has annual sales larger than their [Australian] government’s tax revenue.’13

The movement towards a single market, dominated by large multinational companies, will pose significant regulatory issues for governments. On one hand, globalisation creates new opportunities, wider markets for trade, greater capital flows, and improved access to technology. However, it also has the potential to weaken the power of the state to manage its domestic affairs, as it is much harder to control the flow of information, money and goods. The increase in global commerce has the potential to greatly increase trade and commerce, particularly through the Internet. However, there is the possibility at least some proportion of this business will not be captured by tax authorities through, for example, a goods and services tax which will be implemented
in Australia from 1 July 2000. Any such loss of government revenue could be very significant for government’s ability to fund programs.

As multinational corporations’ primary motivation is profitability, and they are virtually only accountable to their shareholders, which are generally not from the country in question, governments may find the activities of those corporations somewhat threatening to their ability to govern. For example, the apparent ease with which multinational companies can shift profits between entities in different countries and structure their legal operations to take advantages of tax havens, generally causes the most concern. This alone could have a significant effect on government taxation revenue. There is also the possibility that governments may wish to attract these types of companies leading to “a ‘race to the bottom’ in which governments slash taxes and services to lure global business”.

The typical multinational corporation employs more than two-thirds of its workforce in its home country and is from a major OECD country (the likelihood estimated at 85 per cent). A number of governments may therefore have avenues to pursue many multinational corporations, that is, through the multinationals’ home government and legal system. One possible outcome is that a plethora of Governments could implement similar taxation laws, reducing the potential gains to multinational companies of investing in foreign jurisdictions. These companies may then shift their focus from international to domestic trade, to the detriment of many developing countries. The United States (US) Government has, in the last 6 years, amended its transfer pricing regulations twice to counter the concern that foreign multinationals are not contributing to domestic tax revenues. These changes give US tax authorities additional powers to change tax assessments.

In Australia, the Tax Commissioner has recognised that transfer pricing is a major issue because of increasing globalisation and the emerging impact of the Internet. The Commissioner has the power to adjust the taxable income of a taxpayer engaged in international dealings on the basis of the consideration that might reasonably be expected to have passed between independent parties dealing at arm’s length. A major program is being undertaken aimed at improving the level of taxpayer understanding and compliance in order to ensure Australia receives its fair share of tax.

Without even taking into account the trend towards greater globalisation, tax administrations face great difficulties in enforcing tax laws when dealing with international, compared to domestic, transactions. The myriad of different taxation laws can have a detrimental effect on tax assessments when attempting to obtain the necessary documentation or information. This is because taxation laws may provide different rights of access to necessary documentation. In tax havens, this potential problem can be particularly pronounced, as it can be almost impossible to determine the ownership of offshore entities or shareholders or beneficiaries where such exist. When this is coupled with a jurisdiction’s bank and any laws to protect commercial secrecy, many tax administrations can find it difficult to pursue satisfactory investigations.

The move towards greater utilisation of the Internet also has the potential to pose a real threat to government tax revenues. The reason why this could occur is that “the World Wide Web is an entirely new channel for moving goods and services from producers to
The nature of the Internet may make it hard to identify or locate the people who are carrying out potentially taxable transactions. The ability of governments to collect taxes is contingent upon knowing who is liable to pay the tax, or even being aware that a taxable transaction has occurred. Identifying taxpayers may become increasingly harder as the use of ‘anonymous’ electronic money and robust encryption technology are developed and utilised.

In 1996, the Australian Taxation Office (ATO) established a Task Force on Electronic Commerce. Their reports have demonstrated that the issues surrounding the growth and regulation of Internet commerce are significant. In its second report, the Task Force stated that:

‘While this report continues to show that current levels of Internet-based business activities have little immediate impact on tax revenues, it is important for the ATO to be positioned to take advantage of the opportunities offered by new technology and to meet challenges as they emerge.’

The report also highlighted Australia’s limited ability to shape effective operational and regulatory arrangements without international cooperation.

The public sector as regulator

The power to make laws and associated regulations is a central role of government. Governments regulate in order to influence or modify the behaviour of individuals or business in ways which are consistent with their broader social or economic policy goals. Regulatory intervention by government has often been used to deal with situations of apparent ‘market failure’, that is, in effect, being a surrogate for the kind of economic efficiency expected in an open market environment. ‘Market failure’ does not necessarily justify government action but, rather, it suggests that government action may be called for to improve upon market outcomes. In order to justify regulatory action it needs to be demonstrated that such action will largely overcome market failure and improve the community’s welfare.

Regulatory action takes many forms, but generally falls into two broad categories, economic regulation and social regulation. Economic regulation seeks to address market failure which is typically associated with the exercise of market power. Economic regulation in Australia has concentrated mainly on the regulation of those aspects of market structure and market practices which result in anti-competitive conduct, or which have other adverse effects on economic efficiency; and the regulation of natural and mandated monopolies in order to guarantee access to the regulated service and to ensure an efficient level of pricing (and prevent monopoly pricing). Social regulation addresses issues such as personal or public safety, environmental protection, and consumer protection. These issues typically concern ‘externalities’, where it is generally not possible to quarantine the effects of particular action on designated groups, and/or the lack of information which can unduly disadvantage individuals. Social regulation can sometimes be used as a form of de facto economic regulation in so far as it may impose costs on business, or otherwise restrict the entry of individuals or firms into particular markets. It has been noted that:
Considerable attention has been given over the last few years to the need for regulatory review and reform in Australia. Our country has made a significant transition from an economic and industrial environment which was highly regulated to one focussed on exposing key sectors of the economy (including public services) to the benefits of competition. Moreover, Australia has been progressively moving away from an inward-looking, industry-specific regulatory apparatus to an open broad-based economic focus premised on the need to introduce greater competition and contestability into the Australian marketplace. Nevertheless, it needs to be recognised that increasing globalisation provides challenges for regulators, for example:

- The International Conference on Occupational Health, held in Finland in June 1999, highlighted risks associated with occupational health regulation. The conference noted that developed and developing countries needed to be vigilante to potential problems, especially those caused by globalisation. From a developing country’s perspective, Dr Richard Helmer from the World Health Organisation (WHO) indicated that “from the occupational health perspective, trends towards globalisation of trade pose certain health risks. For example, in order to reduce costs, industries with their accompanying occupational hazards are being relocated to developing countries.” In developed countries, the WHO pointed to increased levels of stress in the workplace. Research conducted in industrialised countries indicates that over 50 per cent of workers complain about stress, and US expenditure on health care is nearly 50 per cent greater for workers who report high levels of stress at work. This would indicate that improved management of stress and other workplace health issues would, in the long term, greatly reduce the cost of health care and potentially improve economic performance.

- Environmental issues, whilst being important for governments, often take on a global perspective. The occurrence of man-made disasters in one country, like the nuclear meltdown at Chernobyl, can affect entire continents, not just the surrounding region. Furthermore, the trade in endangered species and hazardous waste can threaten a region’s ecological balance. The Australian Government has been heavily involved on both the international and domestic levels, in an effect to minimise the possible harmful effects on a global basis. On the international front, Australia is a signatory to a wide range of multilateral agreements, which include the BASEL Convention (ban on all exports of hazardous waste), the Ramsar Convention (protection of Wetlands of International Importance), and the CITIES (Convention on International Trade in Endangered Species of Wild Fauna and Flora).

There is a continuing move away from a traditional ‘protective’ regulatory regime to one which is more reliant upon ‘self-regulation’ and consumer empowerment. The emerging less regulatory environment is characterised by efforts at ‘deregulation’, simplification and streamlining, coupled with efforts by governments to reinforce the essential ‘contract’ between consumers (or clients) and the providers of goods and services, whether in the private or public sector. Auditors have to understand such environmental changes if we are to be an influencing factor in any improvement in governance as well as providing the necessary assurance to Parliamentary institutions.
that these changes are being implemented as intended. The imperative will be more evident if there is increasing momentum to the so-called ‘triple bottom line’ reflecting the way organisations impact on the economy, society and the environment.

Privatisation does not necessarily diminish the public interest inherent in the operation of certain businesses. Accordingly, where government has seen a public interest need for regulation of privatised companies or industries in which privatised companies compete, Auditors-General can perform an important accountability function in examining and reporting on the public sector’s performance in regulating privatised businesses and/or administering government contracts with these businesses. The regulators themselves have to be accountable as well as being reasonably independent – a suitable balance is often difficult to achieve.

There is a risk that needs to be recognised and addressed in regulation namely, regulatory capture. In particular, the failure to implement cost-effective surveillance and enforcement programs (for whatever reason) can negate the effectiveness of regulatory requirements and result in inequities between non-complying and complying businesses. Regulatory capture has always been a risk, but the regulator’s independence, objectivity and (potentially) fairness can be impaired if it fails to recognise that the transfer of ownership interest to the private sector has fundamentally changed the nature of the relationship between the regulator and the business entity.

Public sector financial operations in a global economy

Governments are often involved in international trading activities through the need to procure goods and services such as Defence equipment, provide or receive aid and operate diplomatic posts in other nations. Such activities give rise to significant financial risk exposures, including variations in exchange rates. Exchange rates are highly volatile and, accordingly, a government’s international financial flows need to be prudently managed. My office is currently examining the management of foreign exchange risk by Australian Public Service agencies. Work completed to date indicates that foreign exchange risk is not effectively managed by the audited agencies. Specifically, there are questions arising concerning their systems and policies to identify risk exposures, analysis of the extent of these exposures and their impact, as well as steps being taken to manage the resultant risks cost-effectively.

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

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

An important step in any risk management program is goal specification. Many commercial organisations aim to reduce volatility of cash flows, earnings and/or market value through management, or hedging, of foreign exchange exposures.  This is reflected in hedging objectives of not taking speculative positions, eliminating foreign exchange transactional risk, minimising hedge costs and taking advantage of the structure of spot and forward markets to increase returns or reduce costs. Hedging refers to the process of managing risk by eliminating, or at least reducing, the underlying exposure. This is often achieved by using financial derivatives.

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

Although originally developed as a risk management tool, derivatives also involve risks that need to be managed. For example, in recent years a number of entities have suffered significant financial losses associated with derivatives. Subsequent reviews have attributed the losses, in part, to flawed corporate governance systems that did not establish effective risk management and internal controls to ensure approved policies and risk limits were applied and were effective. There is also a risk that derivatives may be used to speculate on financial market movements, thereby creating new risks rather than managing existing risks.

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

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

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

Of note is that the Australian Government’s Treasury Department has made extensive use of interest rate and cross-currency swaps with over 300 swaps transacted since May 1988 with a notional principal value of more than A$38 billion. This swap program is aimed at changing the debt portfolio to fixed and floating interest rates as well as seeking to obtain foreign currency exposures which may reduce debt costs. While legislation removes any doubts about the Treasury’s legal authority to enter into these transactions, Parliamentarians have questioned the Treasury about the purpose of this swap program and the extent of the Commonwealth’s associated financial and risk exposures. Treasury assured the Parliament that the swaps program is soundly based with substantive processes that protect appropriately the Commonwealth’s exposure. My Office recently completed an audit of Commonwealth Debt Management and the control and governance framework for the swaps program was an important element of the audit scope. Many of the audit recommendations were aimed at strengthening the control framework in order to manage the significant legal, operational and market risks that are inherent in the use of financial derivatives.

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

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

I noted earlier that, the Australian Public Service has been steadily evolving towards a more private sector orientation with a new emphasis on the contestability of services; the outsourcing of functions which the private sector can undertake more efficiently; ensuring a greater orientation towards outcomes, rather than just on process; and an accent on continuous improvement to achieve better performance in an environment of devolved authority and greater management flexibility. These developments have been described as the ‘privatisation’ or ‘commercialisation’ of the public service.

A major impetus for the changes we are seeing has been the fundamental questioning of what government does, or should do, allied with a perception of inefficient (costly) and ineffective (lacking client focus) delivery of public services due to its monopoly provision and/or other constraints of public sector administration. Put simply, it is considered that public services would be provided more efficiently and effectively, with greater client satisfaction, in a more market oriented environment which provided greater flexibility for management decision-making and the discipline of competition.38 Indeed, history shows varying support for such a view but with reservations, for example, about market imperfections and public goods arguments – using economic terminology. Nevertheless, some have a quite pragmatic view about notions of clients and markets as the following indicates:

‘The privileges of governance and the political consequences of disappointing sufficient citizens, therefore, require that governments be more than disinterested facilitators of market exchanges. ... the limits of a government’s responsibilities to its citizens are far more extensive than that of delivery performance.’39

The privatisation of the public sector also requires proper accountability for the stewardship of public resources, as it is accountability which is fundamental to a democratic system.40 Importantly, the privatisation of the public sector does not obviate or limit the need for accountability to stakeholders. Instead, less direct relationships such as the introduction of a new player in the accountability chain - the private sector service provider - and greater decision-making flexibility strengthen that need. These changes also have important implications for auditing approaches where management and accounting techniques have much in common with those in the private sector. There is also a growing impact on the demand for similar auditing skills and experience. Unfortunately, this growth also coincides with increased demands for accounting skills, linked to the move to accrual accounting and budgeting in the public sector, which, among other things, is impacting adversely on my Office’s recruitment and retention programs.

It is during the transition period, as these accountability arrangements and changed organisational structures are bedded down, that the greatest risk to effective decision-making arises. In my view, such risk is accentuated with greater involvement of the private sector in contractual arrangements; loss of corporate memory in agencies with downsizing of the public sector; the greater use of computing technology with attendant control and fraud related issues, particularly when outsourced; a lack of required skills in project and contract management in the public sector; and insufficient experience generally in managing on an accrual accounting and budgeting basis.
Private sector delivery of public services

A feature of the changing public sector environment has been the outsourcing of functions which, it is judged, the private sector can undertake more efficiently. Three prominent examples at the federal level in Australia are indicated below:

- The Defence Department’s Commercial Support Program which was introduced in 1991. This program seeks to make greater use of civilian infrastructure and national resources by contracting out support functions where this was operationally feasible, practicable and cost-effective. The objective of the program is to achieve best value for money in the acquisition of support services for the Department of Defence and to give the private sector an opportunity to participate in the provision of those support services. The program process involves requesting offers from the private sector to perform support services and comparing those offers with the proposal put forward by any in-house option, where such a proposal may be feasible. The option assessed as providing the best value for money is then selected and a contract is negotiated or, if the in-house option is selected, an agreement for the provision of the service is prepared. In 1998, at which time 94 activities had been market-tested under with a total value over $1.5 billion, my Office completed an audit of the program. The program was chosen for audit due to the significant value of activities involved and the relevance to other Government activities which may be subject to market-testing and outsourcing.

- More recently, the Commonwealth has undertaken its most significant outsourcing to date, that of employment services. This outsourcing initiative (now known as the Job Network) involved contracting out some $1.7 billion of services previously provided by the public sector with payment structures and incentives for service providers linked to the placement of job seekers in work. In September 1998, I tabled a report which examined the management of this process. We found that the agency had followed key principles of good project management in implementing the new market arrangements, that each of the project-planning criteria had been met and that risks had been managed in line with good practice. My Office identified a range of good practices implemented by the agency examples of which are highlighted throughout the report as well as opportunities for improvement. We are presently examining the agency’s management of these contracts with employment service providers. I will say more about this program later.
The decision to outsource information technology infrastructure and telecommunications services across budget-funded agencies, subject to the outcome of competitive processes to be undertaken within a ‘whole of government’ framework. Through this strategy, the Government aims to achieve effective support of business needs and service delivery requirements as well as substantial economies of scale resulting in budget savings. Agencies were formed into groups to conduct competitive processes to market test outsourcing of significant components of their information technology infrastructure and telecommunications services. A number of contracts have been let with significant savings forecast. The administration of this initiative is being examined by my Office to assess the administration and financial effectiveness of the implementation of the initiative including assessing the effectiveness of the tendering, contracting and monitoring process undertaken to date.

Outsourcing advocates point to the opportunities offered in terms of increased flexibility in service delivery; greater focus on outputs and outcomes rather than inputs; freeing public sector management to focus on higher priorities; encouraging suppliers to provide innovative solutions; and cost savings in providing services.43 However, outsourcing also brings risks to an organisation which cannot be ignored. A recent report by the Public Accounts and Estimates Committee of the State of Victoria provides an extensive listing of the potential risks and benefits of outsourcing.44

The experience of my Office has been that a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and considerable public concern.45 For example, the Job Network referred to above provides a good example of the inherent difficulties in applying a purely commercial model to the contracting out of community services. With media reports suggesting a number of the original 321 service providers were experiencing financial difficulties, pressure was placed on the Government for additional funding and changes in the commercial relationship. This situation emphasises the need to recognise the complex set of objectives and stakeholder views which must be taken into account when we make decisions in the public sector. For example, questions have been asked as to whether sufficient consideration was given to the impact of a service provider’s closure on unemployed clients.

The main message from this experience is that savings and other benefits do not flow automatically from outsourcing. Indeed, that process, like any other element of the business function, must be well managed and analysed within an overall business case which includes an assessment of its effect on other elements of the business. The latter can be positive or negative. In the case of the Department of Finance and Administration’s (DOFA’s) outsourcing of all its human resource management functions, it was assessed as positive for its core business. That arrangement recently won a worldwide outsourcing achievement award.46

Outsourcing represents a fundamental change to an agency’s operating environment. It brings with it new opportunities as well as risks, requiring managers to develop new approaches and skills. Managing the risks associated with the increased involvement of the private sector in the delivery of government services, in particular the delivery of services through contract arrangements, will require the development and/or
enhancement of a range of skills across the public sector and will be a key accountability requirement of public sector managers. In particular, outsourcing places considerable focus and emphasis on project and contract management, including management of the underlying risks involved. The thrust of this change is reflected in the Australian Senate’s Finance and Public Administration Committee’s recently released second report on Contracting Out of Government Services:

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

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

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

Selling public sector assets

One of the most prominent forms of the commercialisation of the public services has been the outright sale (or privatisation) of government businesses to the private sector. In Australia, the last ten years has seen an increased focus on privatisation of government business entities, with approximately $50 billion raised by the Federal Government through such asset sales over this time.\(^{48}\) In addition to raising significant cash proceeds, asset sales provide an opportunity to transfer risks to the private sector and has been argued to offer the potential for improved business efficiency.

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

The underlying objective of a financial statement audit is to express an opinion on the fairness of the information reported in the financial statements. However, for the public sector auditor, audit coverage needs to extend beyond the minimum work necessary to substantiate financial statement disclosure. If the Auditor-General is to truly add value and provide appropriate assurance, it is important that the public sector audit coverage should recognise and report matters which, although not directly related to the financial statements or supporting systems, impact directly or indirectly on the efficient, effective and ethical use of public resources.\(^{49}\)

Asset sales invariably represent a significant and financially material government activity. The United Kingdom Treasury has noted that a range of legislative, commercial and propriety issues arise when a public sector business or service is privatised.\(^{50}\) From our perspective, it is worth noting that Auditors-General have wider responsibilities than the traditional private sector auditor. Our New Zealand colleagues have previously noted that, in order to provide assurance to the Parliament, and the community, that the privatisation process has been successful, post sale audit activities need to consider:

- satisfying public information requirements about the sale. For example information about the nature of the tendering process or the terms of sale may not always be known to the public. In these circumstances the reporting of such information by the Supreme Audit Institution (SAI) goes some way toward meeting that need for information by the general public;

- ascertaining and reporting whether the maximum value for money was achieved on sale;
• ascertaining and reporting whether the sale achieved the objectives set preceding the sale. For example, some governments offer the sale of commercial activities carried out in the public sector as a way of redeeming public debt or improving the efficiency of delivery of social services such as public health. The SAI might consider whether it is appropriate to provide public comment on whether that objective has been met; and

• assessing whether any regulatory requirements accompanying the sale have been met on an ongoing basis.51

The assurance provided by such audit activities plays an important role in enhancing accountability for the stewardship of the sale process and whether post-sale performance is meeting the objectives set by government. Australia has an ongoing program of asset sales. My Office has undertaken a program of performance audits to examine the extent to which government sale objectives have been achieved: the effectiveness of the management of the sale; and the ongoing risk exposure. Risk management has been a particular focus of the public service reforms in Australia, particularly in an era of devolved authority and commensurately less central control.52

To ensure their effectiveness, my privatisation audits (such as the recent audits of the Telstra (our major public sector communications supplier) share offer53, the leasehold sales of Federal airports54, and third tranche sale of the Commonwealth Bank55) are undertaken by a team of experienced officers who understand the commercial nature of the transactions and the overlaying public accountability issues. In addition, we engage appropriately qualified professionals to provide specific technical, including commercial, advice.

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

Asset sales in Australia are invariably conducted by way of public share offers or trade sales. Although there are similarities in some of the administrative processes associated with the management of public share offers and trade sales, there are also stark differences which need to be considered when planning and undertaking audits of such sales. Because of the time pressures and commerciality of these sales, ANAO audits have all been ex-post. Opportunities were available to undertake probity audits of the sales processes but there were potential conflicts of interest as well as resourcing issues which inhibited our participation.
By virtue of their scale and complexity, audits of public share offers are quite challenging undertakings. Furthermore, the scale of such offers particularly emphasises the importance of sound administrative practices because small deficiencies can have significant adverse financial implications. My Office has examined the three largest public share offers conducted in Australia, namely the first and second tranche sale of shares in Telstra Corporation and the third tranche sale of shares in the Commonwealth Bank. These three sales collectively raised proceeds of some AS$35 billion. These reports have examined the key factors that affect the success of any public share offer, such as:

- the level and structure of fees paid to stockbrokers and advisers as these fees significantly influence the motivation for these firms to act in the vendor’s interest. While fees need to be high enough to motivate them to sell shares, it is important that the entity overseeing the sale should take advantage of the competitive broking market by considering the level of fees sought by individual brokers when deciding on the composition of the selling syndicate for the offer. It is equally important that the division of fees and commissions between the fixed component shared among the selling syndicate and the ‘competitive’ component paid according to which broker secured the order for shares provide an incentive for all brokers to actively market and sell shares, and that fees and commissions only be paid for services provided. For example, underwriting fees should only be paid on shares that are actually underwritten;

- the ‘price discovery’ process which is important to achieving value for money in initial public offers. In Australia, the final offer price is established by a ‘bookbuilding process’ whereby investors submit bids in advance of the pricing of the share offer and, on the basis of this information, shares are allocated to qualifying bidders. In secondary offers, a market price already exists for the shares being sold and this makes the process of establishing the issue price less complex. However, in an initial public offer, the bookbuild performs a more important price discovery role and it is important that the bookbuild allocation criteria, and any indicative price ranges specified by the vendor, encourage and reward bidders who indicate their price elasticity of demand for shares; and

- the logistics of the settlement process, if the vendor is to receive the full proceeds from the share sale in a timely manner. This requires comprehensive settlement procedures to be developed and advised to successful bidders, ongoing monitoring and reconciliation of relevant bank accounts, and the implementation of effective settlement default procedures.

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

A common objective of any privatisation is to obtain a fair value from the sale. ANAO audits of trade sales have adopted the Australian Accounting Standards’ definition of fair value, namely: the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm’s length transaction. In trade sales, fair value can be achieved through an open, competitive
tender process that enables a market value for the assets or business to be established. For this reason, a clear focus of performance audits of trade sales has been on the tender process and the evaluation of tenders. From these audits, my Office has identified a number of principles of sound administrative practice to guide future Commonwealth trade sales, including:

- the advantages of flexible data access arrangements to minimise the costs of potential buyers understanding the business in order to develop their bid;
- adopting structures such as tender evaluation committees to enhance transparency and accountability as well as structuring these committees so that relevant agencies are able to satisfy themselves that the evaluation is fully informed, properly conducted and identifies the best possible offer for each business;
- the development of appropriate priorities which set out the relative importance attaching to each evaluation criterion;
- carefully considering the nature of fees paid to commercial advisers to ensure advisers do not have a pecuniary interest in the outcome of the tender process;
- seeking early resolution of the government’s position on future service requirements, and any ongoing subsidies or payments to the business, so that bidders have a full picture of the potential for the business and can frame their bids accordingly; and
- the merits of undertaking a credible assessment of the net financial benefits of all tenders in order to maximise financial returns from the sale.

It has been pleasing to observe that ANAO privatisation audits have had a real impact on the way sales are being conducted. For example, Federal airports in Australia have been sold in two tranches and each tranche has been audited. An aspect of my Office’s approach to auditing the second tranche sale was to examine action taken in response to recommendations made in the audit report on the first tranche sale. We found that all eleven recommendations in our 1998 report were implemented by agencies, even though not all had been fully agreed to by the agency responsible for Federal asset sales. The improved processes resulting from implementation of these recommendations supported an effective overall outcome for the Phase 2 sales. This outcome was also due to the greater understanding of the accountability requirements by private sector contractors who not only addressed audit comments but also initiated related discussions with the auditors concerned.

I also welcome the serious attention the ANAO audit of the first sale of Telstra shares was given in the planning and conduct of the second sale, which was completed late last year and is presently being examined by my Office. The 1998 audit report on the first sale found that overall value for money in future sales could have been improved and the report included 11 recommendations aimed at improving the future management of Commonwealth public share offers, particularly financial management. Although the recommendations were not universally accepted by the relevant agencies, the Government required that the issues raised in the 1998 report be taken into account
in the management of the Telstra 2 transaction. Early indications from the audit are
that this has occurred, to the benefit of the sale process and outcomes.

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

Private financing of government activities

In the current budgetary environment, public sector entities in many countries have
often found it difficult to provide dedicated funding for large projects out of annual
budgets, thus resulting in lengthy delays before projects can proceed, or projects
proceeding incrementally over a number of years. Delayed access to needed
infrastructure can be costly to the community while budget constraints can lead to sub-
optimal project outcomes. The encouragement of private sector investment in public
infrastructure by governments is one response to these fiscal pressures. It has also
given rise to additional challenges and demands for public accountability and
transparency because the parameters of risk are far different than is the case with
traditional approaches to funding public infrastructure and the potential liabilities
accruing to governments may be significant.

Extensive use has been made of private financing in the United Kingdom. The Private
Finance Initiative was introduced in 1992 to harness private sector management and
expertise in the delivery of public services.\textsuperscript{58} By December 1999, agreements for more
than 250 Private Finance Initiative projects had been signed by central and local
government for procurement of services across a wide range of sectors, including
roads, rail, hospitals, prisons, office accommodation and IT systems. The aggregate
capital value of these projects was estimated to be some £Stg 16 billion.\textsuperscript{59}

The United Kingdom National Audit Office has noted that the private finance approach
is both new and more complicated than traditional methods.\textsuperscript{60} This brings with it new
risks to value for money and requires new skills on the part of the public sector. Since
1997, the National Audit Office has published eight reports on such projects. These
reports collectively suggest that, for privately financed projects to represent value for
money, the price must be in line with the market; the contract must provide a suitable
framework for delivering the service or goods specified; and the cost of the privately
financed option (taking into account risk) should be no more than that of a publicly
funded alternative.\textsuperscript{61}

It is difficult to evaluate the overall benefits that accrue from private financing
initiatives. In financial terms, it has been recognised that, generally, the private sector
is not able to borrow as cheaply as governments can. This is because government
borrowings are considered by markets to be risk-free because of their capacity to raise
taxes and because of the absence of default by most sovereign borrowers.
Accordingly, delivering financial benefits from private financing requires cost savings
in other aspects of the project and/or the effective transfer of risk. Clearly, any savings
that are assessed from these aspects are sensitive to the benchmarks and assumptions used:

- The initial benchmark for comparison purposes is often any incumbent public service provision of similar goods or services. However, it is not uncommon for such benchmarks to be adjusted to improve comparability. This introduces further assumptions and subjectivity to the evaluation process.

- Unless risk is transferred to the private sector, private financing may achieve little other than provide the private sector with the benefit of a very secure income stream, similar to a government debt security, but with the private sector able to earn returns above those available from investing in government debt securities. However, the transfer of risk to the private sector is only really cost-effective where the private sector is better able to manage and price these risks. Even where the risk has been transferred, there can remain a residual risk that the public sector may have to step-in in the event the private sector contractor experiences difficulties in meeting its obligations. This is because, where the provision of public services or goods is involved, private financing does not equate to contracting out ultimate responsibility.

In relation to the transfer of risk, the United Kingdom National Audit Office has observed that:

'Appropriate risk allocation between the public and private sectors is the key to achieving value for money on PFI projects. If the private sector are asked to accept responsibility for a risk that is within their control, they will be able to charge a price for this part of the deal which is economically appropriate. However, if the Department seeks to transfer a risk which the private sector cannot manage, then the private sector will seek to charge a premium for accepting such a risk, thereby reducing value for money. The Department should therefore have sought to achieve not the maximum but rather the optimum transfer of risk, which allocated individual risks to those best placed to manage them.’

In Australia, most of the activity in private financing initiatives has occurred at the State government level, particularly in relation to infrastructure projects such as roads. Prominent examples include the Sydney Harbour Tunnel and the M2 Motorway (New South Wales) and the City Link project in Melbourne (Victoria). Notably, these high profile projects have been the subject of external scrutiny that has raised concerns about the exact distribution of risk and financial benefits between the public and private sectors, for example as indicated by the following audit observations:

- The New South Wales Auditor-General has consistently commented that, although private sector owners have been given long-term rights over important road networks, there has not been a proper comparison of the cost-effectiveness of private sector involvement and the traditional public sector approach. Accordingly, the Auditor-General was unable to conclude that the projects that have been undertaken were in the State’s best interests from a financial viewpoint. In particular, the
opportunistic and ad hoc use of private finance was criticised as it was considered unlikely to improve the overall efficient use of the road network and reduce the total costs of road maintenance and management.65

- The Melbourne City Link project is one of the largest infrastructure projects ever undertaken in Australia with an estimated total cost of around $2 billion. It involves around 22 kilometres of road, tunnel and bridge works linking three of the Melbourne’s most important freeways. A report by the State Auditor-General found that, while the users of the City Link via toll payments will, in substance, be the financiers of the project, the private sector has accepted substantial obligations associated with the delivery and operation of the City Link, including traffic and revenue risks. However, the auditors also found that the decision to establish the City Link as a toll road was not supported by a financial model which compared project costings on the basis of private sector financing versus government borrowings.66

Significantly, there have also been concerns raised about public accountability for privately financed projects. This has stemmed from difficulties Parliaments have experienced in gaining access to contract documents. For example, in relation to the aforementioned M2 Motorway in New South Wales, the Parliament was denied access to the contract deed between the public sector roads authority and the private sector counterparty.67

The 1996 National Commission of Audit observed that the private sector has a significant capacity for a greater role in infrastructure services. The Commission also concluded that the role for government could be reduced and suggested that the identification of good opportunities for private sector investment in infrastructure could assist the goal of increased national saving.68 Accordingly, there has been increasing interest in private financing initiatives in Australia at the federal level, although to date there has been limited actual adoption. One example where this has been adopted involves the agency responsible for funding and managing the development of Australian government office and diplomatic properties. This agency adopted private financing for a number of projects but has since discontinued private financing arrangements. My Office’s examination of one of these projects found that the financing costs were above those that would have resulted from the usual public sector debt issuance activities and there was no transfer of risk to the private sector. The key message here is the need for public sector managers to fully appreciate the nature of the commercial arrangements and attendant risks involved in private financing initiatives.

An early Australian example of private sector involvement in financing public activities is reflected in the Cooperative Research Centres Program which involves collaborative research between industry, federal and State governments and universities and other research organisations. Funding of activities is shared between the participants and the distribution of any revenue from the commercialisation of commercial property is also negotiated.69
The Australian Defence Department is also examining the merits of using private financing to realise financial savings or improve effectiveness in the delivery of Defence services. This is to include capital equipment as well as Defence facilities, logistical support and IT programs. Any such examination should clarify what core business the Department needs to maintain in order to manage effectively the longer-term risks that are involved in any outsourcing. The Department has indicated that private financing is to be considered for all capability proposals and tested as an acquisition method unless the capability:

- involves the direct delivery of lethal force (core Defence business); or
- is demonstrably inappropriate and uneconomic (that is, does not reflect best value for money).\(^{70}\)

Their clear objective in widening the use of private financing is to achieve the best affordable operational capability. You may be interested in their identification of lessons learnt from case studies arising from the United Kingdom Ministry of Defence’s experience as well as that of two State Governments in Australia.\(^{71}\)

In view of the growing interest in and use of private financing initiatives and the important financial, risk transfer and accountability issues raised, it can be expected that Auditors-General will increasingly focus their attention on examining such activities. It is hoped that such scrutiny can assist optimise outcomes and provide assurance to the public and Parliaments about the processes adopted and outcomes achieved. In this context, I commend the work done by the United Kingdom National Audit Office in examining privately financed projects and in providing sound guidance to auditors on how to examine value for money of privately financed deals.\(^{72}\)

### IV. CORPORATE GOVERNANCE

This brings me to the issue of corporate governance and agency controls, which is particularly important in relation to privatisation of the public sector in its broadest sense. Corporate governance is largely about organisational and management performance. Simply put, corporate governance is about how an organisation is managed, its corporate and other structures, its culture, its policies and the ways in which it deals with its various stakeholders. Corporate governance has been an issue in the private sector since the advent of joint stock companies in the United Kingdom in the eighteenth century. The core of the issue is, and has long been, how to ensure that the interests and expectations of owners and other stakeholders of corporate bodies are adequately addressed by the governing body and the executive management of corporate bodies.

Key components of corporate governance in both the private and public sectors are business planning, risk management, performance monitoring and accountability. The framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation’s stakeholders and those who are entrusted to manage resources and deliver required outcomes.
Good corporate governance in both the public and private sectors requires clear definitions of responsibility and a real understanding of relationships between the organisation’s stakeholders and those entrusted to manage its resources and deliver its outcomes. In a complex operating environment, such as is evident in the Australian Public Service, these requirements become that much more important for both accountability and performance to a range of stakeholders. Good corporate governance is based on a clear code of ethical behaviour and integrity which is binding on management and staff and communicated to stakeholders. Such a culture is also essential for the establishment of sound risk management approaches and the confidence it can give to those stakeholders in the organisation and in what it does. Repeating, a robust accountability approach which encourages better performance through sound risk management is integral to any corporate governance framework.73

As well as the similarities, it is important to recognise the basic differences between the administrative/management structures of private and public sector entities and between their respective accountability frameworks. The political environment, with its focus on checks and balances and value systems that emphasise issues of ethics and codes of conduct, implies quite different corporate governance frameworks from those of a commercially-oriented private sector. It is equally important to recognise that the diversity of the public sector requires different models of corporate governance. That is, one size does not fit all even though there will be common elements of these models.

The values, standards and practices which underpin corporate governance in public sector agencies flow from peak public service values, obligations and standards, which in turn are derived from legislation, policy and accepted public service conventions. In Australia, the new public service values are a key element in the Government’s public sector reform program and have been included in the new Public Service Act 1999. The following are some of the values that agency heads are required to uphold and promote within their organisations:

- the Australian Public Service is apolitical, performing its functions in an impartial and professional manner;
- the Australian Public Service has the highest ethical standards;
- the Australian Public Service is accountable for its actions, within the framework of Ministerial responsibility, to the Government, the Parliament and the Australian public;
- the Australian Public Service delivers services fairly, effectively, impartially and courteously to the Australian public; and
- the Australian Public Service focuses on achieving results and managing performance.

Regulations require agency heads to integrate these values into the culture of their agency. The Public Service Commissioner has to report annually on how successfully this had been achieved. My own agency, to take one example, has as its key values independence, objectivity, professionalism, and knowledge and understanding of the
public sector environment. These values are guided by the ANAO Code of Conduct which has been developed within the framework of the new Australian Public Service values and the Australian Public Service Code of Conduct, together with the Codes of Ethics promulgated by the professional accounting bodies.

**Defining individual roles and responsibilities**

One of the most important components of robust accountability is to ensure that there is a clear understanding and appreciation of the roles and responsibilities of the relevant participants in the governance framework, importantly, of the responsible Minister(s), a Board and a CEO. Furthermore, the absence of clearly designated roles weakens accountability and threatens the achievement of organisational objectives.

Any discussion of corporate governance within the private sector and, indeed, for public authorities and companies, usually begins with a discussion of the role of the Board of Directors, who have a central role in corporate governance. This was clearly indicated as follows by Sir Ronald Hampel’s Committee on Corporate Governance which has been extensively quoted in governance papers and discussions:

> ’It is the Board’s responsibility to ensure good governance and to account to shareholders for their record in this regard.’

In the private sector, there is a clearly defined relationship structure between the main parties. That is, the generic private sector governing structure consists of a board of directors, including the chairperson of the board, and a CEO responsible for the ongoing management of the agency. However, this model is not readily transferable to the public sector, even with GBEs, because of the different roles and relationships between the responsible Minister(s), the CEO and (possibly) the Board. As well, Australian citizens (stakeholders) have no choice as to their investment.

It is important to recognise the distinction between agencies that are governed by the CEO, possibly with the assistance of a board of management in an advisory capacity, and those organisations that have a governing board to which the CEO should preferably be accountable, such as Commonwealth authorities and companies. The latter, of course, have more in common with the private sector. They also have added complexities as a result of the additional party in the accountability chain. Organisations will need to tailor their governance practices to take account of such differences.

I should mention here another apparent difference between the public and private sectors which is reflected in a public sector organisation’s relationship to its stakeholders. Private sector approaches tend to focus primarily on shareholders, while recognising other stakeholders such as employees, customers, suppliers, creditors and the community. This can be illustrated by the US Business Roundtable’s view that:

> ‘... the paramount duty of management and of boards of directors is to the corporation’s stockholders; the interests of other stakeholders are relevant as a derivative [my underlining] of the duty to stockholders.’
Richard Humphry, Managing Director and CEO of the Australian Stock Exchange, expressed a similar view last year. In his view, a private sector board would be abrogating its fundamental responsibility to its shareholders if it responded to issues in a manner that went beyond the traditional internal focus on shareholders. While I agree that a board’s primary responsibility should be to its shareholders, I would suggest that concepts of greater social and community responsibility are increasingly being embraced by the private sector, as a matter of course. Boards are beginning to recognise that being seen as ‘good corporate citizens’ is integral to the long-term viability of an organisation and, therefore, in the interests of shareholders.

While, in the public sector, we can identify citizens in a similar role to shareholders, in practical terms boards, CEOs and management have to be very aware of their responsibilities to the government (as owners or custodians and regulators), to the Parliament (as representatives of citizens and legislators) and to citizens (as ultimate owners as well as in their particular client roles as citizens).

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

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

Thus, the threshold requirement of sound governance must be agreement between the key parties, whether this is the board and management (including the CEO) or the CEO and management, on the broader corporate objectives. These parties should jointly develop the corporate objectives which the CEO is responsible for achieving.

**Principles and practice of good corporate governance**

Attention to the principles of corporate governance requires those involved to identify and articulate their responsibilities and their relationships; consider who is responsible for what, to whom, and by when; acknowledge the relationship that exist between stakeholders and those who are entrusted to manage resources and deliver outcomes. It provides a way forward to those, whether in the public or private sectors, who find themselves in somewhat different relationships than either have experienced before. Therefore they need to look beyond what have become their expectations over time particularly in view of the recent changes that have occurred in both sectors.

In the last decade, Australian Public Service agencies have put in place many of the elements of good corporate governance. These include corporate objectives and strategies; corporate business planning; audit committees; control structures,
including risk management; agency values and codes of ethics; identification of and
effective service to stakeholders; performance information and standards; evaluation
and review; and a focus on client service to name just a few. However, too often
these elements are not linked or interrelated in any way so that people in the
organisation understand both their overall purpose and the various ways the various
elements are linked to achieve better performance. This is also necessary to ensure
that a mutually supportive framework is produced that identifies outcomes for
identified stakeholders.

Therefore, the real challenge is not to define the elements of effective corporate
governance but to ensure that all the elements of good corporate governance are
effectively integrated into a coherent corporate approach by individual organisations
and well understood and applied throughout those organisations. If implemented
effectively, corporate governance should provide the integrated strategic management
framework necessary to achieve the output and outcome performance required to fulfil
organisational goals and objectives. Corporate governance also assists agencies
discharge their accountability obligations.

Effective public sector governance requires leadership from the Board (where
applicable), the CEO and executive management of organisations and a strong
commitment to quality control and client service throughout the agency. An effective
framework requires clear identification and articulation of responsibility and a real
understanding and appreciation of the various relationships between the organisation’s
stakeholders and those who are entrusted to manage resources and deliver required
outcomes. It should be based on a set of values including a clearly specified code of
ethical and professional behaviour which is binding on management and staff and
communicated to stakeholders. Such a culture is essential for the establishment of
sound risk management approaches and the confidence it can give to stakeholders in
the organisation and what it does. Public sector executives leading by example is
perhaps the most effective way to encourage accountability and improve performance.

Concern has been expressed that there has been more emphasis on the form rather than
the substance of good corporate governance. I want to stress that effective corporate
governance is more than just putting in place structures, such as committees and
reporting mechanisms, to achieve desired results. Such structures are only a means for
developing a more credible corporate governance framework and are not ends in
themselves.

However, there are positive examples of where both elements are being achieved
contributing to greater understanding and commitment at all levels of the organisation.
The work that the ANAO has previously done with Australian public service agencies
has clearly indicated the contribution that good corporate governance can make to an
organisation’s performance and to the confidence of stakeholders. For example, from
the ANAO’s observation, the Australian Taxation Office’s governance framework has
facilitated:

- achievement of corporate objectives;
- identification and management of risk (including determination of priorities);
• promotion of high ethical standards; and
• clarity of various management roles and accountabilities.

This example demonstrates that effective governance of agencies can provide a more robust, pluralistic and adaptable decision-making framework. The challenge for public sector CEOs is not simply to ensure that all the elements of corporate governance are effectively in place but that its purposes are fully understood and integrated as a coherent and comprehensive organisational strategy focussed on being accountable for its conduct and results.

In recognition of the need for good corporate governance in the public sector, the ANAO in July 1997 circulated a discussion paper, Principles for Core Public Sector Corporate Governance: Applying Principles and Practice of Corporate Governance in Budget Funded Agencies. This paper was designed to fill the gap in core public sector awareness of the opportunities provided for improved management performance and accountability through better integration of the various elements of the corporate governance framework within agencies. As well, the paper included a checklist designed to assist Chief Executive Officers (CEOs) to assess the strengths and weaknesses of their agencies’ current governance framework. Although the discussion paper was not meant to provide a comprehensive model for each agency, CEOs should be able to identify those elements of a governance strategy most applicable and useful to their particular agency. The paper identified the following key operating principles that should underpin a sound corporate governance framework in the public sector:

• **openness** is about providing stakeholders with confidence regarding the decision-making processes and actions of public sector agencies in the management of their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information leads to effective and timely action and lends itself to necessary scrutiny;

• **integrity** is based on honesty, objectivity as well as high standards of propriety and probity in the stewardship of public funds and the management of an agency’s affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the agency. Integrity is reflected in the agency’s decision-making procedures and in the quality of its performance reporting;

• **accountability** is the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities and roles are clearly defined through a robust organisational structure; and

• **leadership** involves clearly setting out the values and standards of the agency. It includes defining the culture of the organisation and the behaviour of everyone in it.
These principles should be reflected in organisational structures and processes, external reporting, internal controls and standards of behaviour of the organisation.

**Risk and control as part of an integrated corporate governance framework**

Corporate governance provides the integrated strategic management framework necessary to achieve the outputs and outcomes required to fulfil organisational goals and objectives. Clearly defined roles and responsibilities are essential if we are to be realistically held accountable for our performance. Control structures, incorporating sound risk management, are a particularly relevant element of an effective governance framework because of their importance in promoting effective performance and ensuring accountability obligations are appropriately discharged.

In a recent ANAO publication entitled ‘Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control’ control is defined as:

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

The control structures within a corporate governance framework provide assurance to clients and the Parliament that an agency is operating in the public interest and has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. In contrast, weak internal controls provide an environment where there exists an opportunity to commit fraud.

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

> ‘Corporate governance is the organisation's strategic response to risk.’

The devolution of authority and accountability to agency heads, from various public sector reforms over the last fifteen years and particularly the recent changes to financial and industrial legislation, together with contracting out and contestability, has significantly increased the risk profile of agencies, as I pointed out earlier.

The public sector must manage the risks inherent in this new ‘market oriented’ environment if it is to achieve the levels of performance required and satisfy whatever accountability requirements have been determined. More than ever, this situation will require a formal, systematic approach to identifying, managing and monitoring risk. The intuitive, and often reactive, approach to managing risk that has characterised public sector management in the past will not be sufficient. We all know that reacting ‘after the horse has bolted’ is often quite costly and damaging to the credibility of agencies and Ministers. A more strategic approach is required to stay contestable in such an environment. This is a significant management challenge.
The growing recognition and acceptance of risk management as a central element of good corporate governance and as a legitimate management tool to assist in strategic and operational planning has many potential benefits in the context of the changing public sector operating environment. Such an approach encourages a more outward looking examination of the role of the organisation, thereby increasing customer/client focus, including a greater emphasis on outcomes, as well as concentrating on resource priorities and performance assessment as part of management decision-making. The risk management framework is also a useful means for management to be assured of this approach, including being able to defend their decision-making publicly.

My view of risk management is that it is an essential element of corporate governance underlying many of the reforms that are currently taking place in the public sector. It is not a separate activity within management but an integral part of good management process, particularly as an adjunct to the control environment, when we have limited resources and competing priorities. Against the background of the increasing use of a range of different service delivery arrangements; greater involvement of the private sector in the provision of public services; and with a more contestable/competitive market-oriented imperative risk management can only become more critical.

Risk management is primarily the responsibility of the CEO and/or board. Effective governance arrangements require directors to identify business risks, as well as potential opportunities, and ensure the establishment, by management, of appropriate processes and practices to manage all risks associated with the organisation’s operations.85

To be effective, the risk management process needs to be rigorous and systematic.86 If organisations do not take a comprehensive approach to risk management then directors and managers may not adequately identify or analyse risks. Compounding the problem, inappropriate treatment regimes may be designed which do not appropriately mitigate the actual risks confronting their organisations and programs. Recent ANAO audits have highlighted the need for:

- a strategic direction in setting the risk management focus and practices;
- transparency in the process; and
- effective management information systems.

Management of risk in the public sector involves making decisions that accord with statutory requirements and are consistent with public service values and ethics. This means that more, rather than less, attention should be devoted to ensuring that the best decision is made. This will require placing emphasis on making the ‘right rather than quick decisions’. That said, with the increased convergence between the public and private sectors, there will be a need to consider a private sector point of view where the focus on cost, quality and financial performance is an important aspect of competing effectively.

Complementary to a sound risk management approach is a robust system of administrative control, as I described earlier. The emphasis is on a more systematic approach to decision-making to manage, rather than avoid, risk. A good example is the growing use of computer-oriented rulebase (or expert) systems, particularly to
administer ‘complex legislative and policy material’. The notion of a control environment has to start from the top of an agency. To be effective it requires clear leadership and commitment. This imperative is reinforced by the interrelationship of risk management strategies with the various elements of the control culture.

The adoption of a sound and robust control environment at the top of an agency will strongly influence the design and operation of control processes and procedures to mitigate risks and achieve the agency’s objectives. The clear intent and message to staff should be that such processes and procedures should be designed to facilitate rather than to inhibit performance. This approach should be promoted as good management. In short, the control environment is a reflection of management’s attitude and commitment to ensuring well controlled business operations that can demonstrate accountability for performance.

It is useful to point out here that audit committees provide a complementary vehicle for implementing relevant control systems incorporating sound risk management plans. This view is shared by the private sector where corporate representatives have agreed that effective audit committees and risk management plans are an indication of best practice and markedly improve company performance, including decision making. The internal auditing function of an organisation plays an important role in this respect by examining and reporting on control structures and risk exposures and the agency’s risk management efforts to the agency governance team.

An effective audit committee can improve communication and coordination between management and internal and well as external audit, and strengthen internal control frameworks and structures to assist CEOs and boards meet their statutory and fiduciary duties. The Committee’s strength is its demonstrated independence and power to seek explanations and information, as well as its understanding of the various accountability relationships and their impact, particularly on financial performance.

The CEO or the board of an organisation, together with senior management, are responsible for devising and maintaining the control structure. In carrying out this responsibility management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. The entity’s executive board, audit committee and internal audit are fundamental to this exercise. Management’s attitude towards risk and enforcement of control procedures strongly influences the control environment.

I cannot overstress the importance of the need to integrate the agency’s approach to control with its overall risk management approach in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively.

The key to developing an effective control framework lies in achieving the right balance so that the control environment is not unnecessarily restrictive nor encourages
risk averse behaviour and indeed can promote sound risk management and the systematic approach that goes with it. It must be kept in mind though that controls provide reasonable assurance, not absolute assurance that organisational objectives are being achieved. Control is a process, a means to an end, and not an end in itself. It impacts on the whole agency, it is the responsibility of everyone in the agency and is effected by staff at all levels.

The control structure will provide a linkage between the agency’s strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the organisation’s objectives and which adds value by focusing control efforts on the ‘big picture’. Public sector organisations will need to concentrate on the potential of an effective control framework to enhance their operations in the context of the more contestable environment that is being created as part of government reform policy.

Ensuring good corporate governance in an outsourced environment

In my view, corporate governance becomes more pressing in a contestable environment because of the separation of core business operations and the outsourced service delivery elements. This is because a sound corporate governance framework assists business planning, the management of risk, monitoring of performance and the exercise of accountability. While we can, and should, learn from private sector experience in such areas, public sector managers would do well to be mindful of the need for transparency and the interests of a broader range of stakeholders particularly when assessing and treating risk. We may not always be responsible for delivering public services but inevitably we will be held accountable for results.

The alignment between these core public service values and those of a contractor are particularly important in any outsourcing arrangement. Such alignment is essential if there is to be a genuine partnership arrangement in place, particularly where an organisation’s core business is involved. However, as observed by the well known author and academic Peter Hennessy:

‘Pieces of paper are one thing, real belief systems quite another. It is very hard to export the public service ethic into the private contractor hinterland. Commercial contracts are not susceptible to a foolproof, public service ethical override’.89

The issues of openness and transparency have to be accepted as essential elements of public sector accountability. The public sector has to act both in the public interest and, in common with the private sector, to avoid apparent personal conflicts of interest to the maximum extent possible. These will be particular challenges for agency managers in establishing credible corporate governance frameworks within public sector agencies that are increasingly being asked to act in a more private-sector manner while maintaining public accountability.

It has been suggested that good corporate governance is based on the premise that corporate officers operate best when they are held to account for what they do.90 Accountable individuals know that they must be prepared to defend their decisions – that they have accepted responsibility for the decisions that they make. In short,
accountability provides a way of measuring performance in a practical operational manner that makes sense to those involved.

However, accountability also implies acceptance of responsibility. To date in the public sector, there has not generally been absolute clarity on the extent of a public sector employee’s, officer’s, CEO’s, and board member’s accountability for implicit or explicit action that can affect the citizen. However, the onset of reforms is increasingly raising awareness of, say, legal accountabilities, just as in the private sector. But there is also recognition of the innate complexities of public accountability with its multi-faceted approach that has to be managed at all levels of an organisation.

V. CONTRACT MANAGEMENT

In Australia, the objective of the Government’s reform agenda has been to focus the Australian Public Service on its core activities, that is, policy development, legislative implementation, and the contracting and oversight of service delivery. As a consequence of the greater use of outsourced services as components of program delivery, contract management has become a more critical element in public administration. Public service agencies must strive to maximise overall ‘value for money’ for citizens which requires consideration of not only output costs but issues such as client satisfaction, the public interest, fair play, honesty, justice and equity, as noted earlier.

While the move towards outsourcing of government services has been gathering momentum for a number of years, the trend now encompasses not just the support service contracts, with which most organisations are familiar, but also elements of agencies’ ‘traditional’ core business. This trend is unlikely to reverse in the foreseeable future. It is therefore incumbent on Australian Public Service managers to refine their skills and knowledge to embrace their role as managers of outsourced (contractual) arrangements, as well as the developers of policy.

While the public and private sectors could be said to be converging or re-converging in historical terms, there remain (necessary) differences which are exemplified in the area of contract management (by which I mean the whole process from the initial release of tenders through to ongoing contract performance monitoring). The nub of these differences is that the taxpayers’ dollars are at stake. For instance, the awarding of contracts must of necessity follow a process which has ensured open and effective competition and the realisation of value for money. The reasons for a particular source selection need to be written up and be able to withstand scrutiny, including from the Parliament. Contracts have to be put in place with performance standards clearly specified including appropriate arrangements for monitoring and reviewing contractors’ performance.

It is important to recognise that managing an outsourcing contract starts before any decision has been taken on the selection process, let alone dealing with any relationship with the service provider. For this reason, proper project planning is essential to a successful outsourcing partnership. Indeed, the previous Australian Government Solicitor observed that:
There is often an inverse relationship between the amount of time spent in preparing tender and contract conditions and the resources required to deal with problems in contract administration and disputes after the contract has been formed.  

There is a wide body of administrative case law and procedural guidance applying to government procurement in Australia. The resulting framework embodies important principles such as value for money, open and effective competition, ethics and fair dealing, and accountability. The salient point is that the level of procedures required in the selection process should be in direct proportion to the extent and complexity of the services to be provided.

In the appropriate circumstances, the use of competitive tendering and contracting promotes open and effective competition by calling for offers which can be evaluated against clear and previously stated requirements to obtain value for money. This in turn creates the necessary framework for a defensible, accountable method of selecting a service provider. Significantly, a sound tendering process and effective management of the resulting contract are also critical for the efficient, effective and sustainable delivery of programs.

However, the more rigorous the selection process is, the more protracted the contract negotiation process is likely to be; the more clear and quantifiable the performance standards are, the less likely that there will be an unsatisfactory outcome. In essence, the issue is a trade-off between administrative and accountability processes (or simply ‘bureaucratic red tape’ in the eyes of some) and their impact on costs and prices. Put another way, the challenge of contract management is to maintain accountability and transparency throughout the process, with the ultimate end of achieving cost efficiencies and value for money outcomes. What also needs to be kept in mind is the cost associated with contract management which partially at least offsets the latter, as many studies of outsourcing have shown.

Crucial to meeting the challenge is the contract itself and how it is subsequently managed. The purpose of a contract is to make a legally enforceable agreement. Our audits have clearly illustrated the value of written consultancy contracts that reflect the understanding of all parties to the contract, and which constitute the entire agreement between the parties. Otherwise, the documentary trail supporting the authority for the payment of public money and contractual performance requirements, incentives and sanctions may not be clear. It is recognised that contractual performance is maximised by a cooperative, trusting relationship between the parties. However, it should never be forgotten that such relationships are founded on a business relationship in which the parties do not necessarily have common objectives.

The contract must clearly specify the service required; the relationship between the parties needs to be clearly defined, including identification of respective responsibilities; and mechanisms for monitoring performance, including penalties and incentives, set in place. There should not be any equivocation about required performance nor about the obligations of both parties. I stress that this is as much about achieving the desired outcome as it is about meeting particular accountability requirements. Both require sound, systematic and informed risk management which recognises that:
‘... managing contract risk is more than a matter of matching risk-reducing mechanisms to identified contract risks; it involves an assessment of the outsourcing situation.’

It must be emphasised that effective contract administration goes beyond merely holding contractors to account for each minute detail of the contract. Other key elements of an effective contractual framework include:

- using risk management principles to underpin the contracting process;
- using relevant expertise (such as financial, legal and probity advisers), where necessary, to ensure that both the process leading to signing the contract and the contract itself complies with relevant guidelines and requirements;
- making provision for appropriate access to records and premises by the agency and the Auditor-General to allow them to have sufficient access to fulfil their respective accountability requirements; and
- establishing clear mechanisms for assessing and monitoring performance in the contract, including consideration of sanctions and/or incentives.

To get the most from a contract, the contract manager and contractor alike need to nurture a relationship supporting not only the objectives of both parties but which also recognises their functional and business imperatives. As stated previously, it is a question of achieving a suitable balance between ensuring strict contract compliance and working with providers in a partnership context to achieve the required result. The concept of partnerships and partnering is something I will address in greater detail later.

On the issue of contract preparation and management, Australia’s Productivity Commission has suggested that public sector agencies tend to transfer as much risk as possible to the agent, thus increasing the risk of contract failure. Conversely, bad contract design leaves too little risk with the agent. This can lead to poor service delivery and resulting political problems for the government. The latter reflects the rights of service recipients as citizens who are not party to the principal-agent relationship. This can create other problems as indicated in the following observation:

‘Probably the greatest accountability weakness, from the standpoint of service recipients and other third parties affected by the actions of a contractor, is the limitations of private contract law in dealing with the interests of parties not covered by the privity of contract between the government agency and the contractor.’

In this context, it needs to be recognised that each step in the contract management lifecycle requires management of the business risks associated with that step and management of the performance of that step to maximise the potential benefits to accrue to the organisation. This involves managing risks and resources—both internal and external – at all stages of the contract, namely:
specifying the activity;
selecting the acquisition strategy;
developing and releasing the tender documentation;
evaluating the tender bids;
decision and implementation;
ongoing management; and
evaluation and succession planning.

Nevertheless, contracts should not be a daunting process for either party. The ideal contracts are the ones that you can leave in the bottom drawer but at the same time you are confident that, if a challenge were to arise, the government’s interests are well protected. Such an ideal reflects the establishment of a genuine partnership between the public and private sectors. It is an arrangement whereby the parties operate in tandem rather than at arm’s length and where there is room for some give and take. But the boundaries have to be clear enough that each request for a service or product does not result in either or both of the parties scrambling for the contract to settle differences.

During recent years the management of contracts by public sector agencies has been of particular concern to my Office and I have tabled a number of audit reports which address this area:

- One agency selected a service provider and provided advanced funding of 80 per cent of the contract fee to a contractor without undertaking any financial viability checks on the contractor. The contractor later abandoned the project before it was fully completed because of the withdrawal of its financial backers. As a result the agency terminated the contract and has taken legal action in an endeavour to protect any remaining Commonwealth funds held by the contractor.95

- Similarly, the audit of the $5 billion project for six new submarines found that, although only two submarines had been provisionally accepted by the Navy, the agency had paid over 95 per cent of the construction contract funds. This was compounded by the finding that the contract only provides modest recourse by the Commonwealth by way of financial guarantees and liquidated damages for late delivery and under-performance.96

- In conducting the initial sale of Telstra shares, advisers were appointed without having regard to the fees quoted by the tenderers because the Commonwealth agency considered the expected outcome in sale proceeds to be more important than sale costs. The contract fees, amounting to some $91 million, are the highest ever paid in a Commonwealth public share offer and were significantly above those indicated by other tenderers. Furthermore, the contractual arrangements required fees to be paid for services that were not provided and other fee payments departed from the terms of the relevant contract, which the
agency said did not fully capture the commercial understanding of the parties as to the basis on which fees would be calculated and paid.97

• In 1997, the supplier of passenger and commercial vehicles to the majority of Commonwealth bodies (known as the DASFLEET) was finalised for a price of $408 million. Associated with the sale, a five year tied contract was signed for vehicle leasing and fleet management to be provided by the purchaser to the Commonwealth. The audit of the sale found that the financial implications of the tied contract are such that the Commonwealth is exposed to a range of commercial risks including increased leasing charges (the sale was intended to reduce costs) and potential responsibility for the cost of terminating the contract. As a result of an audit recommendation, the relevant agency initiated a comprehensive review of the Commonwealth’s financial exposures under the contract.

• An important part of the 1994 sale of the former Commonwealth Serum Laboratories (now CSL Ltd) was the execution of a ten year contract for A$1 billion between the Federal Government and the soon to be privatised company for the supply of blood plasma products. The audit of the sale process found that systems had not been established to manage the risk of overpayments under this contract. A follow-up audit of the sale audit, focusing on the administration of the long-term contract by the relevant public sector agency was recently completed. The audit found that the management of the long-term supply contract was deficient in relation to the planning and conduct of commercial negotiations over price adjustments and inadequate financial controls over the payment of more than $400 million in public funds for blood products. The audit also highlighted the need for corporate governance structures that ensure appropriate action is taken to address issues that are raised by internal and external audits.98 This helps to promote improved performance and accountability.

A common theme of these audit reports has been the deficiencies in the project management skills of agency decision makers, despite the fact that some of these projects involve substantial resources and complexity. As well, reports have flagged a need for care in assessing value for money and negotiating, preparing, administering and amending major contracts. The Parliament and the media have also paid particular attention to these issues during recent years with several agencies receiving significant adverse comments and publicity. This situation has to be addressed as a matter of urgency. The public service has to reverse these concerns to win back the confidence of all stakeholders.

Each of the above examples highlights the importance of having a strong project and contract management skills base which can be drawn upon to make decisions and to achieve the required results. This does not necessitate a full time complement of skilled project and contract managers. Rather, agencies should ensure that, if the current decision makers do not have the requisite skills, sufficient external expertise is obtained. Such external expertise may be required, for example, in relation to the financial, legal and technical aspects of contract management.
The significance of agencies having a clear understanding of the legal imperatives associated with contracting was highlighted in a recent seminar in Australia which discussed among other things, the convergence of legal and commercial risks and the need for planning and sound systems for contract management, particularly over the whole life of the contract. Recent judicial decisions have also emphasised the importance of having a legally defensible tender process as an integral part of contracting out. It has always been important for the tender process to be commercially defensible. However, recent rulings have demonstrated that commercial interests are also served by what has to be done to meet legal requirements.

Performance accountability

Although the public sector may contract out service delivery, this does not equate to contracting out the responsibility for the delivery of the service or program. It is the responsibility of the agency and agency management to ensure that the government’s objectives are delivered in a cost-effective manner. The agency must therefore specify in the contract the necessary level of service delivery and required quantitative and qualitative service standards and measures. However, it has also been suggested that:

‘Contracts should be framed for performance rather than detailing how to achieve this performance.’

Put another way, the imperative is often more about cost effective ways to seek solutions to defined problems or requirements in the market-place rather than to attempt to specify those solutions which essentially means an implicit shared responsibility for results between the purchaser and provider. Worse still, there may be a commensurate lack of commitment where there is no real ‘ownership’ by the provider.

Contractors can expect to have their performance scrutinised both by purchasing agencies and by review bodies such as the Auditor-General. Some of my recent audit reports suggest that many contractors have yet to fully appreciate this aspect of working for government or to embrace the higher and/or different standards of accountability that are required when public money is involved. The latter is essentially the issue being covered by this address with any trade-off possibly being more about the nature and level of accountability rather than about efficiency per se. However, it is not difficult to envisage at least some cost for accountability over a purely market-oriented transaction.

Contracting, while providing the benefits of cost efficiency and enhanced service delivery, can expose the public sector to increased risk. The public service is, in many cases, no longer directly responsible for program outputs, instead being reliant on a private sector contractor for the provision of particular services or products. Nevertheless, the relevant agency is still accountable for those outputs under current accountability requirements. Accordingly, an agency must also ensure that an adequate level of monitoring of service delivery under the contract is undertaken as part of the agency’s contract administration and in line with its broader service delivery responsibilities, such as might be set out in a Client Service Charter. Particularly with large and complex projects there should be provision for:
The competent management of the contract is often the Commonwealth’s key means of control over its outputs and their contribution to outcomes. This is why it is essential that we ensure our staff have the capability and capacities to manage contracts effectively if we are to achieve the results required of us. But I stress that it is not just skills in relation to contracting that are important, there is still a high premium on knowledge and understanding of the functions/business that we are managing. Put simply, we have to be in a position to know what we are actually getting under a contract and whether it is meeting the objectives we set. If we do not, we are virtually risking the success of our agency and its very reason for being.

There is no doubt that the more ‘market-oriented’ environment being created is inherently more risky from both performance and accountability viewpoints. To good managers, it is an opportunity to perform better, particularly when the focus is more on outcomes and results and less on administrative processes and the inevitable frustration that comes from a narrow pre-occupation with the latter. Having said this, it is important for us all to remember that the Public Service is just as accountable to the Parliament for the processes it uses as for the outcomes it produces. That is inevitable and proper. In my experience, however, some agencies, faced with the prospect of adverse comment in an audit report about the transparency and accountability of their risk management or other processes, have argued for a greater emphasis on the outcomes achieved by the agency. The following observation made by the then Chairman of the Australian Senate’s Standing Committee on Finance and Public Administration, reflects well my response to such arguments:

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

Sound contract management, and accountability for performance, are dependent on adequate and timely information. Therefore it is important that agencies consider the level and nature of information to be supplied under the contract and access to contractors records they require to monitor adequately the performance of the contractor. However, the more detailed the performance standards, the specific requirements for rigorous reporting and monitoring and the need for frequent renegotiation and renewal, the closer the contractual arrangements come to the degree of control and accountability exercised in the public sector. Once again, it is a matter of balancing any trade-offs in efficiency and/or accountability if optimal outcomes are to be secured. Nevertheless, it has been indicated that:
‘... the quality of service improved by 38 per cent when a performance monitoring system was implemented.’  

At present my Office does not have a legislative provision similar to that which applies in the United States that guarantees access by government auditors to the private sector service providers’ records. However, we have been encouraging the inclusion of a suitable access clause in contracts of this nature and have drafted model access clauses which have been circulated to agencies for insertion in contracts. These clauses give the agency and the Auditor-General access to contractors’ premises and the right to inspect and copy documentation and records directly related to the contract.

While the need for the external auditor to have access to the premises of third party service providers is likely, in practice, to be required in very few situations, such access, where necessary, would contribute to an audit being undertaken in an efficient and cooperative manner. As well, it is important for both management performance and accountability. In the main, audit and management’s interests in access are likely to coincide. In my view it is a matter of educating both parties, whether public or private sector, to the requirements of a successful relationship or contract. Vague relationships do not assist either party; nor do they lend confidence to the partnership or use of contractual arrangements. Such accountability is an aspect of the public sector environment with which the private sector is becoming more familiar as outsourcing develops further.

My Office’s experience has shown that agencies have not fully embraced these opportunities. For example, an examination of 35 contracts business support process across eight agencies found that only two of those contracts referred to possible access by the Auditor-General. None of the contracts reviewed, entered into since my Office provided advice concerning standard access clauses, contained the recommended provisions. Furthermore, the level of consideration given to the inclusion of such access provisions in those contracts by agencies was not apparent. Such an approach is unlikely to foster optimum performance nor contribute to appropriate accountability.

**Commercial confidentiality**

The issue of access of information for contract management purposes is linked strongly to that of the commercial confidentiality of certain information. This is an area that has been the subject of considerable parliamentary concern and comment in many constituencies both in Australia and overseas.

I consider that the question as to whether or not commercial-in-confidence information should be disclosed to the Parliament should start from the general principle that information should be made public unless there is a good reason for it not to be. In other words, there should be, in effect, a reversal of the principle of onus of proof, which would require the party that argues for non-disclosure to substantiate that disclosure would be harmful to its commercial interests. This view was also recently endorsed by the Public Accounts and Estimates Committee of the State of Victoria.

Nevertheless, in the context of the Auditor-General’s responsibilities, I am sensitive to the need to respect the confidentiality of genuine ‘commercial in confidence’
information. In our experience, we have found that, almost without exception, the relevant issues of principle can be explored in an audit report without the need to disclose the precise information that could be regarded as commercial-in-confidence. In this way, the Parliament can be confident it is informed of the substance of the issues which impact on public administration. It is then up to the Parliament to decide the extent to which it requires additional information for its own purposes.

The message here is that external scrutiny (through, for example, the activities of Parliamentary Committees and Auditors-General) is an essential element in ensuring that public accountability is not eroded, by default, through contracting out. Just as it is incumbent upon public sector agencies to ensure they have a sound understanding of the commercial nature of any contract, private sector entities need to recognise that there are overlaying public accountability issues, not present in purely private sector transactions, that need to be addressed. The latter need not unnecessarily deter private sector participation if handled appropriately.

Virtually all traditional accountability mechanisms rely on the availability of reliable and timely information. As a result of contracting out to the private sector, the flow of information available to assess performance and satisfy accountability requirements has on the whole been reduced. This situation has arisen where performance data is held exclusively by the private sector or through claims of commercial confidentiality that seek to limit or exclude data in agency hands from wider parliamentary scrutiny. Thus accountability can be impaired where outsourcing reduces openness and transparency in public administration. For this reason, the issue of commercial confidentiality is likely to be of increasing importance as the extent and scope of outsourcing grows. An highly respected academic from the Australian National University captured the concern as follows:

‘The test case is the accountability challenge posed by alternative service providers and their claims that their contracts with government lessen their liabilities of public accountability because of the 'commercial-in-confidence' nature of their performance information.’\(^{107}\)

As the reform of government service delivery continues to evolve, so has the focus of the debate on these accountability issues, with commercial confidentiality and public interest issues (particularly involving ‘sensitive’ information) becoming of increasing concern. The debate has not been limited to Parliamentarians and Parliamentary Committees, Auditors-General, and academics. For example, an editorial in an Australian newspaper last November commented on the Australian High Court’s judgement in relation to the tabling of documents before an Australian State Parliament stated that:

‘This defence (that papers were commercially sensitive and should not be released) is over-used by governments trying to avoid scrutiny and embarrassment and often represents arrogance of the first order; a democracy elects its representatives to act on behalf of the electorate as a whole, not of vested interests. The system requires the utmost transparency and direct accountability from its Parliamentary representatives. Lack of transparency and limiting the capacity of Parliament to review government decisions weakens our democracy.’\(^{108}\)
A recent report of the Victorian Public Accounts and Estimates Committee, quoted earlier, contains a very interesting and useful discussion on confidential commercial material and accountability.\textsuperscript{109}

The Australasian Council of Auditors-General has put out a statement of Principles for Commercial Confidentiality and the Public Interest. As an example, one of the Principles concludes that:

‘Some private and public sector bodies are instinctively apprehensive and protective about the disclosure of any commercial information. But such views often overstate the implied risks to an entity that might be occasioned by the release of commercial data. After-the-event commercial information has significantly less value than commercial information concerning events that have yet to occur. But even where commercial information might have commercial value to others, there are often overriding obligations that require it to be released. This is so for commercial information held in the private sector and, a fortiori, it applies to the public sector.’\textsuperscript{110}

The issues indicated in the above conclusion reflect a number of considerations which have exercised Auditors-General in addressing commercial in confidence material. A particular concern has been the insertion of confidentiality clauses in agreements/contracts which can impact adversely on Parliament’s ‘right to know’ even if they do not limit a legislatively protected capacity of an Auditor-General to report to Parliament. For example, the then Auditor-General of the State of New South Wales, recently observed that:

‘... it appears to me that governments just don’t want to be accountable and are using private sector participation and so are reducing the amount of information that’s available.’\textsuperscript{111}

At the heart of this debate is the on-going problem of clearly defining the ‘public interest’. The public interest is, of course, fundamental to democratic governance and is an issue that public officials, including auditors, continually grapple with. Again, the challenge is about striking the right balance between public and private interests. Legislation precludes publication by my Office of information whose disclosure would, among other things, be contrary to the public interest for reasons including unfair prejudicing of commercial interests of any body or person. Those reasons are more fully described in Section 37 of the \textit{Auditor-General Act 1997}.\textsuperscript{112}

The risk to accountability associated with claims of commercial confidentiality in relation to government contracts has recently been commented on by the South Australian State Auditor-General:

‘In situations where government contracting results in a long term transfer of material government responsibility to the private sector, the right of the people to know the extent and terms of that transfer must take precedence over less persuasive arguments in favour of confidentiality. Not only is the public affected by the transfer of what is government
responsibility but it is further affected by the creation of a new relationship (often long term) between government and a private entity. A relationship about which the public is entitled to advise, consent to or object to through both their Parliamentary representatives and other forums.'

This issue was also addressed by the Senate Finance and Public Administration References Committee in its 1997 Inquiry into Contracting Out of Government Services. My submission to that Inquiry noted that:

‘For agencies to be in a position to support the accountability obligations of their Minister and ensure adequate performance monitoring of contracted services, it is essential there be, at least, specified minimum levels of performance information to be supplied by the contractor to the agency, and agreed arrangements which provide for access by the agency to contract-related records and information.’

In making further recommendations to the Committee, I suggested, as did the Commonwealth Ombudsman, that in relation to commercial confidentiality claims by private sector contractors a reverse onus of proof test should be applied, that is:

‘In our view, the question of whether or not commercial-in-confidence information should be disclosed to the Parliament should start from the general principle that the information should be made public unless there is a good reason for it not to be. In other words, what we are saying is there should be a reversal of the principle of onus of proof which would require that the party arguing for non-disclosure should substantiate that disclosure would be harmful to its commercial interests and to the public interest.’

The Committee agreed and in addressing matters of commercial confidentiality concluded that:

‘The committee is firmly of the view that only relatively small parts of contractual arrangements will be genuinely commercially confidential and the onus should be on the person claiming confidentiality to argue the case for it. A great deal of heat could be taken out of the issue if agencies entering into contracts adopted the practice of making contracts available with any genuinely sensitive parts blacked out. The committee accepts that some matters are legitimately commercially confidential. If Parliament insists on a ‘right to know’ such legitimately commercially confidential matters, the most appropriate course to achieve this would be the appointment of an independent arbiter such as the Auditor-General to look on its behalf and, as a corollary, to ensure that he has the staff and resources to do it properly.’

One of the difficulties in addressing commercial confidentiality issues is that of precise definition as to just what is being covered. While there is broad understanding of the kinds of information which contractors might regard as commercially confidential, the question is how to ensure adequate accountability for the use of public funds while
ameliorating any justifiable ‘confidentiality’ concerns. Recent legal decisions have reiterated the importance of maintaining ‘proper confidentiality’ of tendering proposals.118 With the growing convergence between the private and public sectors referred to earlier, and the considerable increase in contracting, the issue has become a matter of practical importance and some urgency. A particular concern is that agencies may too readily agree to treat contractors’ documents as confidential, notwithstanding the wide access powers that may be provided to the Auditor-General.

VI. MARKET AND NETWORK BUREAUCRACIES

In an increasingly global environment, the question of competitiveness and/or contestability of the public sector against similar elements in the private sector, including benchmarking of performance, would seem to be likely to focus greater attention on the need to be more outwardly than inwardly focused in the future at least. External pressures may require the development of ‘real’ partnerships between the public and private sectors in the interests of maintaining national sovereignty and global competitiveness. The imperative would then be to develop a highly performing public sector to complement the private sector rather than just compete with it. In this respect, it is interesting to consider the United Kingdom (UK) ‘Modernising Government’ approach which stresses ‘partnership delivery’ by all parts of government as well as with the private sector.119 The UK National Audit Office subsequently reported on its response (and strategies) to that policy, including the notion of ‘joined-up’ government.120

In a similar context, a recent article by Professor Mark Considine and Jenny Lewis of the Melbourne University noted the emerging image of ‘network bureaucracy’ stressing co-production of results against ‘market bureaucracy’ with its emphasis on contracting-in and introduction of quasi-markets.121 The move to an output/outcomes framework for managing resources and measuring performance at the Federal Government level has engendered discussion about ‘shared outcomes’ and the strategic and other relationships between outputs that contribute to those outcomes and those organisations responsible for both. Nevertheless, while recognising there are debates, for example, about transactions costs issues associated with contracts and markets, academic writers have also pointed out the limitations of trust-based relationships, longer-term instability of inter-organisational networks, unintended consequences such as fraud and corruption and resistance to innovation and protection for under-performing organisations122. The issues are not simple and require wide-ranging debate but many might support the view that:

‘... the choice between markets, hierarchies and networks should be a matter of `practicality’ instead of `ideological’ conviction’.123

The theoretical framework of the market bureaucracy,124 sometimes referred to as “entrepreneurial governance” or “contractualism”, represents the current prevalent type of public organisation management, in which the internal elements of such agencies are structured around markets, and real or hypothetical tests of consumer demand. Market-type bureaucracies in Australia have taken shape in the rapid increase in recent years of the use of contracting in and between organisations, combined with the
proliferation of a range of ‘quasi-markets’ for certain public service provisions such as health, welfare and educational services.

Market competition provides a potential economic advantage by reducing some of the costs associated with the process of rational choice by allowing the market to determine available means to a defined end. The various solutions offered by potential contractors are considered to represent the feasible range of available strategies, combining both cost and quality considerations. Consequently, the contracting out of services simply requires selection from a known menu of public and private contractors. Academic research indicates that, typically, the market bureaucracy is divided into a strategic core of senior managers responsible for policy and shielded from competition, and a series of separate operational units run as quasi-businesses. These developed their own business plans, devised quotes, and decided work practices according to the real or potential threat faced from other contractors. The development of a contractual rather than employer-employee relationship thus provides senior management with the means to restructure their organisations without the costs of detailed negotiation and without previous forms of industrial dispute.

There are many examples of recent Australian Public Service initiatives that can be regarded as indicative of market bureaucracy at work in public organisations. As I noted earlier, the Defence Commercial Support program provides a significant opportunity for the private sector to participate in the delivery of defence support functions. A performance audit found that the program had heightened Defence’s awareness of the need for economy and contributed to greater cost-effectiveness of supplying support services. Furthermore, the private sector benefited immensely from CSP, winning 70 per cent of the market testing offers available. This proportion is substantially higher than similar programs operating in the US and the UK. While it is not easy to quantify the exact savings accumulated through programs like CSP, Defence projected recurring annual savings of $A155 million dollars. Market testing can clearly have its advantages for large public service agencies responsible for the provision of a wide range of services to a large client base. Its proponents argue that the real strengths of the market bureaucracy lie in its suitability for certain types of cost containment and means of terminating old programs.

What is not certain, however, is that the market form of organisation is effective in developing new systems of quality service delivery and creating functional institutional linkages within policy sectors. As such, there are several potential problems that can result through market bureaucracies.

First, there is scope for increased distortion and goal displacement through the declining use of internal rules and an increase in entrepreneurial behaviour by bureaucrats. There is also the potential for the corruption of central policy goals by contractors seeking to maximise short-term profits and other immediate material payoffs. For example, the extensive use of contracted service providers in some public sector agencies can have important implications for the agency’s ability to maintain its surge capacity in times of high demand, as the need for high level of service provision may be incongruent with the contractors profit motive. Again, Defence is one agency in particular where there is a need to ensure that the overall impact of support service outsourcing does not adversely affect core business and does not erode core capability by default. Further, current audit work in my office has found
evidence to suggest problems with the implementation of market testing and the management of private sector contracts for certain agencies have led to over-inflated contractor payments and excessive prices for contracted services.

An additional concern for Defence’s CSP program, which can be extended to similar programs used throughout the rest of the public sector, relates to the long-term cost-effectiveness of contracted service providers. Increased outsourcing in the Australian Public Service in the last decade has largely been conducted in parallel with the downsizing of the public service. Consequently, private contractors have been able to offer commercially attractive initial prices for support services simply by employing ex-agency employees made redundant through the course of the agency’s downsizing, which has eliminated the contractors’ needs for staff training. This process becomes disadvantageous to the agency when the successful tenderer becomes the monopoly supplier of the service, and the agency must subsequently renegotiate the contract from a position of weakness, having eliminated its own in-house capability to perform the particular service. This is an issue that is going to require increasing attention by public sector managers, as has been recognised by the Australian Parliament’s Joint Standing Committee on Foreign Affairs and Trade in relation to the Commercial Support Program:

‘Frequently, the successful tenderer for the support contract relies on recruiting the trained Defence personnel who have been made redundant in the ADF because of the function’s transfer to the commercial sector. Through employing these already-trained personnel, the successful civilian tenderer is able to provide a commercially attractive initial price for a support capability because there is no need to factor in staff training costs in the contract. This process becomes disadvantageous to Defence where the successful tenderer becomes the monopoly supplier of the support service, and Defence must subsequently renegotiate that contract from a position of weakness, having eliminated its own in-house capability to perform the particular function.’

On the other hand, a number of Federal Court decisions has raised the prospect of outsourcing being subject to the transmission of business provisions of the Workplace Relations Act 1996 which bind a new employer to the awards and agreements of the previous employer. While this can undoubtedly be covered in appropriate outsourcing contract conditions, its retrospective effect could be significant. The most recent such decision129 in relation to the Job Network arrangements previously mentioned, ruled that workers should retain public sector wages and conditions when these jobs are transferred to the private sector130. However the High Court, even more recently, has granted an employer leave of appeal against one of the decisions on ‘transmission of business provisions when outsourcing’. The sole test is if there is ‘a substantial identity’ between the work or service done by the new employer and that performed for the previous employer131.

Financial and performance risks associated with market bureaucracies have also become apparent in Australia as part of the outsourcing of employment services previously provided by the public sector that I mentioned earlier. Under the outsourced arrangements, payment structures and incentives for service providers are linked to the placement of job seekers in work. The publicly owned provider fared
poorly in the most recent round of tender, losing most of its contracted work to provide intensive assistance services, which are considered to be the most lucrative for service providers. However, there was public concern that the loss of these contracts could render the public service provider not financially viable and that it may not be financially viable for commercial entities to provide employment services in some areas, particular rural and regional areas. The Government has committed to fund the public service provider for three years in order to ensure rural and regional access to employment services.

Weaker levels of public accountability can also be characteristic of the market bureaucracy. Services that become market tested are subsequently subject to claims of commercial confidentiality, which restricts the public’s access to knowledge of how public funds are being spent. As outlined earlier, I consider that the question as to whether or not commercial-in-confidence information should be disclosed to the Parliament should start from the general principle that information should be made public unless there is a good reason for it not to be.

The weaknesses in market-based bureaucracies have seen the development of a concept of network bureaucracies. For example, in Australia, it has been commented that:

‘While the market form of organization is thought by its proponents to excel at certain types of cost containment, and is a favored means for terminating old programs, it is less certain that it is able to build new systems of quality service delivery and to create effective institutional linkages within policy sectors. Network advocates have begun to suggest that the competitive market bureaucracy may not mobilize support, share information successfully, invest in new technologies, create common service standards, and focus upon the individual needs of suppliers and clients. Furthermore, it is suggested, markets may undervalue the rights of individual clients when the cost of difficult clients is higher than the benefit to be gained from “creaming” only the better priced customers.’

In comparison, the network bureaucracy concept proposes interdependence as a binding characteristic where services are tailored to individual or small batch clients and costs are shared across an inter-organisational web of co-producers. Network agents are the local officials who take direct responsibility for establishing effective links between suppliers, co-producers and customers.

The adoption of a market-based approach to public administration has been reflected in Australia, for example, through the wide adoption of purchaser-provider relationships. However, there do appear to be indications that network bureaucracy concept is gaining favour, particular in the area of purchaser/provider relationships. For example, one recent ANAO report discussed how three welfare agencies were defining their particular outcomes and outputs and how the outputs of one of these agencies were directly related to the outcomes of the purchasing departments. These arrangements have subsequently expanded such that this particular Commonwealth agency (known as Centrelink) now delivers services on behalf of a total of four agencies under the formal purchaser/provider arrangements.
A further indication of a possible move towards network bureaucracies is the renewed focus on the needs of clients. This is, at least partly, a consequence of a Government decision in March 1997 to introduce Service Charters in order to promote a more open and customer-focused Commonwealth Public Service. All Commonwealth Departments, agencies and Government Business Enterprises that have an impact on the public must develop a Service Charter. These Charters are to represent a public commitment by each agency to deliver high quality services to their customers. Where relevant, the charters will guarantee specific standards for service delivery. The importance of such performance has been stressed by the Senate Finance and Public Administration Legislation Committee in the Annual Report context as follows:

\[\text{The Committee will continue to monitor the results of implementation of charters to ascertain the extent to which identified customer needs and quality of services are being met and that any problem areas are addressed.}\]^{137}

Again, the notion is to make the public sector more accountable to the general Australian community and more outcomes focused. The New Zealand Auditor-General has recently published a comprehensive report on service delivery including best practice criteria and a discussion of what distinguishes public from private services.\[^{138}\] As well, the report included an analysis of service delivery over the Internet.\[^{139}\]

Where service delivery has been outsourced, Service Charters will clearly have a direct impact on the private sector contractor. In particular, it is to be expected that outsourcing contracts will need to reflect the Service Charter commitments if the Charters are to have any meaning. It will also be important to require, as part of the contractual arrangement, the provider to supply outcome, output and input information against which the provider’s performance can be assessed, including whether processes are efficient and the service quality is satisfactory. In this way, even if the client is one or more steps removed from the responsible department, it should still be possible to ensure clients are receiving the appropriate level and quality of service, consistent with the Service Charter. Such an approach may also be expected to reinforce the notion of both the private sector provider and the contracting agency being dependent on one-another for delivering a satisfactory level of performance and accounting for this performance. Whether this could be best achieved by means of a ‘soft’ contract would need to be tested on a case-by-case basis.\[^{140}\]

Further evidence of a push for greater interdependence between the public and private sectors is the increasing popularity of the notion of partnerships in the delivery of public services. This concept refers to the public sector working in partnership with the private sector, or indeed any public sector agency working in partnership with another agency and with private sector firms, for example through purchaser/provider arrangements, to deliver public services. Such arrangements are also likely to be encouraged through the increased adoption and impact of E-Commerce with its focus on coordination and collaboration in the business environment in particular and with shared data bases as well as greater electronic integration in a virtual ‘one-stop’, or even ‘no-stop’, service delivery environment. Partnerships depend on common understanding, trust and goodwill, not legal compulsion. However, the reality is that there will be testing times even in the best of relationships. Consequently, it is good
practice for such relationships to be based on sound tendering and administrative processes and an enforceable contract aimed at ensuring a responsive public service to citizens.

VII. CONCLUDING REMARKS

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

Convergence represents a major challenge for public service managers to establish an appropriate balance between achieving cost effective outcomes and accountability for the manner in which public sector resources are used. While the public sector reforms demand a greater focus on achieving efficient and effective outcomes for citizens, we also need to recognise that such outcomes also depend importantly on robust and credible administrative and management processes. In short, good processes should ensure good outcomes. They are complements not alternatives.

As experience has shown, savings and other benefits do not flow automatically from privatisation and commercialisation. Accordingly, the convergence of the public and private sectors raises a number of important questions for public sector managers, their private sector partners and accountability institutions such as Auditors-General. Significantly, the privatisation of the public sector does not obviate the need for proper accountability for the stewardship of public resources, as it is accountability that is fundamental to a democratic system. Furthermore, in my opinion, accountability can contribute to improved performance in terms of value for money.

Such a relationship is reflected in the integrated nature of effective corporate governance frameworks. The public sector does have something to learn from the private sector in this respect while recognising the public interest factor and associated wide-ranging accountability requirements of the former. On the other hand, if privatisation of public services is to work effectively, private sector providers have to recognise the rights of citizens not just as customers or clients, and the associated accountability that goes with that recognition.

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

‘... as long as management in the public sector continues to be assessed by private sector standards, and as long as the private sector continues to be increasingly entrusted with public purposes, both political and social as
In my opinion, there needs to be at least some movement towards striking a balance on the appropriate nature and level of accountability and the need to achieve cost-effective outcomes by:

- emphasising project and contract management skills in public sector managers;
- basing commercial relationships on sound tendering and administrative processes and an enforceable contract; and
- ensuring that public accountability is not eroded, by default, through contracting-out that reduces external scrutiny through public reporting and the activities of Auditors-General.

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

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

However, are these necessarily roadblocks to consideration of a different kind of public accountability? This is an issue basically for governments and Parliaments to resolve. In the meantime we have to deliver the ‘expected’ accountability by those stakeholders and seek the cooperation of private sector providers in doing so. Hopefully, this will be more likely to be in partnership mode where both parties understand and act on public interest and commercial imperatives that need to be met by public sector purchasers and private sector providers respectively. The notion of partnership should also extend to agency and entity cooperation and coordination, particularly on setting strategic directions and sharing of better practice. This is evident in what appears to be a move towards greater networking rather than simply growing market-based bureaucracies. Nevertheless, the two approaches may be mutually reinforcing rather than mutually exclusive.

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

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

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

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

‘... continue to question, in estimates and in annual report or other agency operating processes, such matters as the delivery of services when contractors go to the wall, legal costs, the immediate and longer-term costs and benefits of the use of contractors, the probity of tender processes, et cetera.’

At the very least, we will need to be in a position to respond in a timely and effective manner to such questions as part of our accountability to Parliament.
NOTES AND REFERENCES

6. Ibid., (page 2).
13. Ibid.
14. Ibid.
15. Ibid.
20. The main types of ‘market failure’ occur: when there is ‘monopoly power’ in a market; if there is insufficient or inadequate information available; when goods or services are ‘public goods’; when there are external costs or benefits (externalities or spillovers) resulting from a transaction in a market; dealing with excessive competition; controlling for moral hazard; and rationalising inefficient industry. Australia (September 1995), Office of Regulation Review, A Guide to Regulation Impact Statements and Cranston, R.F., (1982) “Regulation and Deregulation: General Issues”, University of New South Wales Law Journal, Volume 5 (1-28), (page 5).
24. Ibid.
For example, in February 1995 the Barings investment bank failed as a result of over $1 billion in futures and options trading losses incurred by one of its employees. Similarly, in December 1994, Orange County in California filed for bankruptcy after losing an estimated $1.7 billion on the county Treasurer’s large and highly leveraged investments. Another example involved a major OTC derivatives dealer which, according to the Federal Reserve Bank of New York, failed to adjust its internal controls in response to a riskier new line of business, namely marketing and sales of leveraged derivatives. Source: United States General Accounting Office 1996, ‘Financial Derivatives - Actions Taken or Proposed Since May 1994’, Washington, November, Chapter 2:1.

For example, the January 1991 decision of the United Kingdom House of Lords in the Hammersmith and Fulham case voided derivatives contracts between more than 130 local councils and over 75 of the world’s largest banks. The House of Lords ruled that the London Borough of Hammersmith and Fulham, a local government authority that had been an active participant in the market for sterling interest rate derivatives, lacked the capacity to enter into those transactions.


In late 1997 I completed a performance audit of government monitoring of the activities of Government Business Enterprises. The audit noted a Government owned rail transportation and freight business that had entered into financing arrangements based on future gold prices and movements in the Japanese Yen currency. The report concluded that governance arrangements for such enterprises needed to be strengthened in order to manage the risk that activities not directly related to business purposes were properly considered and authorised and reduce the risk of future calls on the government budget. Source: Audit Report No. 2 1997-98, ‘Government Business Enterprise Monitoring Practices’, Canberra, September, (pages 43 to 45).


For example, in October 1998 I tabled Audit Report No. 10 1998-99, ‘Sale of One-third of Telstra’. The audit concluded that, as an essential element of the outsourcing of project management for future Commonwealth public share offers, overall value for money could be improved by giving greater emphasis to financial issues when tendering for advisers; encouraging more competitive pressure on selling commissions and fees; paying fees only for services actually provided; and instituting a more effective and commercial approach to administering payment for shares by investors.

The Financial Management and Accountability Act 1997 requires Chief Executive Officers of Commonwealth agencies to promote efficient, effective and ethical use of Commonwealth resources (Section 44).

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

Statement of Accounting Standard AAS21, 1985. ‘Accounting for the Acquisition of Assets (including Business Entities)’.

These were the subjects of two Reports by the Audit Office of New South Wales, 1995. ‘Private Participation in the Provision of Public Infrastructure: The Roads and Traffic Authority’, New South Wales Auditor-General’s Office, 1994; and, Roads and Traffic Authority: the M2 Motorway, Performance Audit Report, the Audit Office of New South Wales,


The Discussion Paper identified the following lessons, reflecting a large degree of consistency, from case studies:

- **Know what you want, but avoid over prescription.** Specify outcomes and standards rather than process.
- **Long term contracts, defined as at least 7 years, but usually in the 15 to 35 year range, are needed for the private sector to recoup investment.**
- **Assessment of projects should be based on the private sector’s cost of capital rate, which in turn is based on the project risk.**
- **Projects need to be aggregated to an economic size, rather than a number of small ‘packets’, taking into account the benefits of proposals over the life of the asset and the benefits to the organisation as a whole.**
- **Private financing involves higher initial transaction costs, and higher cost of finance, than traditional procurement, which need to be offset by whole of life savings and benefits. For this reason, private finance and traditional tendering processes should not normally be carried out in parallel.**
- **Contracts have generally led to improvements, either through savings or through an improved level of service.**
- **Risk assessment and management is critical to success.**
- **A centre of expertise is necessary in private financial policy and practice, as is ready access to external financial expertise, to effectively manage and assess privately financed projects.**
- **Competition needs to be retained in the marketplace as much as is practicable.**


Ibid, (pages 9 and 10).

Ibid., (page 5).

Fulwider Donald G. 1999. ‘Recognizing Fraud Indicators’. International Journal of Government Auditing, Vol.26, No.2, April (page 13). The author provides examples of signs, signals and patterns indicating fraud which may be encountered during an audit such as Weak Management with its failure to enforce existing controls, inadequate oversight of the control process, and failures to act on fraud; and Loose Internal Controls with inadequate separation of duties involving cash management, inventory, purchasing/contracting and payments systems which allow the perpetrator to commit fraud. (page 13).


Department of Finance and Administration, 1999, ‘Submission to the JCPAA Inquiry into Corporate Governance and Accountability Arrangements for Commonwealth GBEs’.


Ibid., (page 29).


Section 37(2) of the *Auditor-General Act 1997* sets out the following reasons for non disclosure of information in the public interest:

(a) it would prejudice the security, defence or international relations of the Commonwealth;
(b) it would involve the disclosure of deliberations or decisions of the Cabinet or of a Committee of the Cabinet;
(c) it would prejudice relations between the Commonwealth and a State;
(d) it would divulge any information or matter that was communicated in confidence by the Commonwealth to a State, or by a State to the Commonwealth;
(e) it would unfairly prejudice the commercial interests of any body or person;
(f) any other reason that could form the basis for a claim by the Crown in right of the Commonwealth in a judicial proceeding that the information should not be disclosed.’


Ibid., (page 71).


Ibid., (page 12).

Op.cit., Considine and Lewis (page 471)

Ibid.


Joint Standing Committee on Foreign Affairs, Defence and Trade 1998, ‘Funding Australia’s Defence’ (page 35).


Ibid.


Ibid., (pages 128 to 135).


