‘TAKING OUT CORPORATE GOVERNANCE INSURANCE ON RISK’

Presentation by

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to

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1. INTRODUCTION

I am pleased to be invited to present, at this Risk Odyssey 2001 conference, a Commonwealth public sector perspective on risk management issues within the context of corporate governance. I am certain that this forum will provide an opportunity to explore and discuss some important issues associated with the management and operation of agencies and businesses at a time of significant reform of the public sector, and particularly transformation, in its delivery of public services.

Risk management is a central element of any corporate governance framework, whether in the private or public sectors. Systematic risk management is not just an option for organisations. Moreover, it requires considerable commitment, ownership and particularly investment, by senior management and generally at all levels of the organisation. A sound corporate governance framework can help to provide the essential discipline and structures, as well as a level of assurance to management and staff that not only are performance requirements of stakeholders being addressed but also that effective action is being taken to achieve expected results. In these respects, it is not pushing the analogy too far to suggest that such a framework is also a good insurance policy against the increasing risks confronting organisations both in terms of taking the opportunities they present in a timely manner and minimising any adverse impacts that such risks might involve.

Corporate governance has been seen as relevant to the public sector in recent years. The greater involvement of the private sector in public sector activities, including in service delivery, means that we need to understand better the similarities and differences between the sectors, including in risk identification, assessment, treatment and monitoring/review as the basis for corporate and operational strategic planning and build this into the established public sector governance context. This is central to our performance on which we will be judged and, indeed, to our organisational survival in a period of considerable change.

Moreover, in an increasingly global environment, the question of competitiveness and/or contestability of the public sector against similar elements of the private sector, including benchmarking of performance, may, in the future, be more internationally focused than nationally based, thus expanding the risk horizons. The imperative may be therefore more about establishing effective partnerships between those sectors within national boundaries to enhance country sovereignty and global competitiveness rather than just focussing on competition between the sectors. While the notion of such partnerships is not new, there are many issues to address, particularly in the public sector context, to ensure they are credible and workable in an operational sense.

As with any risk assessment process, the following part of this presentation starts with an examination of the environment in which we are operating and the major factors impacting on it from a risk management perspective. The third part outlines the various elements of a corporate governance framework in order to explain how they can assist in both addressing and dealing with risk in a positive and systematic manner. The fourth part provides some examples of major risks confronting the federal public sector and ways in which they are being dealt with. Finally, I will
provide a brief overview of the on-going challenges we face in dealing effectively with risk and stress the importance of on-going investment in our corporate governance frameworks as a necessary insurance in that respect, as it is in many others.

2. UNDERSTANDING OUR CHANGING ENVIRONMENT

It is not possible to do justice to the many factors impacting on the public and private sector environments, including their increasing interrelationships, as part of this background material. Nevertheless, it is important to have some understanding of those factors to assess both the risks being confronted as well as the importance of a sound corporate governance framework to help deal with them.

Reforming the public sector

The Australian Public Service (APS) reform agenda has spanned almost two decades. Similar reforms have been conducted at local and State government levels, albeit in different timeframes and to varying degrees. Australian governments generally have been focussing increasingly on achieving a better performing public sector and less costly, more tailored, or better oriented, and higher quality services to citizens. Governments have reacted to budgetary pressures on expenditure and, at the same time, strong demand from the community for the maintenance and even extension of government services, by seeking to make the administrative elements and structures that provide public services more efficient and effective. The Commonwealth Government’s aim for the APS has been outlined by the then Minister Assisting the Prime Minister on Public Service Matters as follows:

The Government is looking at more effective ways of serving the Australian public. It is no longer appropriate for the APS to have a monopoly. It must prove that it can deliver government services as well as the private or non-profit sectors. This will require a new emphasis on contestability of services, outsourcing those functions which the private or non-profit sector can undertake better and ensuring APS commitment to the process of performance benchmarking and continuous improvement.¹

Accordingly, the APS has been steadily evolving towards a more private sector orientation with a particular emphasis now on:

• the contestability of services;
• the outsourcing of functions which the private sector can undertake more efficiently;
• adapting or adopting private sector methods and techniques;
• an accent on continuous improvement to achieve better performance in an environment of devolved authority and greater management flexibility;
• ensuring a greater orientation towards outcomes, rather than just on process; and

• 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 citizen 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 at the federal level in Australia has involved 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 A$50 billion in Commonwealth assets or business to private sector owners.

Accountability, risk management and corporate governance in an environment of public sector reform

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 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 and prices. Such issues include client satisfaction, the public interest, fair play, honesty, justice, security and equity. With the greater participation of the private sector in the delivery of public services, one question is to what extent can, or should, both sectors share responsibility and accountability in at least some of these latter respects as well as for the risks that go with them?

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. Market-testing, competitive tendering and contracting out all 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, as well as encouraging a focus on corporate governance 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.

In the context of the Australian public sector, ‘accountability’ implies conformity with a system of administrative processes designed to provide authority for administrative actions and, at the same time, a framework for reporting and checking on actions taken.² In this way, accountability measures seek to ensure that public sector agencies and their staff are responsible for their collective and individual actions and the decisions leading to them, and are then required to submit themselves to appropriate external review, checking and scrutiny.

It is sometimes put by government members of Parliament that the ultimate form of accountability is the fact that governments are subject to the decision of the people at election time (see, for example, Dr John Uhr’s discussion of this matter³). This attitude has some relationship with the ‘mandate’ claimed by incoming governments after an election to take basically unrestricted actions. However, in my view, decisions on accountability that might need to be taken by voters at the end of a political cycle depend also on the provision of information (an ‘accounting’) on government actions on an ongoing basis, and not just through, by definition, a relatively short politically-oriented election campaign.

Further, it is clear that bodies such as the Administrative Appeals Tribunal, the Ombudsman and my office of Auditor-General, and legislation such as the Freedom of Information Act, are agents of accountability acting on behalf of the general public. At least, collectively, such structures ensure that a form of public scrutiny may be applied to actions taken by individual public servants and agencies within a context of accountability including personal, as well as agency, responsibility.

Accountability also requires that all parties have a clear understanding of the rule of law that applies to their actions, and also a clear understanding of their respective responsibilities and roles within the various structures that are part of the accountability process, notably Parliament, as well as Ministers, departments and agencies, review bodies, and enforcement bodies. Detailed questioning of ministers and senior bureaucrats in the Senate’s (the Upper House’s) examination of Budget Estimates each year, involving examination of government processes and both past and intended performance with respect to outputs and outcomes, provides an example of the interrelationship between these elements.

Why is accountability considered to be so vital in the public sector? The first point to note is that, as one academic commentator on the process has observed:

... civil servants work for the government, and in democratic governments it is assumed that they work at least indirectly for all citizens.⁴

More particularly, accountability of public servants is tied in with the ‘Westminster’ concept of ministerial responsibility to Parliament. While it is arguable whether this arrangement still applies to its ultimate extent in the era of ‘the new public management’, the conventional view has been that ministers take responsibility for the administration of their departments and, by extension, for all those bureaucratic actions undertaken by public servants within the various entities in the minister’s
portfolio (or at least that they may be required to answer to Parliament on relevant issues arising in the portfolio).

Under this scenario, public servants are accountable to the line of authority that exists between superiors and subordinates within the relevant agency, and ultimately to the minister as a representative of the government. In the APS context this is the line taken by the then Management Advisory Board/Management Improvement Advisory Committee (MAB/MIAC) in its 1993 report on accountability.6

The recent and continuing adoption, or adaptation, of private sector approaches, methods and techniques in public service delivery has highlighted issues involving gains and losses between the nature and level of accountability on the one hand and private sector cost efficiency on the other. On this issue, it has been noted by Professor Richard Mulgan of the Australian National University (ANU), who has contributed significantly to the debate over public sector accountability within a climate of significant reform, 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."7

The recent past has been typified by revised accountability arrangements and changed organisational structures.8 Such times present a major risk to effective decision-making. In my view, such risk is accentuated as a result of:

• 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 project and contract management skills in the public sector; and

• insufficient experience generally in managing on an accrual accounting/budgeting and full costing basis.

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’. This latter concept has always been difficult to define or assess 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 the public interest is not being observed, at least from their individual point of view.

Our public service values, which have a relationship to the need for public servants to pursue the public interest, are contained in the *Public Service Act 1999* (s. 10). As well, a Code of Conduct, based on these values, is set out in s. 13, with provisions to deal with breaches in s. 15. These are our collective touchstone and are one of the major factors which distinguish us from the private sector. However, questions have been raised as to whether public administration needs a new set of principles reflecting ‘entrepreneurial values’ in a more private sector oriented environment.9 On the other hand, some have argued that such an environment makes it more vital to underpin public interest with enduring ethical standards *grounded in law and constitutional democracy*.10

Public servants, at least, must understand the pervasive and often decisive influence of ‘politics’, as opposed to ‘markets’, both on public policy and administration. It 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 from those experienced in the private sector.11 This is a reality public servants, meaning all who are employed in the public sector, should never ignore. Consequently, the issue of any 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, is highly relevant for all public servants. However, decisions about such trade-offs are basically ones for the Parliament and/or government to make—to provide guidance to decision-makers, whether in the public or private sector, and not to leave resolution to those decision-makers by default; or, is this yet another risk that has to be addressed by public sector managers?

While having regard to the apparent increasing convergence between the private and public sectors, it is nevertheless possible to identify where the two sectors differ in terms of accountability, for example, 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.12

This is not the place to examine the wide range of risk and accountability issues that any convergence of the sectors may involve. I did this, to a degree, last year.13 However, one issue worth mentioning here as part of recent reform background is that of risk transfer through the use of private finance in areas such as infrastructure, property, defence and information technology (IT). This is currently raising a range of issues of both management and audit interest.

The Private Finance Initiative (PFI) in the United Kingdom14 is being driven heavily by the objective to transfer risk. (PFI is discussed in more detail later in this presentation.) For example, in contracting the funding, design and management of IT and infrastructure projects to the private sector, the associated transfer of risk to private sector managers is being justified on the basis that they are better able to
manage the risks involved. A Report commissioned by the UK Treasury indicated
that some invitations by public sector bodies to negotiate contract provisions
included risks that could not realistically be best managed by the contractor. The
UK National Audit Office concluded that:

Appropriate risk allocation between the public and private sectors is the
key to achieving value for money on PFI projects.

The Report went on to advocate an approach involving the ‘optimum’ transfer of
risk, which simply means allocating individual risks to those best placed to manage
them. As usual, the devil is in the detail but experience is indicating some useful
means of deciding on an appropriate allocation of such risks.

Mr Bob Le Marechal CB, Deputy Controller and Auditor-General of the United
Kingdom (UK) National Audit Office, noted in private correspondence with me on
related matters that:

In practice, on IT projects in particular, we have seen considerable
naivety on the part of government departments as to the extent to which
they can actually transfer risk.

Mr Le Marechal pointed out that departments have found out too late that it is their
job to sort out problems and get results if essential public systems do not work
properly. He went on to observe that:

Under heavy public and political pressure to get systems working
properly, departments are then reluctant to take a hard line on their
contractual rights and so sour relationships with the very contractors
whose cooperation is essential.

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.

At the federal level, recent changes to financial legislation for the public sector 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. One important aspect of Australia’s new public sector 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 Government, 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 APS 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. In this vein the Minister Assisting the Prime Minister for the Public Service has stated that the Government’s objective:

... has been to focus the APS on its core activities of policy development, legislative implementation and the contracting and oversight of service delivery. 21

The Prime Minister has offered the following list of those activities that he considers fall within this realm:

Defence, justice, a social security net, the monitoring of outcomes of, and alternatives to, existing policies—all these will require public service output. And there will also be a real need for high quality economic, constitutional and other policy advice. 22

Within such definitional bounds, just how small the core public sector can become without jeopardising the public interest is still open to debate. If we talk in terms of the outright limits on the extent of the public sector we should take note of the Prime Minister’s observation 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. 23

In the spirit of reform that flows from the core/non-core dichotomy, within the context of seeking to maximise efficiency and effectiveness for the public sector, the changed nature of the Commonwealth’s financial legislation, in particular, also illustrates how significantly the APS management framework has altered 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 the recent replacement of the Public Service Act 1922 by updated and more user friendly legislation, as well as the more principles-based legislation relating to workplace arrangements (which has deregulated and decentralised the APS people management framework), the overall legislative package is intended to provide managers with increased flexibility, including the elimination of unnecessary bureaucratic processes, to respond to the challenges of the evolving APS 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. 24 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 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 management 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 the Departments of the Treasury and/or Finance and Administration (DOFA). 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 APS 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.

I should note here that the responsibilities of individual agencies are, in some instances, not always entirely clear, not least because they may not have been determined or tested until a specific matter arises. The particular matter that I have in mind here involved a court case, that eventually went to the High Court, concerning occupational health and safety responsibilities in an industry subject to regulation by a Commonwealth statutory authority.25 The question to be determined by the High Court, within the context of possible negligence in the exercise of statutory powers, was whether there is a duty of care upon a statutory authority to take affirmative action to protect members of the workforce in an industry regulated by the statutory authority. As the reference notes:

*This case ushers in broader duty of care obligations for government and its statutory authorities in areas where their regulatory responsibilities affect personal health and safety. It also has the potential to extend duty of care obligations to other areas of regulation where plaintiffs can*
prove that their person or property is vulnerable to risks against which they cannot otherwise protect themselves.\textsuperscript{26}

In this case the High Court found that there was a duty of care on the Authority, as a regulator of the stevedoring industry, despite various changes in legislation and lines of authority that had occurred over time.

I cite this matter not as an example of how agencies have to be aware of the responsibilities with which they have been charged concerning occupational health and safety provisions—indeed this should be a given—but as an indication of the need for public sector agencies to take the widest possible view of just what their overall responsibilities may be. That is, given the functions that they are required to carry out, including under legislation, agencies must take care to be comprehensive in their determination of what could be considered to be, in an accounting sense, the ‘liabilities’ of the organisation.

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, such arrangements would take some effort to accomplish within a reform environment of devolved authority and ‘personal’ accountability.

**The impact 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 believe 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, my 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.

and

> People want effective government.

I referred earlier to the reduction in central control in the APS, within the changing governance framework. 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.

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, including risks, as well as significant opportunities for a more responsive and efficient public sector.

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 the 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 these changes. The public sector has also been subject to a range of reforms partly to reduce the costs to business.30

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.31 There is also the associated increase in employment and wages (though there are exceptions) that accompany these investments.32 However, an editorial of The Economist pointed out:

*the ten biggest industrial multinationals each has annual sales larger than their [Australian] government’s tax revenue.*33
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 via, for example, the GST being implemented 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.34

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).35 A number of governments may therefore have avenues to pursue many multinational corporations, that is, through the multinationals’ home governments and legal systems. 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 have been expected to have passed between independent parties dealing at arm’s length. A major program by the Australian Taxation Office (ATO) aims at improving the level of taxpayer understanding and compliance in order to ensure Australia receives its fair share of tax.36

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 company laws to protect commercial secrecy, many tax administrations can find it difficult to pursue satisfactory investigations.37

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 customers.38 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 ‘anonymous’ electronic money and robust encryption technology are developed and utilised.

The ATO established a Task Force on Electronic Commerce in 1996. The Task Force’s 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.39

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

3. CORPORATE GOVERNANCE

Corporate governance, including agency controls, is particularly important in relation to the changing, increasingly privatised and internationalised public sector.

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. Corporate governance largely covers 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.

Key components of the corporate governance framework 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 APS, these requirements become that much more important for both accountability to, and performance for, 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 of integrity and disclosure (accountability) is also essential for the establishment of sound risk management approaches and the confidence it can give to stakeholders in both the organisation and in what it does. Moreover, there is a mutually supportive relationship between corporate governance, risk management and performance orientation. A robust accountability approach which encourages better performance through sound risk management is integral to any corporate governance framework.40

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.

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 Regulations. The following are some of the values that agency heads are required to uphold and promote within their organisations:

- the APS is apolitical, performing its functions in an impartial and professional manner;
- the APS has the highest ethical standards;
- the APS is accountable for its actions, within the framework of Ministerial responsibility, to the Government, the Parliament and the Australian public;
- the APS delivers services fairly, effectively, impartially and courteously to the Australian public; and
- the APS 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 APS values and the APS Code of Conduct, together with the Codes of Ethics promulgated by the professional accounting bodies.

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;
- to consider who is responsible for what, to whom, and by when; and
- to acknowledge the relationship that exists between stakeholders and those who are entrusted to manage resources and deliver outcomes.

A sound corporate governance framework can also provide a way forward to those, whether in the public or private sectors, who find themselves in somewhat different relationships than either have experienced before.

In the last decade, APS 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 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 such a way that people in the organisation can understand both their overall purpose and the various ways the different elements need to be coordinated in order 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 are well understood and applied throughout those organisations. If implemented effectively, corporate governance frameworks 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. 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 where both form and substance are being achieved contributing to greater understanding and commitment at all levels of the organisation. The work that the ANAO has done with APS agencies has highlighted clearly 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 ATO’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 for agencies. 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. However, it is important to recognise that the diversity of the public sector itself requires different models of corporate governance within that sector. That is, one size does not fit all even though there will be common elements of these models both in the public and private sectors.

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 CEOs to assess the strengths and weaknesses of their agencies’ current governance framework. Although the discussion paper, and its checklist, was not meant to provide a specific, comprehensive model for each agency, the ANAO’s identification of general corporate governance principles should contribute to the ability of CEOs 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.42

**Creating an effective control environment**

One of the elements of a corporate governance framework, complementary to a sound risk management approach, is a robust system of administrative control. Control structures are particularly relevant elements of an effective governance framework because of their importance in promoting effective performance and in ensuring accountability obligations are appropriately discharged. In the 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.43

On a related point I was delighted to see that your program for this Conference has, as the international keynote speaker, Nigel Turnbull from the UK. Mr Turnbull was the Chairman of the Internal Control Working Party (the Turnbull Committee), and its 1999 report *Internal Control—Guidance for Directors on the Combined Code*44 has, I believe, established an effective lead towards the introduction of internal control arrangements for the private sector—and, by extension, for commercial elements of the public sector. (The Committee’s report provides guidance to assist UK listed companies implement the requirements in the revised Combined Code of the Committee on Corporate Governance, as the Code applies to internal control.)
In effect the Turnbull Committee has sought to reflect some of the best practices available in designing and operating systems of control, and in incorporating a risk-based approach to corporate governance arrangements. I note in particular, and support, the Committee’s comprehensive statement that:

An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company that, taken together,

- facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company’s objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed;
- help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation;
- help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.  

In the case of the UK, the task then remains to implement revised arrangements that satisfy the new Code, using the guidance provided by the Turnbull Committee. I note that, while the Code is not mandatory, the Listing Rules of the London Stock Exchange require listed companies to state whether they have complied with the provisions, and to describe how they have applied the principles, of the Code. Given the best practice nature of the Code and of the Turnbull Committee’s report, I would suggest, as one source of implementation advice provided for UK private companies puts it, that:

Non-compliance with the Turnbull guidelines, given their wide support, is likely to be viewed unfavourably by the market.  

In the Australian public sector situation, I consider that we can learn from, and apply where applicable, the principles enunciated for private sector arrangements by key authorities such as the Turnbull Committee. It is axiomatic that effective control structures within a corporate governance framework are a vital part of providing assurance to clients and the Parliament that an agency is operating in the public interest, and that it 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 which increases the risk of fraud.  

The notion of a control environment has to start from the top of an agency, that is from the Chief Executive Officer (CEO) and the board, together with senior management. To be effective, control arrangements require 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, robust and ongoing 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. This approach should be promoted as good management. The clear intent and message to staff should be that such processes and procedures should be designed to facilitate rather than to inhibit performance. The emphasis is on a more systematic approach to decision-making to manage, rather than avoid, risk.

In short, the control environment is a reflection of management’s attitude and commitment towards ensuring creation and maintenance of well controlled business operations that can demonstrate accountability for performance.

The control structure will provide a necessary link 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.

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.

**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. 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, in relation to public authorities and companies as well, 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 (relating again to the UK) which has been extensively quoted in governance papers and related 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 Government Business Enterprises (GBEs), because of the different roles and relationships between the responsible Minister(s), the CEO and (possibly) the Board. As well, Australian citizens (major 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 categories of agency, of course, have more in common with the private sector. They also have added complexities as a result of the additional party (the governing board) 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. The shake-up of the AMP Board in April 2000, precipitated perhaps by shareholder/investor criticism about the company’s business performance and share price, seems to me to involve the corporate governance context in which that organisation was involved. It could be seen as an example of an organisation responding to public concern in order to regain an appropriate level of community and shareholder confidence in both the business and ethical nature of the company’s activities.
In the public sector, although 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 roles as clients).

The ANAO discussion paper entitled *Corporate Governance in Commonwealth Authorities and Companies* suggests, *inter alia*, 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, a 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 maximising 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.

The question of corporate governance in the public sector has been taken up more recently during an inquiry conducted by the Commonwealth Parliamentary Joint Committee on Public Accounts (JCPAA). As I mentioned earlier, the Commonwealth introduced revised financial legislation for public sector entities, with effect from 1 January 1998. The new *Commonwealth Authorities and Companies Act 1997* (the CAC Act) introduced new governance arrangements for GBEs, providing a framework for their accountability and setting out key responsibilities for both boards and Ministers. The broad objective of the Joint Committee of Public Accounts and Audit (JCPAA) inquiry was to assess the appropriateness and effectiveness of these arrangements, given that as GBEs are publicly controlled entities, the Parliament has a continuing interest in their governance, performance and accountability.

The JCPAA’s report has, in my view, added much to the consideration of appropriate accountability and corporate governance arrangements for the public sector, in this case GBEs. Among other things, the JCPAA examined the appropriateness of the CAC Act and, in particular, its continued application to GBEs. It recorded the view that:

... where public moneys are involved, there is a need for additional accountability to Ministers and Parliament ...

and concluded that
I must say that this conclusion supports my own view that present governance arrangements provide a robust and flexible framework for the management and accountability of GBEs. This is not to say that further improvements are not possible, both for GBEs and for other elements of the public sector such as departments and statutory authorities. I cover some such possibilities elsewhere in this presentation.

**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.56

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.57 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, it is fair to say that generally there has not been absolute clarity on the
extent of a public sector employee’s, officer’s, CEO’s, board member’s etc., accountability for implicit or explicit action that can affect the citizen. Further, the onset of reforms is increasingly raising awareness of, say, legal accountabilities, just as in the private sector.

In any event, there must be due and continuing recognition given to the innate complexities of public administration with its multi-faceted approach towards accountability that has to be managed at all levels of an organisation.

4. MANAGING RISK IN THE PUBLIC SECTOR

It would be overly ambitious to even try to cover the many risks facing public sector managers that we (the ANAO) have traversed in our audit work. Nevertheless, there are some major areas of risk that are of current interest and which require sound systematic risk management in accordance with the revised Australian Standard AS/NZS 4360:1999. These areas are the outsourcing environment, project and contract management, commercial-in-confidence issues, the private financing of government activities, foreign exchange risks, the risks associated with asset sales, fraud control, procurement including legal issues, technology developments, business continuity, tax and customs revenues and the protection of our coastline. After dealing with these areas, and the matter of insurable risk managed fund arrangements, I conclude this part of the presentation with a discussion on the notion of partnerships and risk sharing. But first, let us look at risk management as part of an integrated corporate governance framework.

Risk management as part of an integrated corporate governance framework

Corporate governance provides the integrated strategic management framework necessary to achieve the outputs \(^\text{58}\) and outcomes \(^\text{59}\) 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.

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. \(^\text{50}\)
>

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 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. Risk management can encourage 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 agency management to be able to provide assurance on agency activities, including being able to defend its 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.

However, the effective implementation of risk management practices is a major challenge for public sector managers, particularly as the culture under which they have operated has traditionally been risk averse. As I have commented elsewhere:

*Parliament itself, and its Committees, are still coming to grips with the implications of managing risks instead of minimising them, almost without regard to the costs involved.*

In the past, risk has been related to the possible loss of assets or the emergence of a liability. As a result, risk management has focused on matters that can be covered as insurable losses. However, the more contemporary definition of risk is far broader, reflecting the increasing complexity of our corporate and economic environment and incorporating corporate governance, operational and strategic objectives. In current day terms, risk management can more properly be defined as:

*... the term applied to a logical and systematic method of identifying, analysing, assessing, treating and communicating risks associated with any activity, function or process in a way that will enable organisations to minimise losses and maximise opportunities.*

An important principle of an effective risk management framework is the transparency of decision-making processes. Transparency is achieved by ensuring that both the decision-making process and, importantly, the reasons for decisions made, are adequately documented and communicated to stakeholders. I note that one of the most significant recent additions to the revised risk management standard is the requirement to identify stakeholders and communicate and consult with them regarding their perceptions of risk at each stage of the risk management process. The
results of such communication should, of course, feed into any decision-making process.

From an ANAO perspective, documentation of key risk management principles and management decisions is an essential element of the public sector accountability framework. As the ANAO is a central element of this framework, we have a particular need to understand the reasons behind agency decisions. As well, documenting and communicating key processes and decisions:

- improves the transparency and consistency of decisions made by the agency over time;
- throughout the organisation contributes to the cost-effective achievement of stated outcomes;
- promotes a shared ownership of decisions throughout the agency; and
- places the agency in a considerably stronger position to defend to the Parliament and clients any decisions made.\textsuperscript{63}

Managing outsourcing and attendant risks

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 in Australia are:

- 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.\textsuperscript{64} 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.\textsuperscript{65} 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 providers. It is estimated that the value of the next round of contracts, which commenced in February 2000 and will run for three years, will be around $3 billion.

- 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. However, outsourcing also brings risks to an organisation which cannot be ignored.

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. 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 DOFA’s outsourcing of all of its human resource management functions, it was assessed as positive for its core business. That arrangement recently won a worldwide outsourcing achievement award.
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 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.69

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 a 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, to manage delivery of community service obligations, or to transfer or sell an interest in the project.

Contract management

In Australia at the Commonwealth level, the objective of the Government’s reform agenda has been to focus the APS 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. 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 about the service provider. For this reason, proper project planning is essential to a successful outsourcing partnership. Indeed, a 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.70

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 value for money considerations 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.71
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 also one which 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, the (then) Industry Commission (now the 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, if too little risk is left with the agent, this can lead to poor service delivery and resulting political problems for the government. Such political problems reflect the rights of service recipients as citizens who are not party to the principal-agent relationship. This can create other problems as indicated 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 limitation of private contract law in dealing with the interests of parties not covered by the privity of contract between the government agency and the contractor._

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. From the point of view of an effective public sector manager, 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.74

- 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.75

- 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.76
In 1997, the sale of the supplier (known as DASFLEET) of passenger and commercial vehicles to the majority of Commonwealth bodies 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 completed in December 1999. 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. 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, which is of concern given that some of these projects involve substantial resources and complexity. As well, reports have flagged a need for care in assessing value for money and negotiating, preparing, administering and amending major 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. I am not alone therefore in stating that this situation has to be addressed as a matter of urgency. The various elements of the public sector that are involved in contract administration have to reverse such concerns to win back the confidence of all stakeholders and future audit reports will closely examine relevant contracting issues to ensure that this happens.

The concern that I have expressed in such reports has been echoed in a recent report covering the findings of a survey of government contracting officers and private sector contractors to government, conducted by the Institution of Engineers Australia. The report’s author, Athol Yates, concluded that government is not always a smart buyer of technology, principally due to a lack of subject matter expertise. The report observed that:

Being an uninformed buyer puts at risk the ability to:
- select and justify the option which offers best value for money;
- select and justify an innovative solution;
reduce contractor risks by providing relevant technical details in tender documents; and
prevent unscrupulous contractors taking advantage of the buyer’s lack of knowledge.79

Each of the above examples drawn from recent ANAO performance audits, and the results of the Institution of Engineers’ study, 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 seminar on legal issues relating to the public sector that was conducted by Blake Dawson Waldron last year.80 This 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. Judicial decisions over the last couple of years 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. Moreover, it is apparent that meeting legal requirements and processes is in the commercial interest of those involved in contracting of services.

**Performance accountability under contracting out**

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.81

Put another way, it is often more cost effective 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 my office. 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:

*Contract milestone reviews in the progress of the project, with tests wherever appropriate that prove the progress, and provisions for relief in the event of default.*

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 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
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.

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 the ANAO has drafted a set of model standard access clauses which have been circulated to agencies for insertion in contracts with the private sector. 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.

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. Dr John Uhr, who has written extensively on the question of ethics in public policy, 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. 86

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 the
Australian, commenting on the High Court’s judgement in relation to the tabling of documents before a 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.\(^{87}\)

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.\(^{88}\)

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 New South Wales has 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.\(^{89}\)

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 Auditor-General Act 1997.\(^{90}\)

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

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\(^{87}\) See Australian Council of Auditors-General, Principles for Commercial Confidentiality and the Public Interest, p. 87.

\(^{88}\) Ibid., p. 88.

\(^{89}\) ibid., p. 89.

\(^{90}\) ibid., p. 90.
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 addressed also by the Senate Finance and Public Administration References Committee in a 1997 report following its 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, we 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. 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.

A related, but separate matter has been brought to my attention following a recent audit undertaken by the ANAO into the use of electronic commerce or business in Australian federal agencies. While I will cover some relevant audit findings elsewhere in this presentation, there is one aspect that arose during analysis of survey returns that should be mentioned here. This is the finding that agencies surveyed by the ANAO expected that information about their contracts with the private or community sectors would remain as commercial-in-confidence. Individuals’ concerns were expressed about the broader concept of an individual’s rights to influence the way personal information was collected and used.

Of relevance to this particular issue is that a key provision of the Privacy Amendment (Private Sector) Bill, which has now been introduced into the Commonwealth Parliament, is the inclusion of new ‘National Privacy Principles for the Fair Handling of Personal Information’. These Principles set standards about how business should collect, secure, store, use and disclose personal information. The Bill makes a distinction between ‘personal’ and ‘sensitive’ information. The latter includes information on a person’s religious and political beliefs and health where the private sector is more strictly limited in its collection and handling. This legislation could have a marked impact on that sector’s involvement in the delivery of public services.

**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 only 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 from those involved in traditional approaches to funding public infrastructure. Indeed, 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.99 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.100

The United Kingdom National Audit Office has noted that the private finance approach is both new and more complicated than traditional methods.101 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.102

It is difficult to evaluate the overall benefits that accrue from private financing initiatives. In financial terms, it has been recognised that it is difficult for the private sector to borrow as cheaply as governments can. This is because government borrowings are considered by markets to be risk-free because of governments’ 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 the 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.103

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 in Sydney104 and the City Link project in Melbourne. Of note is that 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.105 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.106

- 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.107

Significantly, there have also been concerns raised about public accountability for privately financed projects. This has stemmed around 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 counterpart.108

At the national level, the 1996 National Commission of Audit observed that the private sector has a significant capacity for a greater role in infrastructure services. The Commission 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. 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 it 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. At the time of preparation of this presentation my Office was examining one of these projects, within the context of risk management on foreign exchange dealings. The key message in this context 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.

The Department of Defence also is 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. The clear intention on the part of Defence in widening the use of private financing is to achieve the best affordable operational capability. Of course, any such move towards private financing of Defence activities would need to consider what core business the Department needs to maintain in order to manage effectively the longer-term risks that are involved in any outsourcing. With this in mind, the Department has indicated in a recent Discussion Paper 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).

The Defence Discussion Paper identified a number of lessons drawn from case studies arising from the UK Ministry of Defence’s experience as well as that of two State Governments—these may be of interest to other audiences, who are required to deal with similar private financing issues, albeit involving different subject matter.

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 in optimising outcomes and providing 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.\textsuperscript{114}

**Dealing with foreign exchange risk**

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.\textsuperscript{115} 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.*\textsuperscript{116}

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.\textsuperscript{117} This is reflected in hedging objectives such as not taking speculative positions, eliminating foreign exchange transactional risk, minimising hedge costs\textsuperscript{118} 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 Senate 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 Commonwealth Treasury 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.125 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.126

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 to127; 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.

**Risks associated with asset sales**

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 period since 1987-88 in particular has seen an increased focus on privatisation of government business entities, with some $31 billion raised by the Federal Government through sales of major assets over the period 1987-88 to 1997-98.128 In addition to raising significant cash proceeds, asset sales provide an opportunity to transfer risks to the private sector and, it has been argued, offer the potential for improved business efficiency. In themselves, the sales processes involve significant risks which, in some cases, go well beyond the finalisation of the actual sale of an asset.

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.\textsuperscript{129}

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.\textsuperscript{130} From an audit 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.**\textsuperscript{131}

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.

The Federal Government 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. To ensure their effectiveness, my privatisation audits (such as the audits of the Telstra share offer,\textsuperscript{132} the leasehold sales of Federal airports,\textsuperscript{133} and third tranche sale of the Commonwealth Bank\textsuperscript{134}) 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 has led to improved overall value for money and project management quality in subsequent sales. In short, a major audit objective is to identify better practice in order to add value to public administration.

Asset sales at the Federal level 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. 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, collectively raised proceeds of some $35 billion. The related audit 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 are important 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 concerned, not least by the auditors concerned. Consequently, we all have to re-examine our risk management exposures and sales related processes to maximise our performance.

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, which also impact risk management, in order 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 audit activity 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.

**Fraud control**

The prevention and management of fraud are not new issues in the APS. However, as I noted earlier, the significant changes that have affected the APS over the last decade have resulted in new pressures for agencies, including pressures on their established fraud control systems. The changes have included:

- the use of a range of service delivery options, raising new concerns about transparency and accountability;

- the focus on outcomes, which although appropriate in guiding program objectives, can impose pressures on agencies by promoting the view that the end justifies the means and processes do not matter; and

- the increasing use of technology and links with communications, making it possibly easier to commit e-commerce fraud and divert payments via, for example, false identification documentation.
The prevention and detection of internal fraud is an issue of the utmost importance to all APS agencies. Ensuring the protection of Commonwealth revenue, expenditure and property from attempts by members of the public, contractors, agents intermediaries or Commonwealth employees, to gain by deceit financial or other benefits, is imperative to protect the security and reputation of public sector agencies.

The Australian Taxation Office (ATO) is one agency that has actively sought to establish measures to minimise the potential for fraud. The Commissioner for Taxation, Mr Michael Carmody, recognises that, given the number of people the ATO employs (approximately 17 000) and the amount of Commonwealth revenue it collects ($141.7 billion in 1998/99), it is important:

... that the ATO has effective measures in place to both minimise the potential for such fraud and misconduct, and to hold to account those who engage in it.137

A key measure integral to the Commissioner’s fraud management strategy was the development of a comprehensive Fraud Control Plan. The ATO Fraud Control Plan is used to identify, and provide preventative controls for potential ATO fraud related risks. The risks outlined in the Fraud Control Plan cover all areas of ATO operations and are identified by operational staff in conjunction with the experienced fraud investigators of the ATO’s Fraud Prevention and Control Section.

The ATO Fraud Prevention and Control Section comprises a team of 22 trained internal investigators, who report directly to the Commissioner for Taxation. The section’s activities aim to minimise the incidence of fraud within and on the ATO through fraud prevention measures (such as fraud prevention training for staff) and investigations.

The ATO’s procedures for preventing fraud are also discussed in the Senate Economics References Committee’s report on the ATO138.

Against the background of changes to the APS environment bearing on fraud, my Office has undertaken a series of fraud control audits. The audit of fraud control arrangements in the Department of Employment, Education, Training and Youth Affairs has been completed139. Audits are underway in four other agencies (the Departments of Industry Science and Resources, Health and Aged Care and Defence, and the ATO140).

Furthermore, a survey of fraud control arrangements across the APS is well advanced. The survey of some 150 APS agencies and GBEs is designed to provide an overview of the fraud control framework agencies have in place. The overall objective of the survey is to assess key aspects of fraud control arrangements in place across the APS against the Commonwealth Law Enforcement Board Guidelines,141 in order to provide assurance to Parliament on the preparedness of agencies to prevent and deal with fraud effectively.

It is not appropriate to reveal the results of the survey in detail here as, at the time of preparing this presentation, the report had not yet been finalised. However, I will
outline the overall objectives and scope of the survey in some detail to give you a flavour of the kinds of issues with which the report will deal.

The survey sought information on numerous topics, including:

- agency-specific fraud control policies, fraud control plans, procedures and guidelines;
- the existence of management information systems;
- awareness raising and training for staff;
- the conduct of investigations; and
- quality assurance systems.

The survey results will give us a useful picture of, among other things, the status of agencies’ fraud policy and planning arrangements, the incidence and nature of fraud awareness and training and the elements of agencies’ fraud control operations.

Although the ANAO survey and the various fraud control audits will lift awareness and understanding of issues surrounding the prevention and management of fraud in the current public sector environment, no one could realistically expect that they will provide all the answers. Indeed, fraud will continue to arise as an issue in agencies from time to time. The management challenge is to put in place an appropriate corporate governance framework (embracing, of course, the various fraud control strategies and measures) to manage that latter risk as effectively as possible—to reduce its incidence and/or mitigate its effect.

In this particular context, I note that the requirements for management to establish and maintain policies and procedures that manage the risk of fraud, and on auditors to oversight such arrangements, are to be reinforced at the international level shortly. Action is underway through the International Federation of Accountants (IFAC) to tighten the International Standard of Auditing (ISA) 240 on fraud and error, with an expectation that draft guidelines, presently released for comment by accountants, auditors and managers, will be adopted as a global auditing standard by the end of this year. While the existing standard provides guidance to auditors as to how to treat fraud and error when they detect it, the revised standard will require auditors and, most importantly, management of entities, to take a more proactive role in both prevention and detection.

Specifically, under the proposed new standard:

... auditors will be required to quiz managers and boards of directors about what systems they have to detect fraud and glaring errors.

Auditors will also need to check whether incorrect statements in the company books, including omissions of amounts and disclosures, are simply honest mistakes.
Businesses will not only have to notify auditors, in writing, of any fraud or suspicious activity; they will also be required to produce any financial statements that turn out to be incorrect and that management claimed were immaterial.

Auditors will be required to pass these details on to those in charge of governance at the company that is being audited.\textsuperscript{142}

In putting out the revised standard for comment, the Chairman of IFAC’s International Auditing Practice Committee, Mr Robert Roussey, made the following apposite points that I certainly agree with, as the CEO of an audit practice, and that I am sure would be endorsed by those of us who support best practice in corporate governance arrangements:

- \textit{It is the responsibility of management to establish and maintain policies and procedures that would contribute to the orderly and efficient conduct of the entity’s business.}

- \textit{This responsibility includes implementing and ensuring the continued operation of accounting and internal control systems which are designed to prevent and detect fraud and error.}

- \textit{Further, it is the responsibility of those charged with governance to ensure, through oversight of management, that these systems are in place.}\textsuperscript{143}

It would seem appropriate to put the onus on managers and directors, including those in public sector agencies, to ensure that their organisations have internal controls to prevent and detect fraudulent activity as well as any undue errors. My audits do not set out to detect fraud but do strenuously check all entity systems bearing on financial management and reporting. We have limited forensic audit skills. Any apparent fraud is referred to the Australian Federal Police for investigation.

**Legal risks in procurement**

As I noted in the contract management section of this presentation, the greater use of outsourced services has meant that procurement and contract management in particular have become critical elements in public administration.

It is also worth repeating here my comments about the principles that underlie the government procurement framework (namely value for money, open and fair competition, ethics and fair dealing and accountability). These principles collectively support a sound tendering process and together with sound management of the ultimate contract, can produce efficient and effective service delivery.

Sound tendering processes and management of the contract may be easier to articulate than to actually perform, particularly in view of the quite stringent processes required to discharge the legal obligations regarding the tendering process.\textsuperscript{144} I also mentioned in the section ‘performance accountability’ that, under contracting out, although contracting can provide efficiency and service delivery
gains, it does introduce risks, because the public service is no longer directly responsible for program outputs—these being produced by the private sector contractor. In other words, there is a gap between responsibility and accountability. There are also legal risks associated with the contracted out service.

Quite apart from the legal risks associated with the contracted out service flowing from challenges in proper tender selection, good contract management requires that the contract be a legally enforceable agreement. The contract must therefore specify the services required and the relationships and responsibilities of the relevant parties, the monitoring mechanisms and the performance promotion measures (sanctions and incentives). These things are not necessarily easy to define and yet they are basic building blocks of a sound contracting and service delivery process.

There are also legal risks in terms of determining who is liable for the service delivery deficiencies—these questions bear on the strength and completeness of the contract arrangements. Because outputs can be difficult to specify (and indeed may even be the combined product of more than one agency) it can be difficult to specify the circumstances in which ‘non-performance’ has occurred, in order to press for successful contractor performance, given these complex linkages and, moreover, to specify enforceable responses.

Legal risks may also be confronted in the contracted provision of services to the Commonwealth by more than one party. In such circumstances, one of the key concerns would be to promote comparability and consistency of service across providers and over time (even if uniformity is not possible).

The Commonwealth’s practices for Commonwealth Departments and agencies purchasing legal services in a ‘deregulated environment’ are a case in point. Major reforms to the provision of legal services came into effect in 1999. From that time, unless the matter involves ‘tied work’, public sector agencies are free to engage private law firms for legal services such as provision of legal advice and carriage of litigation in court—allowing them to function as possible alternative providers to the Australian Government Solicitor (AGS).

I was interested to see how, in this environment of multiple service providers and devolved decision-making, the Commonwealth sought to assure itself that the legal services it receives from the range of legal firms it engages is of suitable quality and conforms to the standards required. The Commonwealth, that is the Government, responded in part to the risks of divergent standards and practices by issuing Legal Services Directions. The Directions are designed to enable the Attorney-General to manage and reduce risks inherent in the provision of legal services to the Commonwealth and to ensure that these services are of a high standard and consistent with the public interest. The CEOs of each agency engaging private legal services are responsible for ensuring that each agency’s arrangements for legal services comply with the Directions and that the lawyers engaged by the agency assist the agency to do so. The Office of Legal Services Coordination in the Attorney-General’s Department provides advice to the Attorney-General on the operation and administration of the Directions.

I would suggest that, while acknowledging the special significance of this type of service procurement for the Commonwealth, agencies must pay the same close
attention to managing such risks in the procurement area. Most risk management responses would perhaps not require the promulgation of formal standards, as was done in relation to the provision of legal services to Commonwealth Departments and agencies. However CEOs must similarly be aware of, and seek to manage actively, the wide range of risks (including legal risks) involved in procurement, as they are required to do formally in this instance.

Technology risk and business continuity

The past decade has seen a radical transformation take place in the role of information technology (IT) within organisations worldwide, not to mention the impact it has had on individuals’ lives. This brings into sharp focus a range of access, security, privacy, storage and retrieval issues. Put plainly, organisations and individuals are significantly challenged in their capacity to effectively access, interpret, manage, apply and disseminate the volume, diversity and often uncertain origin of information enabled by IT (and the Internet in particular).

The use of IT in the public sector is having considerable impact on agency accountability and risk management, both positively and negatively. As both public sector managers, and auditors, we must recognise that there are risks inherent in the management of IT systems themselves, particularly relating to the security of agency data in a contestable or outsourced service delivery environment where public servants do not have direct access and control.

In 1997, the Australian Government outlined new measures designed to enhance prospects of growth and strengthen Australian industries’ capacity by, among other things, helping to ensure that business, the community and all tiers of government maximised opportunities to add to and benefit from the global information age. These measures included a plan to establish the Commonwealth Government as a leading-edge user of technology, including establishing a Government Information Centre and committing to all appropriate services being Internet-deliverable by 2001. Internet services were to complement—not replace—existing written, telephone, fax and counter services, and to greatly improve the quality, user-friendliness and consistency of those services.

Delivery of Government services on the Internet has the potential to:

- give access to a wide range of government services to a large group of the population, including those in remote areas of Australia;
- give access to government services and information 24 hours a day and seven days a week;
- allow the public to navigate to the government information source without the need for prior knowledge of where to look; and
- be a relatively inexpensive form of service delivery compared with other arrangements such as face to face and call centre interaction.
Commensurate with the potential for improved service and reduction in costs is increased risk in the following areas:

- the security of information transferred over the Internet;
- the privacy of information on individual or business; and
- the ability to authenticate the user requesting government services or financial assistance.

Recent ANAO financial statement audits have identified several emerging issues regarding the security and internal control mechanisms of IT systems in public sector agencies. IT supports various entity programs and can be integral to the validity, completeness and accuracy of financial statements. Consequently, the audit of IT systems and processes is fundamental to forming an opinion on the adequacy of proper accounts and records that support entities’ financial statements. The 1997-98 financial statements identified several specific IT control issues, including:

- system access rights found to be excessive or unauthorised;
- inadequate review and approval of users’ access to systems;
- an external service provider having unlimited access which was not monitored; and
- inadequate review, approval and testing of changes to applications.\(^{147}\)

Similar issues were identified for the 1998-99 statements.\(^{148}\)

The need to focus on effective systems controls is further highlighted by a recent report of the Australian Institute of Criminology which indicates that the increased usage of information technology will lead to a major rise in white collar crime against governments.\(^{149}\) Allied to this concern are warnings about growth in the use of e-mail not just in terms of adequate systems controls to prevent compromising network performance and the efficient conduct of functions or business but also the possibility of litigation where communications are not subject to executive review but could involve liability for the organisation.\(^{150}\)

Earlier in this presentation I mentioned that my Office has recently undertaken an audit of the use of electronic commerce or business in Australian federal government agencies. This audit was undertaken in recognition of the increasing pressure on management of APS information systems and systems controls that the move to electronic commerce and greater use of the Internet has brought about for Commonwealth agencies. The audit was conducted largely through a survey of agencies on their use of technologies, such as the Internet, to conduct business and their expectations of what will be their position in 2001.

Ideally, agency planning for Internet use should include arrangements for monitoring, review and performance evaluation of agency outputs and outcomes. Effective planning would enable agencies to begin to monitor the effectiveness and efficiency
of such use from the outset. Agencies’ review of reliance on the Internet for program delivery is also warranted because Internet service delivery is not necessarily of higher quality than available alternatives, particularly at this stage of the Internet’s development. The ANAO survey, referred to above, showed that agencies have adopted a wide range of measures involving use of the Internet. Promoting a set of common measures that agencies use to assess the success or otherwise of their efforts would facilitate further understanding of Internet service delivery from a whole-of-government perspective with benefits for all agencies.

Where there is Internet service delivery, financial and other kinds of losses and damage can be suffered by agencies’ clients through agencies publishing incorrect or misleading information on their Websites. This may be a result of ignorance, negligence, abuse or deliberate sabotage, and lead to legal liabilities for the agency. In other words, the delivery of services via the Internet introduces new risks and exposures that can result in a legal liability for government. Well-designed security and privacy policies can minimise risks and liabilities while informing agencies’ clients of important aspects of the services they can expect to receive. The ANAO considers that, where they have not done so already, agencies should develop policies and operational strategies for the security of their Websites together with policies and strategies regarding information related to individuals or organisations available from the site.

While it clearly has provided benefits, technology has also presented new risks not only for an organisation’s control environment but also for its knowledge base and the skills composition of its workforce. Of specific interest to auditors has been the recent Auditing Guidance Statement (AGS 1050) on ‘Audit Issues in Relation to the Electronic Presentation of Financial Reports’. The AGS identifies specific matters which may be addressed by the auditor with management to reduce the risk that the audit report on an entity’s financial report is inappropriately associated with unaudited information on the entity’s Website.

With the increased involvement of the private sector in the provision of public services, the security of agency data is a critical issue. Contracts negotiated between public service agencies and their private sector providers must include provisions which acknowledge Australian federal government IT security requirements. In addition to the technical issues associated with the protection of the data held by government agencies from unauthorised access or improper use, there are also issues associated with the security of, for example, personal information held by government agencies which falls within the scope of the Privacy Act. A watchful citizenry will want to be certain that agencies and their contractors cannot evade their obligations under such legislation.

Government agencies need to come to terms quickly with the potential applications of Public Key Infrastructure (PKI) technologies to encrypt, decrypt and verify data. In public key technologies, each user of the system has two keys, a public key and a private key which can be used to ensure the privacy, authentication, non-repudiation and integrity of information contained in messages. PKI is of importance to all agencies wishing to embark on initiatives that do more than just disseminate information. It is a core enabler. Key issues addressed by PKI are as follows:
• each person communicating electronically needs to ensure that the recipient is who he or she thinks it is, so that one cannot later deny being the sender of a particular electronic message or transaction. This ability to rebut a party’s denial of sending a message is called non-repudiation; and

• the ability to encrypt data transmissions over an open or public network (such as is used by the Internet), so that those transmissions can be read only by the intended recipient.

GATEKEEPER is the Commonwealth Government’s strategy for implementing a government PKI. An important element of on-line transactions with the Commonwealth is the ABN-DSC (Australian Business Number – Digital Signature Certificate) which will be used to verify electronic signatures.

The ANAO is seeking to bring the issue of IT controls and security to the attention of all public sector agencies and our first step in this process was the production of a better practice guide (released in October 1998) in relation to security and control for the SAP R/3 system. SAP R/3 is the most widely-used financial management information system in the APS today with over thirty Australian federal government entities currently using it. The areas covered by the guide include the amount of time and investment necessary for effective implementation of the system to minimise the risk of future security problems. While the guide deals specifically with SAP R/3, generic risk management controls are discussed which can be applied to other financial management information systems.

The foregoing issues are indicative of the many challenges for audit agencies, such as the ANAO, inherent in the proliferation of electronic information and communication systems. Technological innovation has conditioned users to expect virtually instantaneous communications and—by extension—virtually instant decisions and results.

As an aside, an example of the use of IT systems as ‘enabling technology’ that provides quality information in order to facilitate decision-making can be seen in the growing use of rulebase decision systems (or expert systems) to administer complex legislative and policy material. While the widespread adoption of rulebase systems to support administrative decision-making has been foreshadowed for some years, the relatively recent adoption of such systems by Commonwealth Government agencies indicates that they will be increasingly used to support, control and improve administrative decision-making based on legislative and/or policy rules.

A paper on this topic, which was presented to an Institute of Public Administration Australia seminar last year, identified the opportunities and risks associated with the use of rulebase systems. It is clear that there is a need to balance both opportunities and risks in order to make the most effective use of this technology. Opportunities include improvements in the quality, accuracy and consistency of decisions and administrative processes, and hence improved client service. Such opportunities may be realised as a result of managing, reducing and removing different risks from aspects of the decision-making process by providing staff with access to information relevant to their decisions. The risks involved relate to the complex IT development processes needed as well as the lead times involved in
system development, the potential for a loss of staff skills and knowledge of policy over time and an over-reliance on IT systems to produce the right answer every time.

Importantly, the authors assert that such systems cannot be introduced in isolation and should be accompanied by a broader redesign of the decision-making process and environment, including changes to service delivery arrangements, work structures and practices, staff skill sets and quality control practices. This type of technology does not replace the need for judgement or skills on the part of staff. However, it does provide a new model for decision-making based on a risk management perspective.

In the public sector we have, at the moment, a three tiered communications hierarchy with hardcopy documentation (traditional paper file based records) still at the top in many, if not most agencies, followed by electronic or digitally based information (using virtual office systems or groupware, electronic diaries or data and e-mail archives) and verbal communications (which may or may not be supported by notes, diary entries, tape recordings or other evidentiary material). A focus on results requires a capacity to make decisions and act quickly but, hopefully, not at the expense of due consideration in a robust risk management environment (culture) and lacking accountability for those decisions and actions.

There appears to be an increasing tendency for policy and administrative decisions to be communicated and confirmed through e-mail communications. This is a function of our changing expectations about the speed of communications, a growing emphasis on timely management of the ‘political’ dimensions of policy, and the appropriation by the public sector of a ‘commercial paradigm’ in which ‘deals are done’ (which is given added impetus by the involvement of private sector ‘partners’ in various aspects of government operations). Nevertheless, as better practice private sector firms demonstrate, good record-keeping is an integral part of a sound control environment and subject to a regularly reviewed risk management strategy which is integral to their required outcomes.

The increasing use of e-mail poses significant challenges in terms of our traditional evidentiary standards (which customarily hinge on paper-based records) and the skills base of our auditors. We are already confronting situations in which traditional forms of documentary evidence are not available. Technological change has resulted in a degree of ‘de-skilling’ in traditional public sector audit practice but a commensurate ‘re-skilling’ in decision-making systems. Auditors are already confronting situations in which they are having to make links in the chain of decision-making in organisations which no longer keep paper records, or having to discover audit trails in electronic records, desktop office systems or archival data tapes.

The problem is that we do not always have on hand the range of skills necessary to do the job and we need a strategy to overcome this deficiency. Essentially, auditors are expected to possess a level of forensic IT skills they have not traditionally had to have at the Commonwealth level. To these forensic skills they also need to add evidentiary standards appropriate to these forms of information—in other words, how does the auditor establish whether communication has occurred and obtain assurance about the records they have found?
Perhaps we need to look to the example of our colleagues in the areas of prudential assurance or criminal investigations who are continually refining investigatory methodologies to keep pace with offences such as insider trading, corporate fraud or misuse of drugs. If we go down this path, we may have to consider whether there is need to harmonise more closely evidentiary standards for audit with those of the criminal or civil justice systems in our respective jurisdictions. For the moment it might be that the technology is evolving far more rapidly than governments can respond with legislative or statutory controls. This is of particular concern for the management of Commonwealth records by National Archives of Australia.

Finally, we will need to address the ‘Pandora’s Box’ represented by the boundary between official and personal communications. Electronic records—especially e-mail records—are likely to contain both official records and personal communications. (A separate, but just as important, issue is the inappropriate use of e-mail.) Any position taken on personal communications on official systems should have regard to the organisation’s internal communications policy as well as of any applicable legislative framework. In any event, it would seem prudent for an auditor to consult early with the organisation’s management to determine an appropriate protocol for extracting required electronic records which not only protects the auditor’s right to access such records but also provides protection against unnecessary infringement on personal records and personal privacy.

Of course, the changing information technology and communications environment has been reflected recently in the challenges faced by the public sector in ensuring that the IT systems that agencies had in place were Year 2000 (Y2K) compliant. While it is not appropriate to cover in this presentation the outcomes of Y2K preparedness programs for the public sector, there is one aspect that our reliance on IT to deliver even the most fundamental of services, and therefore the necessity for consideration of Y2K issues by public sector agencies, has brought to the fore. This is the necessity to implement business (or function) continuity management within our organisations.

In my view, business continuity management can be considered basically in terms of risk and investment. As such the issue is important for everyone in an organisation—that is, it is not just a decision and concern of top management and/or a Board.

Business continuity is at the core of effective corporate governance. When it comes to the crunch, there is little point in establishing a best practice governance framework, with all the associated discipline, if, at the end of the day, the business becomes impaired for some foreseeable reason or, worse still, ceases to operate for any length of time. Whilst there is clearly a cost that needs to be taken into account as part of any risk assessment, and indeed of the application of risk management approaches and techniques, I would suggest that a more positive approach by decision-makers would regard such a cost as an investment in the future of the business.

As a result of the greater interest in, and attention applied to, related issues, my Office has recently prepared a Business Continuity Management Guide. The Guide includes two major features: the first part deals with business continuity management concepts in a risk management context; the second part identifies the processes and procedures required to be undertaken to produce a business continuity plan.
The accompanying Workbook provides a number of pro-forma schedules, working papers and questionnaires to facilitate the business continuity implementation process within agencies.

As I said when I launched the Guide in February this year:

_The Guide ... recommends that the business continuity plan be developed in conjunction with the risk management plan for the organisation. There are no short cuts in this area and no substitutes for systematic risk identification, assessment, prioritisation, treatment, monitoring and review, including systems testing. As an aside, I was very pleased to see the prominence given in the Guide to our most critical resource, our people and their interdependence with facilities, telecommunications, information systems and business processes._

The Guide makes the point that organisations, through a structured, systematic process, must attempt to manage all significant business risks pro-actively, by implementing appropriate preventative controls and other risk treatments. This risk management process is designed to reduce the residual risk of an event—in terms of its likelihood of occurrence and/or its consequences, to an acceptable level. Moreover, for effective risk management, the Guide notes that it is equally important that organisations design controls that are implemented once a risk event has occurred. After all, it is the business interruption consequences that mainly determine the process.

The Guide has proved useful to a range of managers either as a check on what they already have in place in their organisations or in those with which they deal, or, more fundamentally, as a basis for developing a suitable management approach to the issue.

**ANAOF audits—risk management issues**

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.

To be effective, the risk management process needs to be rigorous and systematic. 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.

Given the recognition of the significance of risk management and corporate governance in public administration, it is not surprising that risk management and corporate governance are pervasive themes in our audits of government agencies. Many audits over the past few years have addressed these matters explicitly. I will briefly refer to a selection of these reports to highlight the extent of agency activity and our analysis in that regard.

**Dealing with risk in the Australian Taxation Office (ATO)**

The ATO has adopted a risk management methodology in carrying out its responsibilities, including the collection of revenue. The ATO’s Health of the System Assessment (HOTSA) process forms the basis of a continuing assessment of the risks involved in the collection of tax. In use within all business lines of the ATO, the HOTSA is a key input into the ATO’s strategic planning framework. Risk assessments, which are the foundation of the HOTSA, lead to definition of priorities and subsequent resource allocation. Risk assessments derived from the HOTSA process are part of the compliance strategy implemented throughout the ATO.

The ANAO has reported specifically on risk management practices within the ATO in two reports. The first, *Risk Management—Australian Taxation Office*\(^\text{160}\) focussed on the broad strategic issues relevant to risk management for the ATO as a whole. The later report, *Risk Management in ATO Small Business Income*\(^\text{161}\) focused on the practical applications of these strategic issues within the ATO’s then Small Business Income business line.

In addition to these reports which dealt with risk management quite specifically, several other audit reports relating to the activities and responsibilities of the ATO have also commented on risk management practices as applied in particular areas. These reports deal with a wide range of topics such as sales tax\(^\text{162}\), the Superannuation Guarantee\(^\text{163}\), individual taxpayers refunds\(^\text{164}\) and the Prescribed Payments System for the collection of income tax.\(^\text{165}\)

The audit of the ATO’s administration of tax penalties conducted its examination within the context of the ATO's corporate governance framework and control environment.\(^\text{166}\)

My Office is undertaking currently a performance audit examining the management and operations of the ATO’s High Wealth Individuals (HWI) Taskforce. The HWI taskforce was set up by the ATO to investigate and enhance HWIs’ compliance with tax laws. The audit is examining the taskforce’s activities and, in essence, assessing...
the extent to which they are consistent with sound corporate governance and risk management principles.

**Australian Customs Service (ACS) – a comprehensive approach to risk**

Running concurrently with, and complementing, the performance audit that examined the risk management framework across the ATO, my Office examined risk management specifically in the ACS in the performance audit of the then Commercial Compliance Branch. The audit reviewed the risk management processes in that particular area of ACS (it being responsible at the time for assuring that clients complied with ACS commercial reporting and financial requirements). The audit also examined the wider risk management context across ACS. In the context of the early adoption of formal risk management as per the APS Guidelines for Managing Risk, the audit sought to draw out lessons for implementing and continually refining risk management processes that were relevant to the ACS and the public sector generally.

The application of the principles of risk management in practice was also examined in the performance audit of ACS’ postal operations. Postal operations involve ACS risk profiling and screening articles moving through the postal environment to intercept prohibited and restricted imports for community protection and to determine and collect customs duty and sales tax, where relevant. The features of the process and the environment mean that the control of postal operations is basically an exercise in risk management, requiring the identification, assessment, prioritisation and treatment of community protection and revenue risks and continual monitoring and review.

The recent audit report on Coastwatch again brings to the fore the practical application of risk management and corporate governance principles in ACS. The audit sought to examine Coastwatch’s administration of the Australian civil and coastal and offshore surveillance and response service. A significant area of interest to us concerned aspects of its corporate governance arrangements bearing on performance and associated accountability. Predictably, risk management was a recurrent theme in the audit as a whole and was of particular relevance in the context of corporate governance specifically.

**Insurable risk managed fund arrangements**

The establishment in July 1998 of insurable risk managed fund arrangements for the Commonwealth, called Comcover, is another expression of the increased attention being devoted to risk management in the public sector and the significant initiatives being developed to support it. Comcover replaces the Commonwealth’s previous policy of non-insurance, or rather ‘self-insurance’ in which the Commonwealth as a whole carried its own risks, rather than individual agencies. The introduction of the new fund will, for the first time, require the systematic identification, quantification, reporting and management of risk across Commonwealth agencies.

Comcover provides for a single managed fund to cover all general insurance risks, with the exception of workers’ compensation (with formal pooling of risk, premiums
and reinsurance) and requires all Commonwealth agencies (including departments) and entities to participate, unless specifically exempted. The creation of such a fund is a timely reminder that failure to identify and treat risks properly and adequately is itself a significant risk for CEOs and public sector organisations, particularly as the Commonwealth’s new financial legislation, mentioned elsewhere in this presentation, imposes personal and Board accountability and responsibility obligations.

Although the new Comcover arrangements necessitate additional reporting and oversight, on the positive side Comcover aims to provide improved risk management benefits to the Commonwealth by:

- helping to protect programs and the Budget against unexpected insurable losses over time;
- achieving transparency and greater accountability in the management of the Commonwealth’s insurable risks;
- requiring the full identification of risk exposures by each agency;
- enabling the Commonwealth to centrally accumulate risk knowledge and expertise;
- reducing costs by pooling and spreading of risk; and
- providing incentives for better risk management with the application of a claims sensitive premium.\(^{173}\)

Despite the obvious benefits of such arrangements, the Commonwealth’s arrangements through Comcover only provide for those risks that can be covered as insurable losses. No cover is possible for other eventualities, such as the loss of appropriately skilled staff. Whatever the case, my view is that it remains incumbent on public sector managers to manage risk actively. That is, public sector managers should not fall into the trap of failing to manage risk simply because there is an insurance policy as a safety net. With the increasing provision of public services by the private sector, part of the public sector’s accountability to the Parliament and the public for the effective delivery of public services will be to manage, rather than simply insure against, the risks associated with outsourcing in particular.

**Partnerships and risk sharing**

In an increasingly global environment, the question of competitiveness and/or contestability of the public sector against similar elements in the private sector 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.\(^{174}\) The UK National Audit Office subsequently reported on its response (and strategies) to that policy, including the notion of ‘joined-up’ government.\(^{175}\)
In a similar context, an academic paper published in 1999 by Professor Mark Considine and Jenny Lewis of the University of Melbourne noted the emerging image of ‘network bureaucracy’ stressing co-production of results as against ‘market bureaucracy’ with its emphasis on contracting-in and introduction of quasi-markets. 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 organisations.

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.

The theoretical framework of the market bureaucracy, 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 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 discussed briefly earlier in this presentation, in 1998-99 my Office completed a performance audit of the Department of Defence’s Commercial Support Program, or CSP, which provides a clear example of a large-scale market bureaucracy where service provision is dominated by competitive tendering and contracting. The objective of CSP is to achieve best value for money in the acquisition of support services for Defence and to give the private sector an opportunity to participate in the
provision of those services. The 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 services is prepared.

At the time of report tabling, 94 Defence activities had been market-tested under CSP with a total value of over $1.5 billion. The 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 $155 million. 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.

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 by the APS 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 may become 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
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.\textsuperscript{183}

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,\textsuperscript{184} 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, particularly 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.\textsuperscript{185}

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, it has been commented that:

\textit{While the market form of organisation is thought by its proponents to excel at certain types of cost containment, and is a favoured 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 mobilise 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.\textsuperscript{186}

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. Such arrangements are likely also 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 databases as well as greater electronic integration in a virtual ‘one-stop’ service delivery environment.

However, there do appear to be indications that the network bureaucracy concept is gaining favour. For example, one recent ANAO report\textsuperscript{187} 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 the particular Commonwealth agency, Centrelink, now delivers services on behalf of a total of four agencies under formal purchaser-provider arrangements.\textsuperscript{188}

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 context of agency Annual Reports, as follows:

\textit{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.}\textsuperscript{189}

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 published recently a comprehensive report on service delivery including best practice criteria and a discussion of what distinguishes public from private services.\textsuperscript{190} As well, the report included an analysis of service delivery over the Internet.\textsuperscript{191}

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.

5. 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 and an accent on continuous improvement to achieve better performance. In effect, we are witnessing a 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 proven, 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.

Public sector managers will be held accountable still 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. I note that 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.192
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.

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, it is my view that accountability can assist to improve performance.

Accountability and improved performance stem from integrated, 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 public sector. 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.

The growing convergence between the public and private sectors gives focus to the distinctions between the two, while also offering opportunities for greater partnership and synergy between them. Further, the convergence raises issues about whether there should be a change in the nature of accountability. There are a number of realities to recognise, such as the following observation:

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

In a similar vein Professor Richard Mulgan of the ANU has observed that:

*... as long as management in the public sector continues to be assessed by private sector standards, and as long as the private sector continues to be increasingly entrusted with public purposes, both political and social as well as economic, we can expect further pressure on the distinction between the two sectors in matters of accountability.*

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 for their part are under pressure to recognise the commercial ‘realities’ of operating in the marketplace. A recent paper has drawn attention also to differences in legal responsibilities, particularly in the context of the *Corporate Law Economic Reform Program (CLERP) Act* and the *Commonwealth Authorities and Companies (CAC) Act 1997*.

Corporate governance provides the integrated strategic management framework necessary to achieve the output and outcome performance required to fulfil organisational goals and objectives. Risk and control management are integrated elements of that framework. There is really no point in considering each in isolation. A sound corporate governance framework offers some worthwhile protection against risk. More particularly, the framework offers a chance to improve agency performance.
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 for the public sector. However, the effective implementation of risk management practices is a major challenge for public sector managers, particularly given the public sector culture. Parliament itself, and its Committees, are still coming to grips with the implications of managing risks, instead of minimising them, almost without regard to the costs involved of the latter.

In the past, risk has been related to the possible loss of assets or the emergence of a liability. As a result, risk management has focused on matters that can be covered as insurable losses. However the more contemporary definition of risk is far broader, reflecting the increasing complexity of our corporate and economic environment and incorporating corporate governance, operational and strategic objectives.

I see risk management as an essential, underlying element of the reforms that are currently taking place in the public sector. Management of risk in the public sector involves making decisions that accord with statutory requirements and are consistent with public sector values and ethics. Such an approach encourages a more outward-looking examination of the role of the agency or entity, 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. As well, with the increased emphasis on contestability and the greater convergence of the public and private sectors, there will be a need to focus more systematically on risk management practices in decision-making that will increasingly address issues of cost, quality and financial performance.

There is no doubt that the more ‘market-oriented’ environment being created is inherently more risky from both performance and accountability viewpoints. As I have noted earlier, contracting out, project management and new technology, both computing and communications, make for a new environment which is inherently more risky from both performance and accountability viewpoints than in the past.

Within the APS, old paradigms are being replaced; the new paradigms require us to make substantial adjustments to what were, for some of us, the practices of many years. We are all, my agency included, on a steep learning curve in this new environment. Public servants who may have helped deliver an acquisitions or maintenance program, or perhaps were responsible for an agency’s IT requirements now find that their responsibilities have been delegated to a private sector operator. New skills and new mechanisms are demanded as agencies divest themselves of particular responsibilities but not, they come to realise, of their accountability obligations.

Agency heads undoubtedly feel that the accountability expected of them is greater than in previous years, as not only do they have to manage their own activities but they must also oversee the contractors now performing increasingly what were previously core public sector functions. Although their goal in employing contractors is greater efficiency, this objective, as they very quickly discover, may be confronting in relation to their obligation to adhere to expectations of accountability. The
accountability/efficiency trade-off goes to the very core of their heightened risk profile.

To good managers, the new environment 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 that, 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. As experience shows, good processes contribute to good outcomes.

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 to the changing environment of the public sector with a greater focus on the market and the involvement of the private sector.

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, as well as the internal cohesion and direction, essential to successfully drive the organisation forward and to respond quickly and coherently to changing external conditions.
The latter may demand better networking and development of ‘real’ partnerships, both internally and externally, with other public sector entities and, increasingly, with the private sector. Sound corporate governance frameworks will enhance the development of such networks and partnerships and facilitate risk management so that opportunities can be taken by organisations to be more responsive and improve performance while minimising risk. This is not the responsibility of a few. It involves all of us working cooperatively and sharing experiences and information. In this way we can be more confident about delivering defined outcomes and being accountable for the way in which our results are achieved. Thus, investment in sound corporate governance can indeed provide comprehensive insurance against the myriad of risks that are confronting public sector organisations in an increasingly risky operational environment.
Notes and References


5. ibid., pp. 303-4.


8. Our audit colleagues in New Zealand have recently examined a range of issues surrounding the maintenance of financial and service performance during organisational change in that country.

While their findings for New Zealand have not been tested for the Australian situation, I think that it is of interest that in New Zealand there was found to be a variable degree of success in maintaining financial and service performance during organisational change.

The Auditor-General made the point also that the purpose of organisational change should be clearly articulated to those involved, and that there were practicalities to be considered such as setting realistic time limits for change, ensuring that during change there was clear delineation of roles and responsibilities in the revised structure and ensuring that new skills were available to handle revised functions such as contracting out.


10. ibid., p. 443.


18. ibid.


20. From 1 January 1998, the former *Audit Act 1901* was replaced with three Acts which together provide a robust framework for the financial management of the Commonwealth public sector as follows:
(a) the Auditor-General Act 1997 provides for the appointment, independence, status, powers and responsibilities of the Auditor-General, the establishment of the ANAO and for the audit of the ANAO by the Independent Auditor;

(b) the Financial Management and Accountability Act 1997 sets down the financial regulatory, accountability and accounting framework for Commonwealth bodies such as departments that have no separate legal financial existence of their own (ie they are simply agents of the Commonwealth); and

(c) the Commonwealth Authorities and Companies Act 1997 provides standardised accountability, ethical and reporting provisions for Commonwealth bodies that have a separate legal existence of their own (eg Commonwealth-controlled companies and their subsidiaries and those statutory authorities whose enabling legislation gives them legal power to own money and assets).

21 Kemp, D. 1998, Building the Momentum of APS Reform, address to Public Service and Merit Protection Commission (PSMPC) Lunchtime Seminar, Canberra, 3 August, p. 3.


24 Barrett, P. 1998, Corporate Governance, address by the Auditor-General for Australia to the Defence Audit and Program Evaluation Committee (DAPEC), Canberra, 28 July, p. 4.


26 ibid., p. 1.


29 ibid., p. 2.


33 ibid.

34 ibid.

35 ibid.


40 Barrett, P. 1997, ‘Corporate Governance and Accountability for Performance’, paper for joint seminar conducted by IPAA and the ASCPA on Governance and the Role of the Senior Public Executive, Canberra, August.

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. (p. 13).

As an indication of the importance of this sector, the JCPAA’s report notes that in 1998-99 Commonwealth GBEs accounted for approximately 24.5% of the Commonwealth’s total assets of nearly $165 billion. Department of Finance and Administration (DOFA) has reported that, in 1998-99, GBEs generated revenues of nearly $25 billion, provided dividends of $4.5 billion, and controlled assets of some $40 billion.

Outcomes are defined as the results, impacts or consequences of actions by the Commonwealth on the Australian community.

Barrett, P. 1999, Whither Accountability – the Wisdom of Solomon, presentation to Defence and Strategic Studies Course, Australian Defence College, Canberra, 13 September, p. 16.

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.


In particular, see Clark, J., *CTC: Managing the Legal Risks* and Wedutenko, A., *Contract Performance Management*.
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.


Senate Finance and Public Administration References Committee 1998, op. cit., p. 70.

ibid., p. 71.


United Kingdom National Audit Office 1999, op. cit., p. 64.

Arthur Andersen and Enterprise LSE 2000, op. cit.


United Kingdom National Audit Office 1999, op. cit., p. 52.


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


ibid., p. 25.


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.**

See United Kingdom National Audit Office 1999, *Examining the value for money of deals under the Private Finance Initiative*, op. cit.


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.


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.


127 In late 1997 I completed a performance audit of government monitoring of the activities of Government Business Enterprises. The audit noted that a Government-owned rail transportation and freight business 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 to reduce the risk of future calls on the Government Budget.


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


135 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.

136 Statement of Accounting Standard AAS21 Accounting for the Acquisition of Assets (including Business Entities).


140 The current ANAO audit in the ATO focuses on its internal fraud control arrangements. Audits in the other agencies focus on the management of internal and external fraud control.

141 The Fraud Control Policy of the Commonwealth 1999, Consultation Draft No.1, 21 June.


143 ibid, p. 2.

144 For example, see the decision by Finn J. of the Federal Court of Australia, in Hughes Aircraft Systems vs Airservices Australia, 30 June 1997.
During an internal seminar presentation to the ANAO’s Performance Audit Services Group on 14 April 2000, Ms Rayne De Gruchy, the Chief Executive, Australian Government Solicitor (AGS), noted that only very specific, and limited, legal ‘tied work’ remained sequestered to the AGS. Examples of such work remaining with the AGS that she cited included constitutional and international law.


ibid., p. 5.


DOFA 1999, *Submission to the JCPAA Inquiry into Corporate Governance and Accountability Arrangements for Commonwealth GBES*.


MAB/MIAC 1996, op. cit.
A risk managed fund is a form of self-insurance which collects contributions from participating members, accumulates reserves, and meets future losses from those reserves.


ibid., p. 12.


ibid.


Considine and Lewis 1999, op. cit., p. 471.

Joint Standing Committee on Foreign Affairs, Defence and Trade 1998, *Funding Australia’s Defence*, p. 35.


ibid.

Considine and Lewis 1999, op. cit., p. 471.


ibid., pp. 128-135.


