

Senior Staff of the Board of Audit –  
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**Auditing in an Environment of  
Public/Private Partnership and  
Great Collaboration in the  
Provision of Public Services**

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## **1. INTRODUCTION**

I appreciate the opportunity to address you today on the subject of public/private partnership and collaboration and its growing significance for auditing. In the increasing globalised context in which we are all working today, corporations and government institutions must learn to look at the experiences of the world around them if they are to maintain competitiveness and even viability. That applies in our field of public sector auditing as much as it does in the commercial environment. Indeed, because of the increasing importance of multinational relationships, the imperative to become more global in our outlook becomes ever more pressing. In this context, I would like to set out for you some thoughts, necessarily based on the Australian experience, that reflect on some of the responses demanded of public sector auditors and, in some respects, of the whole audit profession.

My talk today covers three main areas of concern in this more collaborative and demanding environment:

- the Public/Private Interface;
- accountability for performance; and
- adding value to public sector auditing.

I will then draw together some concluding remarks.

## **2. THE PUBLIC/PRIVATE INTERFACE**

All public sector organisations (whether statutory authorities, government agencies, corporations or local authorities) are required to be transparent, responsive and accountable for their activities. Citizens are entitled to know whether public resources are being properly used and what is being achieved with them. Consistent, clear reports of performance and publication of results, are important to record progress and exert pressure for improvement. Such transparency is essential to help ensure that public bodies are fully accountable and is therefore central to good governance.

The challenge for corporate governance is how to deal with, and ensure, proper accountability for performance in all its dimensions with the greater involvement of the private sector in the provision of services to, and in particular for, the public sector. This latter phenomenon has been variously described under many headings, for example new public management, the purchaser-provider model and entrepreneurial governance. The latest emphasis has been on so-called Public-Private Partnerships (PPP) for service delivery. From an academic viewpoint, it would seem to be a mixture of 'public choice' and 'agency' theories, involving transaction-cost economics.<sup>1</sup>

In a more privatised public sector, the question becomes what is a reasonable trade-off when, inevitably in a public sector environment, the perceived needs for accountability can impact adversely on economy and efficiency. A similar

observation extends to the notion of effectiveness, particularly where that concept does not embrace accountability concerns such as transparency, equity of treatment and probity in the use of public resources, including the application of public service values and codes of conduct.

The apparent trade-off has been extensively commented on by, for example, Professor Richard Mulgan of the Australian National University in many articles and presentations in recent years. The following is indicative:

*‘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.’*<sup>2</sup>

A practical comment on the perceived trade-off has been provided by the former Canadian Auditor General, as follows:

*The emphasis should not be solely on greater efficiency or on meeting accountability requirements.*<sup>3</sup>

In other words, an appropriate balance has to be struck, which may involve reconsideration by the Government and the Parliament as to the appropriate nature and level of accountability of both public and private organisations where there is shared responsibility, and even accountability for the delivery of public services to the citizen. However, I am personally inclined to support the observation of Professor John Uhr, also of the Australian National University, that:

*Accountability and responsibility are two parts of a larger whole: whoever is ‘responsible for’ a policy or program is also ‘accountable to’ some authority for their performance within their sphere of responsibility.*<sup>4</sup>

I will discuss this conundrum in more detail in the second part of this address.

When commenting on the need to maintain scrutiny of government operations, Senator Hogg (a Member of the Australian Parliament’s Joint Committee of Public Accounts and Audit (JCPAA)), for instance, has noted that:

*Public funds are not for the private purse of the government nor the bureaucrats to do what they like with. They are public funds for public purposes and should stand the test of public scrutiny by the Parliament.*<sup>5</sup>

This is as it should be. I take the view that accountability of public sector operations depends to a great extent on providing the representatives of the Australian people—that is, Parliament—with wide-ranging information on the operations of agencies and other bodies and on the functions performed therein. In short, Parliament should have access to whatever information is necessary for

accountability purposes. In some situations, because of the nature and complexity of public sector administration in an environment of ongoing reform:

*Additional transparency provisions may be a cost that we have to meet to ensure an acceptable level of accountability.*<sup>6</sup>

There is no suggestion on the part of the Government or Parliament that accountability expectations will be downgraded; if anything, the reforms suggest that additional authority and flexibility require enhanced accountabilities even where there may be an additional cost involved. Parliament's confidence in the accountability of public sector organisations is an on-going challenge to our corporate governance frameworks.

It has been generally recognised that networked arrangements for service delivery, which envisage more sophisticated and cooperative approaches to cross-cutting issues, are likely to focus on the importance of partnerships, coordination and joint working agreements. This is increasingly occurring at the inter-agency level. As well, networking can be expected to evolve to include strategic arrangements and structures between public organisations, private operators and voluntary associations as well as individual clients and the community generally. Such interaction should in turn generate new forms of service delivery and probably redefine the various relationships between government and the community over time. As well, they erode differences between the public and private sectors which, in turn, often tends to focus greater attention on the remaining differences, particularly when considering issues such as public and private interest.

These moves have important ramifications for both responsibility and accountability and raise the question, again, as to 'who is accountable for what?' Are we looking at a more integrated model of public administration? Is it feasible to apply such a model to a more networked environment involving 'real' partnerships as well as direct competition on the basis of genuine competitive neutrality? Figure 1 reflects a more integrated arrangement which directly begs the question as to what trade-offs in approaches are possible and in what situations, not least in the nature and level of accountability and results that can be agreed. Probity, trust and confidence would seem immutable. Some see the creation of a 'level playing field' as levelling down rather than up.<sup>7</sup> Others talk about the 'basic differences' between the public and private sectors.<sup>8</sup>

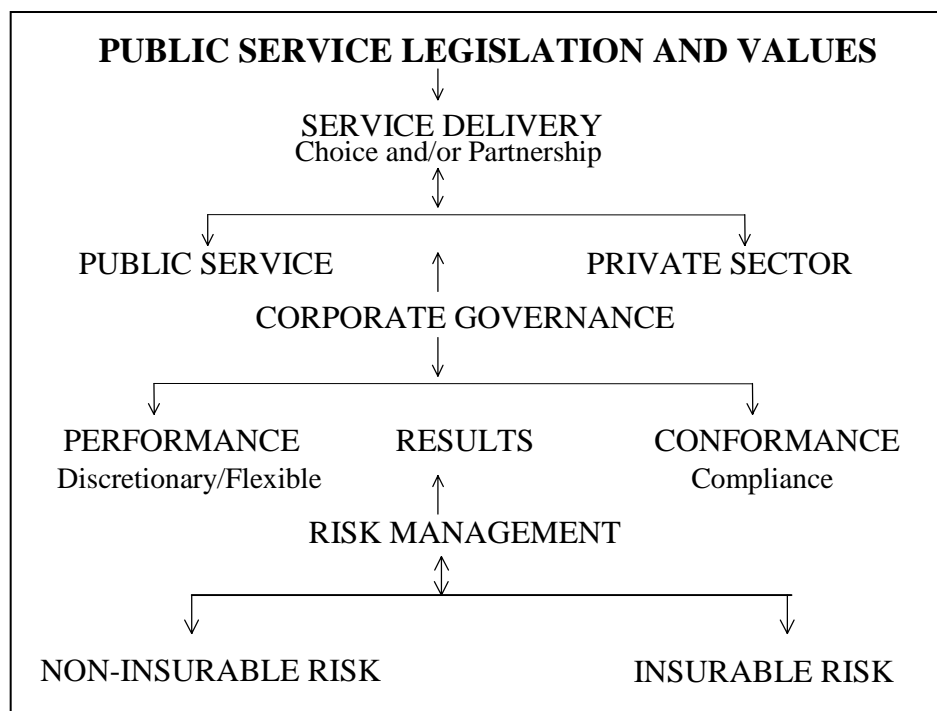
My focus here is on the possible greater integration of both sectors generally, or for selected functions, and not on the creation of two public services reflecting, for example, core government on the one hand, and quasi government operations on the other. Distinctions of the latter kind are often spoken about by Prime Ministers, Ministers and Members of Parliament but, in reality, occur incrementally through a series of policy decisions that transfer particular activities and organisations from the public to the private sector over time. The Minister Assisting the Prime Minister for the Public Service has stated that the Government's objective:

*...has been to focus the APS (Australian Public Service) on its core activities of policy development, legislative implementation and the contracting and oversight of service delivery.<sup>9</sup>*

The Prime Minister has indicated the following list of functions and/or activities that he considers could, and should, be performed and delivered by government:

*...defence, justice, a social security net, the monitoring 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.<sup>10</sup>*

**Figure 1**



A major aim of modern public administration has been expressed as creating the ability to deliver services that appear seamless to the recipient.<sup>11</sup> In other words, the citizen does not necessarily need to know whom he or she is dealing with. In such arrangements, where there is joint responsibility for overseeing and implementing programs across a number of bodies, involving public and/or private sector organisations, a robust governance framework and appropriate accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants, would seem to be required. Perhaps a more controversial aspect is the notion of sharing values, at least to some degree, with the private sector.<sup>12</sup> This may be less of a problem with the not-for-profit segment. Increasingly, relevant governance arrangements will need to cross organisational boundaries to better align activities and reduce barriers to effective cooperation and coordination. Of note, in this respect, is the fact that globalisation has resulted in an increasing number of business networks operating across national borders. Networks do not necessarily require formal organisational

structures to be effective but any arrangements for networking, or coordination, of activities, have to be at least transparent in the public sector.

More networked or partnering arrangements can also help overcome any apparent inflexibilities of a narrowly based contractual relationship. Such arrangements are seen to enable a greater exchange of ideas and information and to allow partners to gain access to knowledge and resources of the other parties which contribute to their joint performance and results. They may also facilitate contract renegotiations and variations which are often more likely to involve WIN-LOSE than WIN-WIN perceptions, including a greater propensity to resort to contract clauses to resolve any problems in working arrangements. A focus on cooperation to overcome any identified problems and/or to deal positively with any issue of collaboration, coupled with a genuine commitment to mutual understanding, can lead to a more productive relationship and better results for all parties. Without such cooperation, it would seem difficult for public sector managers to exert a great deal of influence, or accountability, on private sector providers as opposed to relying on contractual clauses and legal confrontation, even Court action.

Realising the benefits of networking in a cross-cutting mode requires further cultural transformation in government agencies. For example, hierarchical management approaches may need to yield to more 'partnering-type' approaches. Process oriented ways of doing business will need to be at least complemented, if not largely replaced, by results-oriented ones. Organisations operating as virtual 'silos' or 'islands' of activity under devolved authority arrangements will not only need to become more integrated with their partners, but will also have to become more externally focussed if they are to meet the needs of their ultimate clients cost-effectively. What is needed is a positive and encouraging framework for building relationships, meaningful dialogue and genuine cooperation that can lead to:

- *clearer and more realistic performance measurements;*
- *more buy-in on both sides to achieve the results;*
- *a basis for ongoing dialogue throughout the year to improve the likelihood of achieving results; and*
- *capacity for learning and improvement.*<sup>13</sup>

Another important aspect of developing networked solutions is the need to ensure greater availability of information and access to citizens as clients or customers. Information technology is providing significant opportunities for government to put in place facilities for existing and potential clients to have access to the information they require. Information and communications technology provides both the basis to facilitate partnerships and a compelling justification for partnering. It has been suggested that one effect upon businesses in the electronic era, with its emphasis on e-commerce and related technology based service delivery, is that they will need to work more closely together. To fully exploit opportunities created by the Internet will require organisations to develop closer working relationships with their stakeholders.<sup>14</sup> Indeed, rapid advances in

information and communication technologies are likely to demand the establishment of effective partnering and networking to ensure a responsive, efficient and cost-effective public sector providing seamless availability of information and other services to all stakeholders. It could almost be said that there is a 'tyranny of the technology', which is evident even now in many agencies, such as the Taxation Office, with their virtual total dependence on information technology.

### **Private financing of government activities**

A related topic is that of the use of private finance in areas of the public sector such as infrastructure, property, defence and information technology (IT) and the way in which this can lead to risk transfer, or allocation, between the two sectors. Again, the use of such a facility is a test of corporate governance arrangements, literally with shared responsibility, if not accountability. 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.

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. The encouragement of private sector investment in public infrastructure by governments is one response to fiscal pressures. This gives 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. Nevertheless, in a 'cash-strapped' Budget environment, it does provide the opportunity to get significant projects off the ground.

Extensive use has been made of private financing in the United Kingdom (UK). The Private Finance Initiative (PFI) was introduced in 1992 to harness private sector management and expertise in the delivery of public services.<sup>15</sup> By December 1999, agreements for more than 250 PFI 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.<sup>16</sup>

The UK National Audit Office (NAO) has noted that the private finance approach is both new and more complicated than traditional methods of funding public infrastructure.<sup>17</sup> It brings new risks to value for money and requires new skills on the part of the public sector. Since 1997, the NAO 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.<sup>18</sup>

It is not easy to evaluate the overall benefits that accrue from PFIs. 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 relating to 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.

It is apparent that the PFI in the UK is being driven heavily by the objective to transfer risk.<sup>19</sup> 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. However, 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.<sup>20</sup> 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. There would be general agreement that the issue is more about risk allocation than risk transfer. Nevertheless, there is always concern that the ultimate risk often rests with the public sector.

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. At the national level, there has been increasing interest in private financing initiatives, although to date there has been limited actual adoption, notably in the property and defence projects areas. The Department of Defence has recently committed itself to examining the merits of using private financing in the delivery of Defence services, with the aim of realising financial savings or improving effectiveness. Defence services included in this examination are to cover 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, reportedly for as much as 25 to 35 per cent of all future acquisition projects,<sup>21</sup> is to achieve the best affordable operational capability.

As an aside, I note that, in rebutting some criticism that PFI in the Defence context has been seen as 'simply putting Defence capital expenditure on the plastic', the Under Secretary of the Defence Materiel Organisation in Australia has made the point that PFI will link the provision of the capital item or capacity with its life-cycle cost, and hence provide Defence with one *payment for availability*.<sup>22</sup>

An associated move that Defence is making in the area of private financing is to encourage increased participation in such financing methods by small to medium enterprises (SMEs). There are strong indications that SMEs presently feel that the opportunities presented by such initiatives are only within the scope of larger, national and international defence industry players.<sup>23</sup> Interestingly, the Leader of the Opposition in the Federal Parliament recently indicated that a Labor Government would:



- *increase the target value of government purchases from SMEs from 10 to 20 percent;*
- *move to reduce the size of individual government contracts where appropriate in order to ensure that SMEs have more opportunities to tender; and*
- *develop and include in the tender evaluation process a points system for agencies that rewards the inclusion of local SMEs in preferred tenders.*<sup>24</sup>

Of course, any substantial 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 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).<sup>25</sup>

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 agencies 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. The particular challenge for agency management will be to determine what is meant as value for money in terms of the government purchasing policy of the day.

In testing value for money, specific attention, including considerations of accountability, will need to be given by agencies to ensuring that an adequate assessment (pricing) of risk to be transferred between the public and private sectors occurs before such transfer takes place. In that respect, there should be an appropriate public sector comparator, including an assessment being made on a whole-of-government basis. In the latter respect, consideration needs to be given to, for example, the level of expenditure involved and the nature and extent of regulatory arrangements. No doubt these will be considerations undertaken by the new specialist Private Financing Unit (PFU) within the Department of Finance and Administration (Finance). The PFU is to provide a concentrated level of expertise and apply a whole-of-government perspective to potential proposals. The Government expects to issue guidelines in the near future to assist agencies to evaluate private financing proposals. Any savings determined are sensitive to the underlying assumptions used for any comparator as well as consistency of treatment between both the public and private sectors. A perceived lack of consistency has been an issue raised by the private sector in the context of the Government's policy to market test corporate services in all public sector agencies.

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. For example, we have a requirement to ensure ‘competitive neutrality’ with potential private sector providers. This introduces further assumptions and subjectivity to the evaluation process which has been viewed with some concern by the Senate Finance and Public Administration References Committee in a recent hearing on IT Outsourcing<sup>26</sup>. Unless risk is substantially transferred to the private sector, private financing may achieve little other than to 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 where 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 and accountability for the outputs and/or outcomes concerned. In this context, I commend the work done by the UK NAO in examining privately financed projects and in providing sound guidance to auditors on how to examine value for money of privately financed deals<sup>27</sup> as well as identifying better practice in a ‘partnership-type’ relationship.

### **Outsourcing and collaboration**

An interesting outcome of the recent public sector reform directions in Australia is that nearly all of the results the government strives to achieve require the collaborative efforts of two or more agencies/parties/levels of government. Unfocussed and uncoordinated programs waste scarce resources, confuse and frustrate customers or clients (citizens) and limit overall program effectiveness. The development of effective working relationships with stakeholders is, therefore, an important element in a functioning corporate governance framework and can help to identify, overcome and even avoid fragmentation and overlaps in government programs. Market mechanisms may actually create ‘islands’ or ‘silos’ within agencies, particularly where activities are more commercially based and make coordination of services to citizens in a seamless manner that much more difficult for providers, whether in the public or private sectors.

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.<sup>28</sup> The UK National Audit Office subsequently reported on its response (and strategies) to that policy, including the notion of ‘joined-up’ government,<sup>29</sup> with particular comments on risk management. The changes that are occurring at least reflect different risks, perhaps even additional risks, that need to be managed. A particular issue was whether the audit approach would be consistent with the need to manage those risks to achieve the required results. Auditors, generally, have continued to stress the basic differences between risk and risky management.

I noted earlier that partnership arrangements are also likely to be encouraged through the increased adoption and impact of electronic government with its focus on coordination and collaboration in the business environment and with shared databases as well as greater electronic integration in a virtual 'one-stop' service delivery environment. Between agencies, these arrangements are quasi-contractual and tend to be based on 'relational', rather than 'legal', agreements, for example by Memoranda of Understanding. Nevertheless, there are compelling reasons in a number of areas for considering the extension of the relational/partnering approach involving the private sector in a more networked environment. As usual, a balance has to be struck in particular cases between the various demands on managers, which can change depending on circumstances and the environment. The following is a related observation from a private sector perspective:

*...the move to collaborative outsourcing agreements is an admission that the most successful outsourcing organisations are the ones that have a clear idea what they want the outcomes to be, rather than trying to manage (my underlining) the outsourcer.<sup>30</sup>*

In Australia, greater coordination, collaboration, or networking, across agencies is gaining favour as a means of delivering more responsive public services to citizens. For example, an Australian National Audit Office (ANAO) report<sup>31</sup> 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 been managed through a strategic partnering process rather than a legal contractual framework. The arrangements have subsequently expanded such that the particular Commonwealth agency, Centrelink, now delivers services on behalf of a total of four large, and nine other, agencies under formal purchaser-provider arrangements.<sup>32</sup> Centrelink's partnership agreement with the now Department of Family and Community Services reflects their emphasis on building trust; maintaining productive relationships; and dealing positively with legal limitations.<sup>33</sup>

Another example of networking arrangements at the Federal level of Government in Australia is in the area of employment services where a market for such services has been virtually created by outsourcing currently to about 200 private sector providers the responsibility for finding jobs for unemployed people, particularly those who are long term unemployed. The arrangement is known as Job Network. The initial point of contact for a job seeker with the Network is Centrelink. That agency provides information to job seekers and registers, interviews and assesses them for the different levels of assistance.<sup>34</sup> Recently, the Employment Services Minister announced that a review of the Network would assess 'the potential for application of the model to other types of Commonwealth Government services'.<sup>35</sup>

A further indication of a greater move towards network bureaucracies is the renewed focus on the needs of citizens as clients or customers. 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 Australian Public Service. All 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. Two whole-of-government reports have been presented to Parliament reporting, among other things, performance against the ‘principles for developing a Service Charter’ launched in 1997. The second report concluded that:

*Service Charters are proving to be key instruments for innovation and for driving effective service delivery in the 21<sup>st</sup> Century.<sup>36</sup>*

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 real 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 their performance – in effect, trading-off some degree of their individual control for agreement about their joint performance and results to be achieved.

### **Governments as minority shareholders**

In various countries, governments have taken out minority shareholdings in private companies for the purpose of delivering public services. This may be as a result of a deliberate decision that this is a desirable policy response to a particular situation, or as a step on the way to a more privately centred delivery pattern. It seems, from studies by the INTOSAI Working Group on the Audit of Privatisation that in developed economies, this arrangement is likely to represent a small proportion of economic activity. The working group commented:

*There is widespread recognition of the exposure of the state to risk as a result of these holdings (eg of exposure to demand for financial support if the business gets into difficulty, or of criticism from wholly owned or non-subsidised private sector competitors about unfair competition). It is also clear that the state does not have any more legal rights and protection than those offered to other minority shareholders, even though it may in practice if not in law be more exposed to demands for support from the private business than private shareholders (eg indemnities, explicit or implicit).<sup>37</sup>*

Accordingly, the Working Group pointed to the need for more guidance on issues such as:

- *what are the risks to which the state is exposed where it is a minority shareholder and how these can best be managed;*
- *what steps the state needs to take to ensure that its interests are protected (eg by stating its objectives for its investment, ascertaining and securing its legal rights, valuing its contribution, securing a reasonable return, minimising moral hazard);*
- *the skills needed by public bodies required to monitor minority shareholdings or seeking to acquire such holdings;*
- *incentives for public bodies and their staff to protect the state's interests; and*
- *how to carry out constructive examinations where they have access rights to the public body responsible for the state's minority shareholding but not to the private business itself.*<sup>38</sup>

### **Governing the public-private sectors' interrelationships**

Convergence between the public and private sectors has drawn attention to sharing approaches and experiences in relation to corporate governance, particularly in managing the interrelationships. The main focus, however, has been on managing contracts and outsourcing arrangements.

Managing the risks associated with the increased involvement of the private sector in the delivery of government services, particularly through contract arrangements, has required the development and/or enhancement of a range of commercial, negotiating, project and contract management skills across the public sector. We have learnt quickly that outsourcing places considerable focus and emphasis on project and contract management, including management of the underlying risks involved, both within and outside the public sector. The problem has been to achieve both management understanding of, and action on, these imperatives in a reasonable time period.

Over recent years, there has been considerable attention through the audits of the ANAO on the necessity of having in place the 'right' contract, as well as appropriate contract management arrangements, to assist in meeting organisational objectives and strategies. This reflects the greater involvement of the private sector in providing a wide range of public services. One important lesson we have learnt, and that is being reinforced constantly, is that:

*... clear identification and articulation of contract requirements at the outset can save considerable time, cost and effort later in contract management.*<sup>39</sup>

A common theme of these audit reports has been the deficiencies in the project management skills of agency decision-makers. This 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.

Our Parliament and 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. Future audit reports will closely examine relevant contracting issues to ensure that this happens.

### **Risk management as part of sound corporate governance**

The ANAO's experience with outsourcing in recent years<sup>40</sup>, indicates that there is a range of challenges to organisations in seeking innovative solutions to the achievement of business outputs and outcomes through contracting. In particular, the audits have drawn attention to agency deficiencies, particularly in commercial and management skills, to implement risk management effectively in a contractual environment. This is basically a corporate governance issue exacerbated in some ways by the more restricted roles of central agencies in an era where the centrepiece of public service reforms is devolution of authority, complemented by principles-based legislation that helps to form the governance framework for public sector agencies and other bodies.

Management of key business risks tailored to a contractual environment will ensure contracting achieves benefits such as increased flexibility in service delivery, greater focus on outputs and outcomes, freedom of public sector management to focus on higher priorities, suppliers encouraged to provide innovative solutions, and cost savings in providing services.<sup>41</sup> The following is a checklist of risks and benefits of contracting versus in-house provision which was provided in a report<sup>42</sup> of a study conducted into government contracts in the State of Victoria last year.

**Table 1. Risk and Benefits**

<p><i>Contracted provision: benefits</i></p> <ul style="list-style-type: none"> <li>• Services precisely specified</li> <li>• Capacity to enforce</li> <li>• Duties and responsibilities of parties clear</li> <li>• Risks can be allocated to most suitable party</li> </ul>	<p><i>Contracted provision: risks</i></p> <ul style="list-style-type: none"> <li>• Inflexibility</li> <li>• Litigation</li> <li>• Transaction costs</li> <li>• Policy options may be committed for many years into the future</li> </ul>
<p><i>Direct public provision: benefits</i></p> <ul style="list-style-type: none"> <li>• Flexibility</li> <li>• Staff can be directed to remedy errors without resort to litigation</li> </ul>	<p><i>Direct public provision: risks</i></p> <ul style="list-style-type: none"> <li>• Vague specification leading to poor cost control</li> <li>• State may bear wide range of risks</li> </ul>

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 commercial, negotiating, project and contract management skills across the public sector. As such they will be a key accountability requirement of public sector managers.

Agency management has come to grips with these contractual imperatives to varying degrees. However, the transition periods to full contract management have usually left little scope for planned and managed adjustment. Failure to install planned transitional arrangements is not only increasing organisational risk, but also reducing management's capacity to deal with it effectively, both in avoiding unnecessary costs and forgoing opportunities for enhanced performance.

Although the public sector may contract out service delivery, this does not necessarily equate to contracting out the total responsibility for the delivery of the service or program, as I observed earlier. The expectation of each agency and its management is to ensure that the government's objectives are delivered in a cost-effective manner and to be accountable for that outcome and the manner of its delivery. The bottom line, as is often reiterated by the Parliament, is that accountability cannot be outsourced. However, in the more networked environment discussed earlier, we may need to re-think the practicality of the notion of some sharing of accountability where there is apparent sharing of responsibility.

To be effective, the risk management process needs to be rigorous and systematic.<sup>43</sup> If organisations do not take a comprehensive approach to risk management then directors and/or 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.

These same indications are coming from various surveys of both the public and private sectors in Australia. One lesson for the public sector is that risk can be an opportunity for better performance as well as something to be avoided and/or minimised. In a world of uncertainty, we experience insurable and uninsurable risks, both of which have to be managed. In the public sector in Australia, it is estimated that about one third of risks are insurable. A significant risk for any service industry is the inability to provide the expected services to stakeholders. In the public sector, this is also a significant political risk which Ministers fully appreciate.

Business continuity is at the core of effective corporate governance. 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, last year my Office prepared a *Business Continuity Management Guide*.<sup>44</sup> 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. (An 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 last 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.*<sup>45</sup>

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. And this is a major concern in any outsourcing arrangement which has to be closely managed as a major contributor to a business function, particularly in the transition stages from in-house provision. No-one wants to ‘bet their business’ and/or fail in their responsibilities to stakeholders, particularly citizens.

### **The information technology (IT) outsourcing lessons**

The outsourcing of IT in the Commonwealth sphere in Australia arose from a government decision known as the IT Initiative, which was to transfer around \$A4 billion of IT provision in Federal agencies to the private sector. The then Office of Asset Sales and Information Technology Outsourcing (OASITO) managed the Initiative centrally for the government through a series of tenders dealing with groupings of agencies (clusters). These clusters were determined without adequate consultation and involvement of the agencies concerned and, in effect mandated, as opposed to agencies being allowed voluntary participation in groupings with accepted synergy and shared purpose.



Within the public service, there was a variable degree of support for the Office in the way it went about letting the tenders. Several Chief Executives had significant doubts about the ability of the Initiative to deliver the savings projected for it and/or to deliver the quality of service required. Being responsible for the results, it is not surprising that they wanted to assess the Initiative's implementation carefully. Unfortunately, this was later perceived as an unwillingness to change, as I will shortly discuss.

In particular, for those agencies where the IT requirement was predominantly scientific (for example the Bureau of Meteorology or the Commonwealth Scientific and Industrial Research Organisation) or otherwise related to the core activities of a particular agency (for example, the payment of pensions), the arrangement posed significant problems of corporate governance for them. The approach taken by OASITO was designed to implement the Government's policy agenda under centralised direction (and control) despite the perceived reluctance (buy-in) of some of the agency heads because they did not have the degree of control necessary to best manage transition risks, and because they were ultimately responsible for the agency outputs and outcomes and the budgets involved.<sup>46</sup>

Preliminary studies identified significant savings that would accrue from implementing the Initiative. Indeed, the projected savings from the implementation of the IT Initiative were removed, upfront, from the respective agency's forward estimates. What is significant is that the financial evaluation methodology applied in the tenders did not allow for two key factors that were material to the assessment of savings arising from outsourcing the services. The evaluations did not consider the service potential associated with agency assets expected to be on hand at the end of the evaluation period under the business-as-usual case, or the costs arising from the Commonwealth's guarantee of the external service provider's (ESP) asset values under the outsourcing case. Consequently, the financial savings realised by the agencies from outsourcing, as quantified in the tender evaluations, were overstated. This was disputed by OASITO, the central oversighting agency (the Department of Finance and Administration) and by the Minister concerned.

The central issue turned on interpretation of the accounting standard dealing with financial and operational leases. The different interpretations extended into the private sector which were later reviewed by the Joint Committee of Public Accounts and Audit (JCPAA). The JCPAA is currently preparing its report on its own inquiries into the IT Initiative and the outsourcing experience to date.

The ANAO identified a range of issues on which agencies should place particular focus in the management of IT outsourcing arrangements as follows:

- identification and management of 'whole of contract' issues including the retention of corporate knowledge, succession planning, and industrial relations and legal issues;

- the preparation for and management of, including expectations from, the initial transition to an outsourced arrangement, particularly when a number of agencies are grouped together under a single agreement;
- putting in place a management regime and strategy that encourages an effective long term working relationship with the ESP, while maintaining a focus on contract deliverables and transparency in the exercise of statutory accountability and resource management requirements;
- defining the service levels and other deliverables in the agreement so as to focus unambiguously on the management effort of both the ESP and agencies on the aspects of service delivery most relevant to agencies' business requirements; and
- the ESP's appreciation of, and ability to provide, the performance and invoicing information required by agencies in order to support effective contract management, as well as from both an agency performance and accountability point of view.

As a response to the audit, the Government commissioned a review of IT outsourcing conducted by Richard Humphry AO (Managing Director, Australian Stock Exchange). The independent review recognised the implicit management dilemma described above and recommended that, because Chief Executive Officers (CEOs) of agencies had the statutory responsibility, they should be responsible for the outsourcing decisions. In particular, decisions that impacted upon the core business of the agency needed to be taken at agency level. Mr Humphry remarked:

*Priority has been given to executing outsourced contracts without adequate regard to the highly sensitive risk and complex processes of transition and the ongoing management of the outsourced business arrangement.*<sup>47</sup>

The review pointed out that there were several risk management lessons to be learned as follows:

- the most significant risk factors were the unwillingness to change and the failure to buy in the appropriate expertise;
- there was a lack of focus on the operational aspects of implementation;
- there was insufficient attention paid to the necessary process of understanding the agencies' business; and
- there was insufficient consultation with key stakeholders.<sup>48</sup>

The review drew heavily on the Standards Australia publication HB 240:2000, *Guidelines for Managing Risk in Outsourcing*.

The Government agreed with the ten recommendations made by the review, some with qualification.<sup>49</sup> This included that responsibility for implementation of the IT Initiative be devolved to Commonwealth agencies in accordance with

the culture of performance and accountability incorporated in the relevant financial management legislation. Agencies are required to obtain value for money (including savings) and maximise Australian industry development outcomes. Agency heads will be held directly accountable for achieving these objectives within a reasonable timeframe, as well as grouping with other agencies at their discretion, wherever possible, to establish the economies of scale required to maximise outcomes.

Agencies will also be responsible for addressing implementation risks. A separate body has been established within the Department of Finance and Administration to advise agencies, at their request and on a fee for service basis, on managing their transition. Audit experience indicates that the agency emphasis has to be on developing a robust analysis of business requirements at the initial stage, which would be the basis of a strong business case for whatever IT strategy is developed. Without OASITO's involvement, the industry can now deal directly, from the outset, with the people responsible for the function and related outputs and outcomes, as well as with those who will be managing the contract. The inability to have this relationship was the subject of criticism by the industry under the previous arrangements managed by OASITO. This is a significant lesson for all future outsourcing arrangements.

### **Dealing with legal issues in contractual arrangements**

Of particular concern to contract managers, in an outsourcing situation, is how to establish a sound contract and contracting environment. One area of expertise they seek in this process is appropriate legal advice. For example, there are 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. Outcomes can be difficult to specify and indeed may even be the combined product of more than one agency, as I noted earlier. Given these complex linkages, it can therefore be difficult to specify, in order to press for successful contractor performance, the circumstances in which 'non-performance' has occurred or what constitute enforceable responses.

Legal advice should be framed with reference not only to the contract but should also give consideration to the relationship between the contractor and government organisation and the risks the government is exposed to by contracting-out that particular service. OASITO's legal advisers conducted a high level assessment of the legal risks associated with the provision by an external contractor of IT infrastructure services to agencies within a cluster. A considerable number of such risks were identified.<sup>50</sup> Inevitably, so-called transactions costs associated with outsourcing arrangements seemed to be overlooked and/or under-stated.

Equally, unfortunately, is that experience to date has generally shown a risk averse approach to contracting and contract management which has led, in some cases, to an ineffective and inefficient provision of the services under contract. The issue is not simply about a legal process or rules-based culture of public service as opposed to the need to be more responsive and results

oriented. The concern is about achieving the 'right' balance of complementary behaviour and approach to meet both accountability and performance imperatives in sometimes widely varying situations. A robust corporate governance framework can help achieve such a balance.

Effective contract administration in the public sector goes beyond simply trying to hold contractors to account for each minute detail of the contract. 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 that recognises their functional and business imperatives. It is a question of achieving a suitable balance between ensuring strict contract compliance, with resort to legal processes as considered necessary, and working with providers in a partnership context to achieve the required result. According to the OECD:

*'A good contract is one that strikes, at a level which will be robust over time, a balance between specification and trust which is appropriate to the risks of non-performance but does not impose unnecessary transaction costs or inhibit the capacity or motivation of the agency to contribute anonymously and creatively to the enterprise in question.'*<sup>51</sup>

A recent innovation, at least in the Australian context of public sector contracting, has been the use of project alliancing, for the construction of the National Museum of Australia (NMA) and the Australian Institute of Aboriginal and Torres Strait Islander Studies (AIATSIS).<sup>52</sup> A relatively new method of contracting, a project alliance, is an agreement between two or more parties, the project owner and the contractor/s, who undertake work cooperatively, on the basis of sharing the risks and rewards of the project, without either or both having to resort to constant legal advice. Although project alliancing is a business relationship, the aim is to achieve agreed commercial outcomes based on the principles of good faith and trust. As such, it offers potential benefits over traditional contracting but also raises new and different risks that have to be managed. Again it is important that staff required to manage the project have the appropriate skills and knowledge in order to ensure that the project results are effectively achieved. In a recent presentation to ANAO staff, Professor John Langford of the University of Victoria in Canada observed that the general consensus about managing alliances was that it was as difficult as 'stirring concrete with eyelashes', a mind-boggling thought. However, I am more optimistic than that.

The recently issued ANAO Better Practice Guide on Contract Management, quoted earlier, emphasises the importance of not only dealing effectively with risk in contracts but also in developing and maintaining a relationship with the contractor that supports the objectives of both parties and focuses on the agreed results to be achieved. However, as recently observed by the Senate Finance and Public Administration References Committee, there are also concerns that both parties do not understand, or are insufficiently aware of, the requirements for parliamentary accountability.<sup>53</sup> It would be unfortunate if this were perceived as a narrowly based concern with legal process and protection.

## Privacy and security

The question of access to private contractor's premises and records is important to us all and I will come to it later. What I wish to discuss here is how the privacy concerns of citizens are protected in an environment where responsibility for the delivery of services and the collection of information is performed by the private sector on behalf of the government.

For the public sector, with the increased involvement of the private sector in the provision of public services, the security of agency data, and particularly electronic data, is another critical issue that needs to be effectively managed. Contracts negotiated between Australian federal 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. Contracts for outsourcing service delivery need to ensure that prospective service providers are aware of the standard of protection that comes from dealing with people on behalf of the government and that the mechanisms in place do provide effective privacy protection for individuals or groups in society. A watchful citizenry will want to be certain that agencies and their contractors cannot evade their obligations.

To fully address such concerns, a Better Practice Guide, recently prepared by the ANAO,<sup>54</sup> suggests that agency Internet websites should incorporate a prominently displayed Privacy Statement which states what information is collected, for what purpose, and how this information is used, if it is disclosed and to whom. It should also address any other privacy issues.<sup>55</sup>

The risks involved in broadening networks and Internet use also raise issues associated with who has access to an agency's records. This has consequences for the privacy and confidentiality of records, which are of considerable concern to Parliament. This is particularly the case during outsourcing, where private sector service providers have access to collections of personal records that could be used for inappropriate purposes, such as sales to other private sector organisations of mailing lists.

All Commonwealth agencies are subject to the *Privacy Act 1998*, which contains a number of Information Privacy Principles (IPPs) that provide for the security and storage of personal information. The Privacy Act defines personal information as:

*information or an opinion (including information or an opinion forming part of a database), whether true or not, and whether recorded in a material form or not, about an individual whose identity is apparent, or can reasonably be ascertained, from the information or opinion.*<sup>56</sup>

The IPPs state that if a record is to be given to a service provider, the recordkeeper (ie the agency) must do everything reasonably within its power to prevent unauthorised use or disclosure of information contained in the record.

The increased involvement of the private sector in the provision of public services raises issues about the security of agency data and records, particularly in electronic form. In the past, the obligations that apply to Commonwealth agencies under the Privacy Act have not applied to private sector organisations. However, the Privacy Amendment (Private Sector) Act 2000 passed in December last aims to provide privacy protection for personal records across the private sector, including those organisations providing outsourced services to the public sector. The Act enables a contract between a Commonwealth agency and the private sector supplier to be the primary source of the contractors' privacy obligations regarding personal records. The contractual clauses must be consistent with the IPPs that apply to the agency itself, and details of these privacy clauses must be released on request. The Act:

*aims to control the way information is used and stored, and bring to justice those who abuse private information for their own ends. Placed in the insecure context of e-commerce and e-mail transmission of personal details, issues of privacy have become more significant.*<sup>57</sup>

For many organisations, including health services, the new private sector provisions will commence on 21 December 2001. For small businesses to which the provisions will apply (except health services), the new provisions will commence one year later. The Act will apply to 'organisations' in the private sector. An organisation can be an individual, a body corporate, a partnership, an unincorporated association or a trust. It will cover:

- businesses, including not-for-profit organisations such as charitable organisations, sports clubs and unions, with a turnover of more than \$3 million;
- federal government contractors;
- health service providers that hold health information (even if their turnover is less than \$3 million);
- organisations that carry on a business that collects or discloses personal information for a benefit, service or advantage (even if their turnover is less than \$3 million);
- small businesses with a turnover of less than \$3 million that choose to opt-in;
- incorporated State Government business enterprises; and

- any organisation that regulations say are covered<sup>58</sup>.

A key provision of the Act is the inclusion of ten '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 Act makes a distinction between 'personal' and 'sensitive' information<sup>59</sup>. 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 is likely to have a marked impact on that sector's involvement in the delivery of public services.<sup>60</sup>

For those organisations and industry sectors seeking to develop their own privacy codes, the Privacy Commissioner released for comment a draft set of Guidelines on 10 April which are available on the Commissioner's web-site ([www.privacy.gov.au](http://www.privacy.gov.au)).

Section 95B of the *Privacy Amendment (Private Sector) Act 2000* requires agencies to consider their own obligations under the Act when entering into Commonwealth contracts and obliges them to take contractual measures to ensure that a contracted service provider does not do an act, or engage in a practice, that would breach an Information Privacy Principle if done by the agency. The obligation on the agency extends to ensuring that such an act or practice is not authorised by a subcontract.

To ensure that individuals can find out about the content of privacy clauses agreed between agencies and organisations and included in Commonwealth contracts, section 95C enables a person to ask a party to the contract for information about any provisions of the contract that are inconsistent with an approved privacy code binding the party or the National Privacy Principles. The party requested must inform the person in writing of any such provisions. This ensures that parties to a Commonwealth contract cannot claim that provisions are confidential in respect of privacy standards in Commonwealth contracts, thereby preserving accountability and openness in respect of these standards.

Under the Privacy Act as currently constituted, privacy monitoring of outsourcing arrangements falls into two stages:

- assessing the privacy control environment, particularly by ensuring that outsourcing arrangements are governed by contracts that contain appropriate privacy clauses; and
- monitoring the actual implementation of the controls, particularly by monitoring compliance with the contractual clauses.<sup>61</sup>

In practice, to date, feedback from outsourcing agencies and contractors suggests that few, if any, complaints have arisen in relation to privacy breaches associated with outsourcing contracts.<sup>62</sup>

Agencies must also consider the privacy of personal records that are provided to other public sector entities for purposes such as data-matching. There are quite valid privacy protection reservations about the use of data matching, but there is no doubt that it has facilitated better decision-making as well as saving the taxpayer many hundreds of millions of dollars.

Although they probably do not come within a strict Privacy Act definition, the use of clickstream data (collecting information on access to the site, such as server address, top level domain name, pages accessed and so on) and cookies (that can be used to track individual's activities on a web site) are important sources of data on performance that have privacy implications. Many users consider cookies, in particular, intrusive. For practical purposes they should be treated in the same way as other privacy related material. In the interests of transparency their use should be declared. However, legal opinion suggests that the 'click and accept' method by which web page hosts solicit visitors' consent, might need to involve an upfront explanation and then a requirement to check consent at the end of each section and at the bottom of each page.<sup>63</sup>

The current and emerging issues that I have mentioned will continue to become significant as agencies grapple with the challenges presented by the present APS environment, such as increased outsourcing and IT usage. As new high risk areas emerge, public sector agencies need to adopt modern practices to correct underlying management problems that impede effective system development and operations, even where these are outsourced. Robust corporate governance processes that are pervasive throughout an organisation will both help to identify and deal with such problems. Record-keeping is basic to such processes. That is also a focus of audit activity and which is also central to its effectiveness in providing adequate assurance to all stakeholders.

Audit reports have also examined the usefulness of adequate and accessible register systems, and appropriate physical security measures for important and confidential documents, such as Commonwealth guarantees, indemnities and letters of comfort. The ANAO's audit of the *Operation of the Classification System for Protecting Sensitive Information*<sup>64</sup> found that all organisations covered by the audit were not adequately protecting the confidentiality of sensitive information in accordance with the Commonwealth's security classification system, policy and standards, and recognised best practice. As a result, there was a high risk of unauthorised access to sensitive information within most of the organisations examined, particularly in relation to staff and other people dealing with the organisations, such as contractors and clients.

An audit survey found that security was an important issue for agencies intending to use the Internet. Fifty-three of all agencies covered rated data security as a high, or very high, impediment to the introduction of electronic service delivery (ESD). Indeed, this reflects the increasingly confidential, sensitive and, indeed valuable, information that is being shared over both internal and external networks. Such concerns are being exacerbated by the use of developing wireless technologies which have still to pass any stringent security testing. Access is both a technical and a security issue. The current trend towards increased contracting with the private sector for the provision of



government services provides a challenge, not only for agencies' accountability, but also for the ANAO's actual ability to access the relevant records.

A particular issue bearing on the outsourcing question became apparent in an audit we conducted on internal fraud control arrangements in the Australian Taxation Office (ATO)<sup>65</sup>. The ANAO noted the significant risks associated with ensuring the security of the ATO IT systems. These risks related primarily to the storage of taxpayer data on the ATO Wide Area Network and the granting and monitoring of staff access to the ATO IT systems.

The audit also found that these risks factors increased due to the outsourcing of many IT systems functions. This was the result of the IT contractor's staff having limited exposure to ATO fraud prevention, education and awareness material and programs in comparison to that of ATO employees.<sup>66</sup> As well, the ATO could provide no evidence that the IT security section had monitored contractors' activity to ensure compliance with taxpayer data security provisions of its outsourcing contracts.<sup>67</sup>

### **Administrative law considerations**

Inevitably, contracting-out blurs the boundary between public and private law. In particular, the way in which citizens may seek remedy under administrative law for decisions taken by a body that is not itself a statutory body or a government agency. As one commentator has noted:

*The administrative law system is the principal means by which government is accountable to individuals. It also reinforces and complements the mechanisms for financial and political accountability.*<sup>68</sup>

Unless great care is taken, contracts can have the effect of removing an individual's access to:

- Freedom of Information rights;
- the jurisdiction of the Ombudsman or similar review mechanisms; or
- the rights of litigation under administrative law.

Governments are responsible for a wide range of outcomes that affect the well-being of its citizens. That well-being can be understood differently in the context of a variety of social, economic, and political considerations. Governments are obliged to pursue that responsibility by selecting the most appropriate means available to them at the time. Contracts are one such instrument. The move to greater contracting by governments has been largely prompted by considerations of efficiency. But the efficient use of the public resources is not all there is to public governance. It is important that contracts entered into on behalf of the government do not have the effect of unnecessarily restricting the freedom of policy action by successive

governments, while recognising the advantages in certain areas of longer term contracts for all parties concerned.

Contracts for the supply of goods and services often extend for periods in excess of the particular life of the Parliament or the government of the day. Some have consequences that can last for generations, for example, water or waste management. What is important in these circumstances is that administrators do not enter into contracts that have the effect of unnecessarily limiting the ability of governments to use their executive power flexibly for the public good. While there are clearly policy issues involved in this connexion, which are generally outside the audit mandate, there are also resourcing and other issues which would be integral to any contract on which audit assurance would be sought.

The Administrative Law principles require the ANAO's reports to refer to evidence in support of each conclusion reached. As well, each conclusion should be clear and substantiated. A conclusion that there is no evidence about a matter should not be made without having conducted reasonable inquiries to check for the existence of such evidence. In particular, we need to be clear as to the extent of a conclusion. Any conclusion expressly, or impliedly, critical of a person or body should not be made unless that person/body has been informed of the adverse material relevant to that conclusion. In addition, the person/body has to be given a reasonable opportunity to comment or respond to any adverse material. This is a matter of natural justice, with its origins in natural law, which I will shortly discuss further. However, Audit Offices are well aware of the foregoing requirements from professional auditing disciplines.

### **Equity Law and natural justice**

In any consideration of Government contractual arrangements there are also considerations of the law of equity. A former Chief Justice of the High Court of Australia, Sir Anthony Mason, has remarked:

*One aspect of the latest developments in equity is the increasing penetration of equitable doctrine into contract and commercial law...*

and

*It seems inevitable that equity's penetration of commercial transactions, which depends so much on the way in which parties formulate their contracts and shape their arrangements will increase.<sup>69</sup>*

In Australia, the High Court has made it clear that equitable doctrines can apply to the Government as well as to individuals.<sup>70</sup>

My colleague, the Auditor-General of South Australia makes the following comment:

*Where Government transactions are complex and the details of contractual arrangements are confidential the likelihood that outsiders will misunderstand the relationship between the Government agency and private parties increases substantially. The result is a potential future liability of Government for the reasonable reliance by those outsiders due to representations made either by the Government or the private parties involved in the transaction. It has been suggested that the protection of reasonable expectations is more important when government is involved because 'government should act and be obliged to act as a "moral exemplar" in its relationships and dealings with members of the community'.<sup>71</sup>*

Consistent with the Attorney-General's responsibility for the maintenance of proper standards in litigation, the Commonwealth Government and its agencies must behave as a model litigant in the conduct of litigation. Being a model litigant requires us to act with complete propriety, fairly and in accordance with the highest professional standards. This expectation has been recognised by the Courts.<sup>72</sup>

In practical terms, the foregoing discussion suggests that there is a higher standard of integrity demanded of governments and administrators when dealing with the private sector. It is also important to see that where external service providers operate on the government's behalf, they understand and abide by that higher level of expectation. Ultimately, it is the government administrator who is responsible for ensuring that higher expectations of service are met but, as noted earlier, there may be scope in collaborative arrangements for shared responsibilities in this respect.

A particular issue has arisen in relation to our performance audits about the coverage of private sector individuals and firms. As with a number of other Supreme Audit Institutions (SAIs), we provide a copy of our draft reports, in part or whole, to those affected for their comment. Our legislation provides for a period of 28 days for submission of comments on draft reports, which I must consider before preparing a final report (Section 19 of the *Auditor-General Act 1997*). As noted earlier, we have to provide 'natural justice', or procedural fairness as some term it, to those identified in our reports. Natural justice has been described as the minimum standard of fairness that has to be applied in the adjudication of a dispute.<sup>73</sup> It consists basically of two elements, one to ensure a fair hearing, and the other to act without bias. Because of some uncertainty as to the extension of Parliamentary Privilege to such reports, questions of defamation action have arisen. The standard of proof applicable to findings in an audit report is the 'civil standard', that is, it is more probable than not that the matter found to have occurred in fact occurred. This has resulted in the ANAO having to seek legal opinions on some of its reports dealing with private sector participation in government activities.

However, there has also been a problem of the private sector seeing the draft report commentary process as being one for 'negotiation' as to what is to be

included in the final report, rather than ensuring that the ANAO has an accurate understanding of the ‘facts’ of the situation and that those ‘facts’ are correct as would normally occur with public sector agencies and bodies. I made the point in my annual report last year that:

*...full cooperation in responding on this basis will save all parties considerable time and cost and engender confidence in the process.<sup>74</sup>*

I went on to observe that conflicts of public and private interests are not new, but their resolution in performance audit reports is a challenge to all parties without a genuine shared understanding of what constitutes public accountability and, indeed, performance and results.

### **Values and Ethics**

It hardly needs to be emphasised that the ethical administration of government contracts is a key consideration of Audit Offices. In practical terms, however, particularly where fraud and/or corruption is involved, there is a requirement for the application of a range of forensic auditing skills that are not often within the skillset of our public auditors. Conflicts of interest, whether real or apparent, can become increasingly difficult to define, let alone identify, as agencies become further removed from the locus of decision making. At least contracts should be examined to make sure that they establish suitable procedures to expose potential real, or apparent, conflicts of interest.

*The Financial Management and Accountability Act 1997* requires Chief Executives to promote the efficient, effective and ethical use of Commonwealth resources for which the Chief Executives are responsible (part 7, section 44). The Public Service Act sets out the Australian Public Service (APS) Values (part 3, section 10), and the APS Code of Conduct (part 3, section 13). In addition, an agency head must uphold and promote the APS Values (part 3, section 12), as well as being bound by the Code of Conduct (part 3, section 14). The latter section also binds statutory office holders. These Values and the Code of Conduct form the framework for the ANAO’s Code of Conduct which also includes our professional responsibilities.

At the very least, private sector providers need to have these Values and Codes of Conduct brought to their attention. It is highly desirable that they not only be informed of, but also make some effort to understand, the requirements and implications for identified performance and results to be achieved. There are community concerns that private sector service providers are not subject to the same legal requirements as public servants are in these respects. However, it is clearly difficult to impose contractual conditions involving values and ethics that are practically enforceable. That conundrum points to the need to agree on a shared culture, including values and ethics as part of any partnership or collaborative agreement between public sector agencies and private sector providers. At a minimum, there needs to be a shared understanding of what that involves. It would be of considerable advantage to have voluntary adherence in those contractual areas where these are central issues.

### 3. ACCOUNTABILITY FOR PERFORMANCE

The simplest explanation of accountability is the requirement to answer to somebody for something. And therein lie the seeds of possible confusion, conflict and often public recrimination. As the then Management Advisory Board to the Australian Government and its Management Improvement Advisory Committee (MAB-MIAC) observed in 1993:

*In describing the accountability mechanisms within the public service, care has been taken to clarify the basic relationship between the complementary concepts of authority, responsibility and accountability. A mismatch between the first two elements can weaken the accountability relationship.*<sup>75</sup>

It is this relationship that I want to address today, mainly in the context of the greater involvement of the private sector in the Australian Public Service (APS), not only as a supplier to, but also particularly as a direct provider of, that service. In that context, it is useful to see:

*accountability as existing where there is 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.*<sup>76</sup>

Put simply, the challenge becomes to identify who is accountable for what, as I noted early in the address. I accept that there is a continuum of accountability relationships between the electorate, the Parliament, the Government and the public service.<sup>77</sup> However, the ongoing difficulty is to define such relationships in a credible manner that is acceptable to all those parties. This difficulty continues to be exacerbated by successive governments in Australia not having control of the Senate, which puts greater pressure particularly on the accountability relationship between the Parliament and the Government. That, in turn, raises issues for the accountability relationships of the public service with each of those parties. I will also discuss some illustrative examples of such issues to assist understanding.

The clearest accountability imperative is adherence to the rule of law. Conversely, the greatest uncertainties and conflicts are created by the administrative, particularly political, environment and its demands that are not clearly related to the legal framework applying to the public service, including any guidelines derived from particular statutes. Sometimes this is simply described as an area of discretion or judgement. While public servants have always had to deal extensively in such an area, not least of all because of differing political philosophies and expectations, as well as the demands of value systems and codes of conduct, the accountability equation has been made more difficult with recent public service reforms involving greater private sector involvement and related issues of public and private interests. The latter issues are as much about establishing possible commonality as they are about

dealing positively with inherent differences. This is a consistent theme of this presentation.

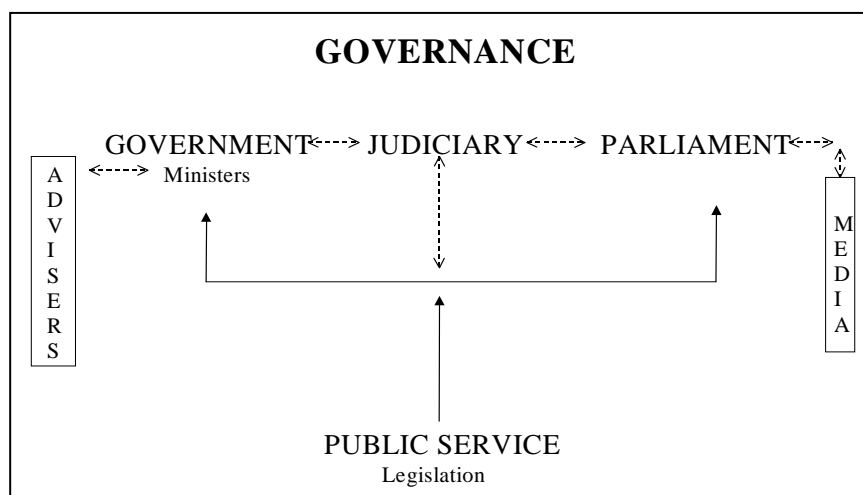
I have noted that, at the federal level of Government, there is a clear legal requirement for Chief Executive Officers (CEOs) to be accountable for the efficient, effective and ethical use of their resources. However, all the major legislation dealing with the public sector is now principles based. This means that, in large part, the required Chief Executive's Instructions (CEIs) have to determine the detail of accountability requirements and/or the extent of discretion available. The lack of attention, including ongoing oversight and review, of CEIs by a number of agencies is therefore somewhat perplexing given their fundamental importance in providing guidance to staff.

That said, Secretaries and Heads of Agencies have been faced with a conundrum given their legal accountabilities, in a reform environment of devolved authority, and the demands made by whole-of-government (centralised) approaches and initiatives. While having to achieve an appropriate balance between government policy, serving a range of different objectives, and accountability for securing value for money outcomes has long been a challenge for CEOs, the legal imperative has changed that balance. In my view, this requires the need for clear recognition of the accountability imperative in any policy statement which has a significant impact on public administration. This would remove any uncertainty, or equivocation, about the accountability obligations. However, this is a matter for the Government and the Parliament to resolve in the first instance. And that is an appropriate note on which to consider some of the issues concerned with accountability to the Parliament, particularly those involving the audit function.

### Accountability to Parliament

Public sector managers have a particular responsibility, to the Government and to the Parliament, to help ensure that accepted notions of responsibility, accountability and performance, including results, are being properly implemented by the public sector. This is a recognition of the supremacy of the Government and the Parliament in the governance framework (see Figure 2).

**Figure 2**



But it is also a reflection of apparent changing accountability relationships between public servants and Ministers on the one hand and Parliament on the other. There has also been a change in the Westminster notion of the overall responsibility of Ministers for both policy and administration in their portfolios. Guidance indicates that where Ministers neither knew, nor should have known, about matters of departmental administration which come under scrutiny, it is not unreasonable to expect that the Secretary or some other senior Officer will take the responsibility.<sup>78</sup> However, Ministerial responsibility is not an issue I will be covering directly here. Nevertheless, I noted with some interest the suggestions made by the Australian Capital Territory Auditor General in his recent report on *Enhancing Professionalism and Accountability*<sup>79</sup> that:

*the Legislative Assembly should consider and determine the extent to which Ministers are to be held accountable for the operation of public sector administrative units. As well, if the Legislative Assembly decides that Ministers should not be held fully accountable for the operation of public sector administrative units, then the Legislative Assembly should consider other means by which clear and full accountability to the public for the use of the public's resources is to be achieved.*<sup>80</sup>

Tensions have arisen, particularly in the context of Australian Parliamentary Committees, about the unfulfilled expectations arising from the trade-offs between providing greater management flexibility and the accountability for improved performance. In part, this perceived 'failure' can be explained by an inevitable time gap between the two events. There would also seem to be scope for agencies to not only take more initiatives to better inform the Parliament and its Committees about what they are doing, particularly in promoting greater accountability and performance management, but also to ensure that they are more attuned to the views and concerns being expressed by those stakeholders. As a result, public sector agencies and bodies should be better equipped to know just how Parliamentary expectations can be met, thus building up a more productive relationship.

In a recent interim report by the Senate Finance and Public Administration References Committee<sup>81</sup>, concern was expressed, by the majority opinion, about the right of the Committee to access documents and information necessary for it to effectively conduct an inquiry into a matter of public concern.<sup>82</sup> The Committee considered that it was one aspect of accountability that had been undermined in its inquiry. The purpose of the interim report was:

*to highlight the apparent lack of understanding in the Australian Public Service about parliamentary accountability, as illustrated by the arguments put forward during this inquiry, and to draw attention to what is clearly a wider problem.*<sup>83</sup>

The Committee also sought to facilitate an improved awareness of parliamentary accountability in the private sector in order for it to understand the rules of accountability. In its further, but not final, report the Committee reiterated its concerns, as well as those of a number of other Parliamentary Committees, about the 'lack of accountability' and noted that 'Parliamentary accountability is the corner stone of modern democracy.'<sup>84</sup> In relation to one IT outsourcing case, the Health Group tendering process, the Committee's (majority opinion's) concern at not being able to obtain unfettered access to all the documents necessary to reach an informed conclusion has led it to requesting me to undertake an examination of the case. I have agreed to a limited scope audit relating to the particular issue of concern to the Committee and, as noted, to other Parliamentary Committees, such as the Joint Committee of Public Accounts and Audit (JCPAA) and Senate Finance and Public Administration Legislation Committee.

While Parliamentary access issues are not new, the current concerns are reflective of the increasing involvement of the private sector. As I will discuss later, this has raised questions about 'new frameworks of accountability'.<sup>85</sup> Quoting Dr John Uhr again:

*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'*<sup>86</sup>

The latter is of audit interest, and is therefore worthy of separate comment later.

Such observations are a particular illustration of the need to meet Parliament's accountability expectations in the area of contract management. Another related issue that has arisen is that of access to contractor records and other information relevant to public accountability. My Office has experienced problems in accessing contractor information both through audited agencies and in direct approaches to private sector providers. This matter should be of concern to public agencies in their role as contract managers, to executive government as decision-makers, and to the Parliament when scrutinising public sector activities. In particular, public service managers need to have a level of access sufficient to ensure they can meet their own accountability obligations.

In this context, I noted with some interest in a recent United Kingdom (UK) National Audit Office Report<sup>87</sup> that a public authority had faced great difficulty in getting timely information on the true extent of the private sector provider's financial difficulties. This was because, under the contract, it had no access to the contractor's underlying financial records.<sup>88</sup> However, the Report also noted that greater rights of access to the private sector party's financial records are now standard in that country.<sup>89</sup>



As part of performing a statutory duty to the Parliament, the Auditor-General may require access to records and information relating to contractor performance. My legislative information-gathering powers<sup>90</sup> are broad but they do not include a statutory right of access to contractors' premises to obtain information. In September 1997, my Office circulated draft model access clauses to agencies and recommended their insertion in appropriate contracts. These clauses give the agency and the ANAO access to contractors' premises and the right to inspect and copy documentation and records associated with the contract.

The primary responsibility for ensuring there is sufficient access to relevant records and information pertaining to a contract lies with agency heads. A Chief Executive must manage the affairs of the Agency in a way that promotes proper use (meaning efficient, effective and ethical use) of the taxpayers' resources, as noted earlier. Such an arrangement reflects the principles of good governance accepted internationally.

For accountability measures to be effective, it is critical that agencies closely examine the nature and level of information to be supplied under the contract and the authority to access contractors' records and premises as necessary to monitor adequately the performance of the contract. I stress 'as necessary' because I am not advocating carte blanche access. I consider that access to contract related records and information should generally be equivalent to that which should reasonably be specified by the contracting agency in order to fulfil its responsibilities for competent performance management and administration of the contract. Access to premises would not normally be necessary for 'products' or 'commodity type' services, such as maintenance and cleaning, which are provided in the normal course of business. It would be a different matter where government information or other significant assets were located on private sector premises.

The inclusion of access provisions within the contract for performance and financial auditing is particularly important in maintaining the thread of accountability with government agencies' growing reliance on partnering with the private sector and on contractors' quality assurance systems. In some cases, such accountability is necessary in relation to government assets, including records, located on private sector premises. This is important both for agency management and audit assurance to other stakeholders, including the Government and the Parliament.

The JCPAA has recommended that the Minister for Finance and Administration make legislative provision for such access.<sup>91</sup> The Government response to that report stated that:

*its preferred approach is not to mandate obligations, through legislative or other means, to provide the Auditor-General and automatic right of access to contractors' premises.*

and that

*the Government supports Commonwealth bodies including appropriate clauses in contracts as the best and most cost effective mechanism to facilitate access by the ANAO to a contractor's premises in appropriate circumstances.*<sup>92</sup>

The response also stated that:

*the Commonwealth Procurement Guidelines would be amended to emphasise the importance of agencies ensuring they are able to satisfy all relevant accountability obligations, including ANAO access to records and premises.*<sup>93</sup>

While noting the Government's response, the ANAO continues to encourage the use of contractual provisions as the key mechanism for ensuring agency and ANAO access to contractor's records for accountability purposes. The ANAO and the Department of Finance and Administration have recently reviewed the content of the standard access clauses which the Minister for Finance and Administration has now approved as part of the revised Procurement Guidelines.<sup>94</sup>

This issue also has implications for agencies' security responsibilities, particularly where direct control over Commonwealth assets and/or information reside with a private sector provider. Specific responsibility is set out in the Commonwealth Protective Security Manual 2000 (PSM 2000) as follows:

*The agency must be able to carry out an examination of the contractor's security procedures when undertaking its regular audit or review of the contractor's methods and procedures. Access must be permitted for a security risk review to evaluate the contractor's security procedures.*<sup>95</sup>

Interestingly, PSM 2000 indicates that a contract must include a general clause providing the agency with rights of access to the contractor's premises and, where necessary, a clause specifying the contractor's right of access to agency premises.

### **Commercial-in-confidence information**

Situations have arisen where performance data relevant to managing a contract is held exclusively by the private sector. Also, private sector providers have made, on many occasions, 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.

The Australasian Council of Auditors-General has released a statement of Principles for Commercial Confidentiality and the Public Interest<sup>96</sup>. Of particular concern to Council members has been the insertion of confidentiality clauses in agreements/contracts that 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 Victoria commented that:

*... the issue of commercial confidentiality and sensitivity should not override the fundamental obligation of government to be fully accountable at all times for all financial arrangements involving public moneys.*<sup>97</sup>

This view has been echoed in almost every audit jurisdiction. For example, the Chairman of the Tasmanian Public Accounts Committee stated:

*Maintaining secrecy by confidentiality clauses in contracts is adverse to the Parliament's right to know. Confidentiality clauses should not, therefore, be used in contracts unless there are specific approvals for them by the Parliament itself.*<sup>98</sup>

I am sensitive to the need to respect the confidentiality of genuine 'commercial-in-confidence' information. In my own experience, I 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 that 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. This view is supported by the Victorian Public Accounts and Estimates Committee in a landmark report last year, as follows:

*'Commercial-in-Confidence should not prevent the Auditor-General and Ombudsman from disclosing information where they assess its disclosure to be in the public interest'*<sup>99</sup>

The Chairman of that Committee recently reiterated that a variety of options exist for dealing with commercially sensitive material and that, where genuine reasons exist, it is possible to take a middle ground between unrestricted access or total confidentiality.<sup>100</sup> The Chairman went on to note that the only Committee recommendations rejected outright related to the disclosure of information contained in tenders (as opposed to contracts) and the conferral on the Ombudsman of an extended oversight role in relation to commercial-in-confidence claims<sup>101</sup>.

Commercial confidentiality concerns have also been addressed by a number of Commonwealth Parliamentary inquiries.<sup>102</sup> Recently, the Senate Finance and Public Administration References Committee, in its *Inquiry into the Mechanism for Providing Accountability to the Senate in Relation to Government Contracts*, addressed a motion that had been put before the Senate by Senator Andrew Murray. Senator Murray's motion sought to achieve greater transparency of government contracting through passage of a Senate Order that would require:

- the posting on agency web sites of lists of contracts entered into, indicating whether they contain confidentiality clauses and, if so, the reason for them;
- the independent verification by the Auditor-General of those confidentiality claims; and
- the requirement for Ministers to table letters in the Senate chamber on a six-monthly basis indicating compliance with the Order.

The Committee's report noted that, at almost every estimates hearing, information is denied Senators on the grounds that it is commercially confidential.

Senator Murray's motion can be taken as a further indication of Parliament's frustration with insufficient accountability reporting associated with government contracting and a belief that commercial-in-confidence provisions are used excessively and unnecessarily in contracts. Most recently, the Senate Finance and Public Administration References Committee commented that:

*The need for confidentiality should be interpreted as narrowly as possible to ensure that the maximum amount of information is in the public domain.*<sup>103</sup>

My Office recently completed a performance audit of the use of confidential provisions, in the context of commercial contracts, in response to a commitment taken at the inquiry addressing Senator Murray's motion. The audit sought to:

- assess the extent of guidance on the use of confidentiality clauses in the context of contracts at a government wide level or within selected agencies;
- develop criteria that could be used to determine whether information in (or in relation to) a contract is confidential, and what limits should apply;
- assess the appropriateness of agencies' use of confidentiality clauses in the context of contracts to cover information relating to contracted provisions of goods and services, and the implications of existing practices of applying the criteria that have been developed; and
- assess the effectiveness of the existing accountability and disclosure arrangements for the transparency of contracts entered into by the Commonwealth, and whether agencies are complying with the arrangements<sup>104</sup>.

The audit approach was to work cooperatively with several agencies to distil their experience and so provide a sound framework for wider applicability across the Australian public/private sector interface. The report noted several weaknesses in how agencies generally deal with the inclusion of confidentiality provisions in contracts as follows:

- consideration of what information should be confidential is generally not addressed in a rigorous manner in the development of contracts;

- where there are confidentiality provisions in contracts, there is usually no indication of what specific contractual information in the contract is confidential; and
- there is uncertainty among officers working with contracts over what information should properly be classified as confidential.<sup>105</sup>

The audit report made three recommendations that were generally agreed by the agencies concerned. As well, the ANAO developed some criteria for agencies in determining whether contractual provisions should be treated as confidential.<sup>106</sup> These criteria are designed to assist agencies to make a decision on the inherent quality of the information before the information is accepted or handed over – rather than focusing on the circumstances surrounding the provision of the information. The report also gave examples of what would not be considered confidential<sup>107</sup> and examples of what would be considered confidential.<sup>108</sup> The Senate agreed a resolution reflecting Senator Murray's motion on 20 June last.<sup>109</sup> On the tabling of Ministers' returns, the ANAO intends to evaluate a sample of the contracts listed for the appropriate use of confidentiality provisions. A report on the finding of such evaluation would then be tabled in Parliament.

The Senate Finance and Public Administration References Committee in a recent report on Commonwealth contracts<sup>110</sup> supported the set of criteria developed by the ANAO for determining whether a sound basis exists for deeming information in contracts confidential. As well, the Committee recommended changes to a Senate Order associated with the above motion which increased the openness and accountability of all Commonwealth contracts with a value of \$100,000 or more aimed at strengthening and clarifying the order.<sup>111</sup>

Information and records are a big element of the authority, responsibility and accountability continuum, if only because they provide a clear evidential trail for managers and other stakeholders. Being pro-active in this respect reduces the risk of unnecessary speculation, confrontation and conflict, particularly where the parties concerned are asserting quite contrary views and/or perceptions. Unfortunately, the adequacy of information and records is often not addressed until an issue is contested.

### **Triple bottom line reporting**

One question I have been raising for some time now is whether we can expect to see an emergence and consolidation of new modalities of accountability in the evolving public/private interface. One example is the so-called *Triple Bottom Line*. A recent article suggested that the current socio-legal construction of accountability in the business world – and I would include government operations in this category – is on the threshold of a major paradigm shift<sup>112</sup>. Public and other stakeholder expectations in an increasingly globalised business and communications environment will, according to the article's author and other proponents of the Triple Bottom Line (TBL), provide

the drivers for a shift away from traditional *input-output* based model of accountability towards a focus on *economic prosperity, environmental quality and social justice*.<sup>113</sup>

TBL goes beyond the current orthodox focus on financial performance (in the narrow sense of profit and loss), the utilisation of inputs and the disposition of outputs, and probity (expressed as conformance with applicable law and the minimisation of liability) to also take into account the environmental and social consequences of business activity. In part, this view is supported by the passage of 'right-to-know' legislation. As well, new corporate governance rules are challenging the traditional non-disclosure or low-disclosure policies of companies and are, consequently, giving rise to new expectations and standards of transparency. One could speculate about the effects of the greater spread of shareholding generally and the impact of large size Management and Superannuation Funds, particularly when their holdings are sufficient to gain a seat or seats on Corporate Boards.

TBL reporting could lead to changes to the manner in which public and private sector organisations report performance and discharge their accountability to their stakeholders. The concept of sustainability requires new definitions of performance and the re-articulation of organisational goals. In the private sector, this would involve some balancing of environmental and social considerations against profitability. The bottom line for the public sector is often diffuse with a range of sometimes apparently conflicting objectives and, consequently, balances have to be struck at points in time and over time.

An important aspect for both sectors is management of reputation, which is an all-pervasive issue for performance assessment. A degree of 'trust and confidence' is essential for a sustainable future, particularly where the general community is placing some value on corporations meeting broader 'environmental' and 'social' goals. In Australia, local government has been quite active in this area of reporting, as has a number of private sector corporations, for example, in the petroleum and mining areas.

#### **4. ADDING VALUE TO PUBLIC SECTOR AUDIT**

The public sector auditor operating in these times of rapid change and developing managerial styles needs to be seen to be a real contributor in the process of finding solutions to the increasingly complex problems faced by policy-makers and program managers, including issues of accountability.

There are many implications and consequences for audit in the current changing governance environment. While there are variations in the mandate, focus and operating arrangements across constituencies, the fundamental role of SAIs remains substantially the same. That role is to provide the elected representatives of the community (the Parliament in our case) 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 my view, Audit Offices 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.*<sup>114</sup>

Corresponding with the public sector changes over time, the role of the Audit Office 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 in 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 SAIs have the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them.

I would argue, therefore, that the role of Audit Offices is more important to effective, accountable and democratic governance today than at any time in the past. As the Public Audit Forum in the United Kingdom has also observed:

*Public audit plays an essential role in maintaining confidence in the stewardship of public funds and in those to whom the responsibility of stewardship is entrusted. Public auditors are, of course, themselves accountable for their performance and are duty bound to undertake their work in a professional, objective and cost-effective manner and with due regard to the needs of the organisations they audit.*<sup>115</sup>

I would also suggest that, as the pace of change remains unabated, this trend will not decline. Rather, it is likely to increase. The roles and responsibilities of the public and private sectors will be more integrated and, perhaps, the differences between the two will become more apparent than real in many aspects of the management task. However, the political environment and the notion of public interest will continue to create fundamental differences between the two sectors.

The United Kingdom Government expressed concern that an over-emphasis on accountability would stand in the way of an appropriate risk management environment in which innovation could flourish. The Public Audit Forum responded by stating that:

*Public sector managers are of course responsible, as stewards of public resources, for assessing and managing the risks associated with innovation and increased flexibility, and for ensuring the proper conduct of public business and the honest handling of public money while pursuing innovative ways of securing improvements in public services. It remains important to ensure proper accountability but this must not be approached in a rigid way which might mean missing opportunities to deliver better value for money. And auditors will respond to this new environment positively and constructively by:*

- adopting an open minded and supportive approach to innovation (including the use of techniques tried elsewhere) examining how the innovation has worked in practice and the extent to which value for money has been achieved;*
- in the process, supporting well thought through risk-taking and experimentation;*
- consistent with their independent role, providing advice and encouragement to managers implementing Modernising Government initiatives by drawing on their audit work in this area, seeking to identify and promote good practice so that experience can be shared and risks minimised.*

*In these ways, we believe that auditors can support and encourage worthwhile change, while providing independent scrutiny and assurance, and fulfilling effectively their statutory and professional responsibilities.*<sup>116</sup>

This issue is not restricted to the public sector. There are many institutions in the private sector that have a significant impact on the level of public accountability and where under-performance has the potential to restrict public policy making. The banking sector here in Japan has been a cause for some concern in recent times. In Australia, the collapse of our second largest insurer HIH has had disastrous effects on many sectors of our economy, resulting in pressure on governments to mount expensive rescue operations. Suggestions that the firm had been trading as insolvent for an extended period have raised public uncertainty about the effectiveness of public regulatory ‘watch-dogs’ in carrying out their functions. In particular, the way in which the company’s auditors have performed their role is being questioned. But the performance of prudential regulators for the industry is also subject to investigation. Unfortunately, this is an area of the public/private performance that receives little attention, particularly in an environment where governments are expected to intervene in the affairs of private companies as little as possible.



The assessment of the performance of regulatory bodies poses particular problems for the SAI. As a general rule, the former's activities are usually highly technical in nature, and the organisations themselves are sometimes the only source of credible expertise.

In the particular Australian example I referred to, the company had adopted an aggressive pricing regime for its policies. The question has to be asked whether the risks of this decision, particularly for revenue, were properly understood and kept properly under review. Within an audit framework, the suitability of the risk management and overall governance framework to provide accurate and timely information on key risks is a central issue of control. As such, it is of considerable strategic and operational interest for any Audit Committee and external audit.

The debate about the responsibilities of external auditors and audit committees has raised the audit profile in both the private and public sectors. The ANAO sees its relationship with an audit committee and internal audit as one of partnership. One important difference is that the Office is employed by the Parliament, not by the corporation or agency. As such, the scope and cost of an audit are decisions by the Auditor-General for which he or she is accountable to the Parliament. In the private sector, such decisions are the prerogative of the Board or Chief Executive but are often determined by an audit committee. It is within the authority of boards and their audit committees to direct auditors as to the scope and quality of the audit, subject to professional, including both accounting and auditing standards, requirements of those auditors.

While the Auditor-General has the statutory independence provided by Parliament, the issue of independence is important, as it is for the private sector, in the provision of non-audit services. There are basic 'conflict of interest' issues arising for both sectors, although clearly of greater concern for private sector auditors. Last year, the United States Securities and Exchange Commission (SEC), particularly its Chairman in widely published addresses,<sup>117</sup> drew attention to the need for more stringent restrictions on the scope of non-audit relationships accounting firms have with their clients. In some instances, non-audit income may be greater than the audit fees for specific clients. The perception is that this may impact adversely on the integrity of the audit. The fundamental principle supported by public sector auditors is that auditors must be, and should be seen to be, free of any interest or relationship which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity (observation by the Australasian Council of Auditors-General).

In Australia, it has been suggested that the responsibility for appointments of auditors to companies should be given to the Australian Securities and Investments Commission (ASIC). This idea has had limited support, if only because it would raise real questions about the extent to which ASIC would have to share responsibility for the effectiveness of audits. It is another illustration of the need to be clear as to who is accountable for what. The SEC last November required companies to disclose, in proxies, a breakdown of fees they paid to accounting firms.<sup>118</sup> Disclosure of the non-audit income paid to auditors in Australia is already part of our requirements, although some would argue there is scope for a greater disaggregation of non-audit services. That said, the level of such income is

a secondary consideration. As well, modern auditing practice does involve a more strategic advisory role as expert consultant. The primary issue is about apparent conflict of interest in relation to significant business processes, or processes underlying the financial statements or data to be audited.

The level of non-audit fees was not explicitly addressed in the Exposure Draft 'Independence' put out by the International Federation of Accountants (IFAC) earlier this year. Nor indeed did the Draft explicitly recognise relevant issues for the public sector. We have asked IFAC to address public sector matters perhaps by way of a 'Public Sector Perspective' at the end of the document. The Australian Government asked Professor Ian Ramsey of the University of Melbourne to head an inquiry into the state of audit independence in Australia. As well, the Institute of Chartered Accountants and CPA Australia have established a continuing joint working party to develop a revised ethical statement on Independence for the Australian profession. Professor Ramsay has now reported<sup>119</sup> but, as we are close to a Federal Government election, there will not be any action on his recommendations probably before next year. That said, the Report has generally been favourably received.

In Australia, the interests of the ANAO now go well beyond the efficient and effective stewardship of public finances which is said to be fundamental to good national governance.<sup>120</sup> While I recognise the importance of legislation as a central element of public sector management, I also stress the Parliament's concerns with the 'rule of law' as a fundamental element of governance. The ANAO is increasing its expenditure on legal advisings each year as a consequence of the extension of such concerns to the greater involvement of the private sector in government activities and service delivery, including considerations of 'natural justice', as I noted earlier.

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 making more real-time contributions to enhancing public administration. 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. Such practice is being derived from both public and private experience but, increasingly, is having to be developed by both parties in the new environment being created with apparently changing notions of accountability and performance assessment. On the other hand, there might be some kind of mixture of traditional public service 'assurance' accountability, aimed at protecting public moneys and other assets, and an accountability for results which reflects both sophisticated risk management approaches and commercial considerations as part of generating required outputs and outcomes.

That said, we are nevertheless conscious of our audit responsibility, particularly to the Parliament as our major stakeholder, to report, for example, significant and/or material breaches of approved guidelines, standards and/or legislation. From my experience, agencies generally understand this obligation even where such breaches are inadvertent. My preferred position would be to work with agencies

to implement effective processes which are preventative and not just detective, so avoiding such situations. In this context, I see the relationship between internal and external audit and that with agency audit committees as being in the nature of an open partnership sharing common goals, thus generating total confidence in the relationship. For most organisations, it is a maturing relationship that is still being tested as a major contributor to good corporate governance.

While clearly having a responsibility to provide assurance about the observance of proper accountability by agencies for the protection and use of public sector resources, there is a parallel audit responsibility for reporting on agency performance. Such reporting can, and should, assist the political stakeholders to determine the nature and practice of accountability in the changing environment. The reality is, that without such determination, the everyday operational imperatives may mean that the nature and practice of accountability may be changing, virtually by default, in ways that may not be subsequently endorsed at the political level. This would be an untenable situation if public confidence is to be maintained in the governance framework.

One aspect of agency governance and audit responsibility, that has arisen with purchaser-provider relationships between public sector agencies, relates to access to audit documents and Chief Executive Officer (CEO) accountability. The CEO of the Department of Family and Community Services has a partnership agreement with Centrelink for the delivery of welfare services, as I noted earlier. Given his accountability for such services, the CEO has contended he should be informed in a timely manner if significant matters relevant to Centrelink arise in any audit of that agency. Our response has been that we provide our audit reports to the CEO of the Agency concerned in accordance with legislative (and professional) requirements. It is up to the two parties to decide how they share such information, whether in a contractual arrangement or by a Memorandum of Understanding. In relation to Performance Audits, I can give a copy of a report to any person who I consider has a special interest in the report. I would have regard to any contractual or equivalent arrangements in place in deciding who has a special interest in such circumstances.

In reality, satisfactory arrangements are in place, admittedly mainly because of the Centrelink Board's cooperation. However, the CEO of the Department of Family and Community Services has recently recommended to a Joint Committee of Public Accounts and Audit (JCPAA) inquiry into the adequacy of the *Auditor-General Act 1997* that the legislation should recognise the accountability of the CEO of a purchaser agency and require the Auditor-General to report significant and relevant matters arising during an audit of a service provider to the Chief Executive of a purchaser agency in a timely manner. The legislation should also include a broad definition of audit reports covering those more detailed reports provided to management. In the ANAO's view, the legislation does not need to be amended to cater specifically for purchaser/provider arrangements and is flexible enough to cope with any reasonable requirements for CEO accountability.

It is relevant to note in this context that the JCPAA inquiry, which reported in September, concluded that, overall, the Act provided an effective framework for the ANAO to carry out its functions<sup>121</sup>.

The foregoing observations suggest to me that Auditors-General need to be more positive in their involvement in reviewing decisions and action being taken in the strategic management phases of an outsourcing situation, including in the latter's implementation and not just after the event. No doubt such an approach would be greatly facilitated by the electronic capability to conduct audits in real time with direct access to agency systems and data banks. Admittedly, such auditing is still in its infancy in many constituencies but, as with the growth of the use of the Internet, Intranets and e-mail, we need to anticipate the demands of our various stakeholders, particularly those whose functions and business are substantially dependent on information technology and electronic communications. This need could also be met in part by a more pro-active approach either by an Audit Office itself, or in cooperation with other interested organisations, to produce suitable Better Practice Guides as an aid to agencies in developing areas of public administration, including for use in future audit examinations, for example as a basis for audit criteria.

The ANAO's Better Practice Guides have been generally well received by the agencies concerned and have provided the basis of subsequent audits. They are seen by most as a positive contribution to the overall administration of government services. In developing them we regularly draw on the experience of other jurisdictions so that the work of others finds some fruit in our publications. We would hope that what we are able to achieve also finds its way around the world where others can leverage off what we have done, such as our recent Guide on Contract Management<sup>122</sup>.

As well as Better Practice Guides, the ANAO has embarked on a program of benchmarking common activities in public administration. To date, benchmarking studies have been completed in relation to the Internal Audit and the Finance functions. My Office has embarked on a study of the Human Resource Management function. In these projects a number of public agencies are benchmarked against each other and an extensive range (several hundred) of private and public entities. We see them as relatively high risk projects for the office but as having substantial benefits for the management of public activity regardless of whether it is performed by the public or private sector. In particular, risk management must address:

- the need to buy in expertise. This relates as much to the range of skills within the Office as to the need for an extended knowledge of the corporate world;
- the quality of the data that is gathered – given the size of the project, it is not audited data, but relies on the data supplied by agencies;
- the range of diagnostic tools available and their relative strengths and weaknesses;
- an understanding of the differences between the environments in which the individual agencies must operate;
- the size and complexity of the project management task; and

- the need to achieve and maintain cooperation with the agencies concerned.

The benefits that can flow from such an exercise are significant. For example, the ANAO report on the Benchmarking of the Finance Function comments:

*An estimate of potential expenditure reductions is made in these chapters on the basis that those organisations in the Commonwealth group with costs above the group median are moved to the median level. The potential reductions total some...20.7 per cent of current expenditure on the benchmarked finance activities.*<sup>123</sup>

Other benefits flow through to policy decision-makers, public sector managers and audit authorities. They can include:

- clear specific criteria for future audit activity and other avenues of assessment;
- where functions are to be contracted out, clear and credible performance criteria to be included in tender and contract documentation;
- credible information on which to base decisions on whether to perform functions in-house or to contract out;
- performance evaluation standards for management to help identify under-performance and reward excellence;
- the benchmarks developed through this method are already being used in other jurisdictions, leading to greater uniformity of performance expectations; and
- in the context of service charters mentioned elsewhere they can help provide for more credible communication with clients or citizens.

The increasing involvement of the private sector in providing public services is a challenge to the ANAO, particularly in the areas of accountability and performance assessment. We are constantly looking for opportunities to add value in such areas which we hope will be enhanced by greater private sector cooperation and participation on our various audits.

## **CONCLUDING REMARKS**

The increasing public/private interface is creating difficulties for public sector managers, not least in terms of determining appropriate responsibility and accountability for performance. Changing organisational cultures and structures can help, but are by no means the complete answer to the problem. Experience demonstrates that sound corporate governance frameworks will enhance the development of suitable networks and partnerships and facilitate risk management so that opportunities can be taken to be more responsive and improve performance while minimising risk.

Fundamentally, good governance arrangements increase participation; strengthen accountability mechanisms; and open channels of communication within, and across, organisations. In this way, the public sector can be more confident about delivering defined outcomes and being accountable for the way in which our results are achieved. These requirements are integral to the more market-oriented approach being taken to public administration in recent years. The disciplines involved have focussed greater attention on performance management and accountability for that performance whether the activity is performed by public or private sector organisations.

Public sector organisations have to recognise performance obligations to stakeholders and the negative aspects of being risk averse. We also have to be aware of the need for leadership and control and the confidence and assurance that the latter engenders for all stakeholders and the reputation of the organisation involved, particularly in any partnership arrangement with the private sector.

New technology should facilitate the sharing of information within whatever constraints of privacy and security and/or need to know that might apply. As well, technology can assist in the delivery systems reflecting ‘seamless’ government and greater responsiveness to citizens. Some writers have radically extended the possibilities of information technologies toward a vision of the automated state in which government would establish and manage contracts for project or service delivery largely through information technology. The suggestion is that the imperatives of technology are creating the conditions for the state to become ‘virtual government’.

It is unlikely that such ‘sharing’ could be definitively covered in present day ‘legally based’ contracts. Other forms of agreement and disciplines are emerging to ensure that both the parts and the whole are held responsible for their overall performance; and that accountability for the results is absolutely clear both to the immediate parties and to other stakeholders. It seems like a tall order. It has been said that:

*Studies of accountability also tend to neglect the requirements of managing an interdependent program with independent organizational units<sup>124</sup>.*

This is a particular challenge for government auditors if they are to maintain the appropriate balance that allows, preferably assists, organisations to meet their objectives and satisfy the requirements of accountability. In the latter respect, it has been suggested that the notion of accountability can be split into four parts as follows:

- *giving an explanation* – through the main stakeholders (for example Parliament) are advised about what is happening, perhaps through an annual report, outlining performance and activity;
- *providing further information* – where those accountable may be asked to account further, perhaps by providing information (eg to a select committee) on performance, beyond accounts already given;

- *reviewing and, if necessary, revising* – where those accountable respond by examining performance, systems or practices, and if necessary, making changes to meet the expectations of stakeholders; and
- *granting redress or imposing sanctions* – if a mechanism to impose sanctions exists, stakeholders might enforce their rights on those accountable to effect changes.<sup>125</sup>

Perhaps these accountability elements could be appropriately shared between the purchasing agency and the private sector provider. However, this is primarily a matter for the Government and the Parliament to decide. The basic issue continues to be determining what is in the public interest, including the application of public service values in dealing with citizens, and any trade-offs between both public and private interests that are possible in a more contestable public sector environment, where greater emphasis is being given to citizen choice and public sector responsiveness.

But the pressures are only likely to increase, even in so-called ‘core’ areas of government, for more ‘cross-cutting’ approaches to better deliver program outcomes, with commensurate accountability for achievement of required results. This is certainly the case in Australia. I referred earlier to a review in which the Government has asked for an assessment of the potential for application of a current networking model involving the private sector to other types of federal government services.

Managers are showing interest in exploring the notion of ‘relational contracts’ in particular environments to test their effectiveness both in terms of performance and accountability. These so-called ‘soft’ contracts focus on cooperation as the guiding principle of contracts. It is, perhaps, another example of the exercise of management flexibility to achieve required outcomes where real partnerships and full cooperation of a range of service suppliers are required to be citizen ‘centric’. On the other hand, is an inability to define adequately performance and accountability requirements or, indeed, lack of private sector acceptance particularly of the latter, sufficient reasons to reject contracting-out? Audit Offices need to keep abreast of these developments and contribute to their resolution.

We should be able to explore different partnership arrangements within the public sector to ascertain what will work in a cohesive and sensible fashion in particular situations. Moreover, it may also be possible to test arrangements within the private sector, where it is involved in the provision of public services, in a way that can accommodate both private and public interests. The future challenge to partnering in the public sector may be to go beyond strategic partnerships with particular contractors and to develop in association with other agencies, community and private sector organisations, public sector ecosystems as described in the private sector. If that is so, an Audit Office needs to be able to move at the same time. We cannot afford to be left behind.

Strategic combinations of public interest and private profit could generate new forms of service delivery and redefine the relationship between governments and the community. I reiterate that whatever is attempted needs the support and endorsement of the Government and Parliament if it is to succeed. These are likely to be considerable challenges, not least in the notion of public accountability with its attendant implications for Audit Offices. As well, there may be consideration given to some sharing of accountability in the public/private interface, at least for particular public sector activities.

In all this we have to consider the changing skills base for auditors. Fortunately, many of us have had experience in dealing with the private sector and in commercial operations, including financial decision-making and accounting. On the other hand, it also makes our staff that much more in demand in both the public and private sectors. Consequently, we not only have a skills enhancement challenge for our offices in a more contractual oriented environment, but we also have a problem of retention of our valuable skills base. How we address any skill deficiencies and staff retention issues will be dependent on the particular environment in which we work. What seems obvious at this stage is that a solution will come from a suitable mixture of internal training, the use of universities and other educational institutions, interchanges between the private and public sectors, the judicious use of 'bought-in' resources, and suitable rewards and recognition, including the opportunity to work in other Audit Offices.

In short, the on-going challenge for the public sector auditor will continue to be meeting performance and accountability expectations, whatever the approach taken to our changing environment. This will increasingly involve establishing agreed modes of network governance to ensure proper integration and coordination of networking activities essential to the effective operation of strategic alliances. Such governance arrangements have to be well understood and accepted by all concerned. In my view, any arrangements have to be dynamic and flexible to meet the needs of all participants including, importantly, those of citizens. And is that not what governance, and corporate governance in the public sector, are basically all about when all is said and done?

Moreover, with the greater involvement of the private sector, particularly in service delivery as part of an outsourcing situation, there is the added complication of generating common understandings, cultures, values and notions of accountability and responsibility. In my view, this will mean that Audit Offices have to be more pro-active in helping to develop such a framework, without undermining the independence of the Office. There will no doubt be a greater focus on the evaluation of policy outcomes as government comes under greater scrutiny from a more informed citizenry. However, it will be:

*the assessment of the contribution of individual businesses (whether in the public or private sector) to the achievement of such outcomes (that) presents one of the most significant challenges for both academics and practitioners in public management.*<sup>126</sup>

As part of this broader responsibility, the Audit Offices will also need to be prepared, and equipped, to engage in real time auditing as electronic technology,



particularly in communication, comes into more widespread use across the public sector. In this way, there will be more scope for preventative action and a learning process for all stakeholders in order to ensure that proper accountability and required performance and results are achieved by both individual agencies and private sector firms, particularly in any 'shared' arrangement or partnership. This is a matter for both the public and private interest. While audit offices have always had to do their best to determine just what has been the public interest in the past, there will now have to be at least a greater understanding of the drivers of private interest and any balancing of interests of both sectors that may be required as part of any accountability relationships established, and endorsed, by the Government and Parliament.

## NOTES AND REFERENCES

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- <sup>2</sup> Mulgan, Richard. 1997, 'Contracting Out and Accountability'. Discussion Paper 51, Graduate Public Policy Program, Australian National University, Abstract.
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- <sup>10</sup> Howard, John The Hon. PM 1997. *The Sir Robert Garran Oration*, National Conference of the Institute of Public Administration Australia, 19 November, Canberra, p.5.
- <sup>11</sup> Public Audit Forum 1999, *Implications for Audit of the Modernising Government Agenda*, 22 April, London. p. 8.
- <sup>12</sup> Zifcak Spencer 2001. Op.cit. p.91  

"...given their different arenas and callings, the transposition of public sector ethics and values into the private sector or the introduction of private sector ethics and values into the public sector will create difficulties and tensions"
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- 14 Braganza, Dr Ashley and Lambert, Rob, 2000, *Dynamic partnerships*, in *Knowledge and Process Management: The Journal of Corporate Transformation – Special Issue into the 'E' era*, Braganza, Dr Ashley and Lambert, Rob (eds), Vol. 7 No. 3, July-September, p.131.
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- <sup>40</sup> Through, for example, audits of the Management of Contracted Business Support Processes (Audit Report No. 12 1999-2000), New Submarine Project (Audit Report No. 34, 1997-98) and the Construction of the National Museum of Australia and the Australian Institute of Aboriginal Studies (Audit Report No. 34, 1999-2000)
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- <sup>42</sup> .Audit Review of Government Contracts 2000, '*Contracting, Privatisation, Probity and Disclosure in Victoria 1992-1999 : An Independent Report to Government*', Report, State Government of Victoria, Melbourne, May, p. 31.
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The legal risk assessment identifies the following areas of risk as possible events or incidents during the life of service agreements:
- service disruption during transition to the contractor;
  - failure by contractor to meet service levels'
  - failure of contract management process by contractor or agency;
  - financial viability;
  - termination of the Service Level Agreement (SLA);
  - breaches of privacy or confidentiality obligations by contractor; and
  - failure to meet Industry Development (ID) objectives.

The legal risk assessment also identifies a number of areas of potential loss or damage that might result from the identified risk events including:

- loss of productivity;

- loss or reputation and public confidence;
- loss of responsiveness;
- difficulties in servicing remote or regional offices;
- damage to commercial, community and stakeholder relations;
- breach of privacy, security and confidentiality undertakings;
- loss of flexibility and responsiveness; and
- legal liability for breach of contract for failing to provide services to community or third party partners.

The legal risk assessment places primary focus on provisions in IT outsourcing contracts and Service Level Agreements (SLAs) to minimise the chance of a risk event occurring, as well as minimising the loss or damage to any of the agencies within the Group and to preserve remedies available.

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- <sup>90</sup> Set out in Part 5 of the *Auditor-General Act 1997*
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- 'Recommendation 5: The Committee recommends that the Minister for Finance make legislative provision, either through amendment of the Auditor-General Act or the Finance Minister's Orders, to enable the Auditor-General to access the premises of a contractor for the purpose of inspecting and copying documentation and records directly related to a Commonwealth contract, and to inspect any Commonwealth assets held on the premises of the contractor, where such access is, in the opinion of the Auditor-General, required to assist in the performance of an Auditor-General function. (paragraph 6.20).'*
- <sup>92</sup> Government response to Recommendation 5 of the 368<sup>th</sup> Report of the Joint Committee of Public Accounts and Audit : Review of Audit Report No. 34 1997-98, New Submarine Project Department of Defence. Letter from the Prime Minister to the Minister for Finance and Administration dated 12 August 2000.
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<sup>104</sup> ANAO Report No 38 2000-2001. *The Use of Confidentiality Provisions in Commonwealth Contracts*. Canberra, 24 May. p.13

<sup>105</sup> Ibid. p.15

<sup>106</sup> Ibid. pp. 55-60

<sup>107</sup> Ibid. p.64. The following types of information in, or in relation to, contracts would generally not be considered to be confidential:

- performance and financial guarantees;
- indemnities;
- the price of an individual item, or groups of items of goods or services;
- rebate, liquidated damages and service credit clauses;
- clauses which describe how intellectual property rights are to be dealt with; and
- payment arrangements.

<sup>108</sup> Ibid. p.65. The following types of information may meet the criteria of being protected as confidential information:

- trade secrets;
- proprietary information of contractors (this could be information about how a particular technical or business solution is to be provided);
- a contractor's internal costing information or information about its profit margins;
- pricing structures (where this information would reveal whether a contractor was making a profit or loss on the supply of a particular good or service); and
- intellectual property matters where these relate to a contractor's competitive position.

<sup>109</sup> Senate resolution, agreed 20 June 2001, that:

- (1) There be laid on the table, by each minister in the Senate, in respect of each agency administered by that minister, or by a minister in the House of Representatives represented by that minister, by not later than the tenth day of the spring and autumn sittings, a letter of advice that a list of contracts in accordance with paragraph (2) has been placed on the Internet, with access to the list through the department's or agency's home page.
- (2) The list of contracts referred to in paragraph (1) indicate:
  - (a) each contract entered into by the agency which has not been fully performed or which has been entered into during the previous 12 months, and which provides for a consideration to the value of \$100 000 or more;
  - (b) the contractor and the subject matter of each such contract;
  - (c) whether each such contract contains provisions requiring the parties to maintain confidentiality of any of its provisions, or whether any provisions of the contract are regarded by the parties as confidential, and a statement of the reasons for confidentiality; and
  - (d) an estimate of the cost of complying with this order.
- (3) In respect of contracts identified as containing provisions of the kind referred to in paragraph (2)(c), the Auditor-General be requested to provide



to the Senate, within 6 months after each day mentioned in paragraph (1), a report indicating that the Auditor-General has examined a number of such contracts selected by the Auditor-General, and indicating whether any inappropriate use of such provisions was detected in that examination.

- (4) The Finance and Public Administration References Committee consider and report on the first year of operation of this order.
- (5) This order has effect on and after 1 July 2001.
- (6) In this order:

“**agency**” means an agency within the meaning of the *Financial Management and Accountability Act 1997*;

“**autumn sittings**” means the period of sittings of the Senate first commencing on a day after 1 January in any year; and

“**spring sittings**” means the period of sittings of the Senate first commencing on a day after 31 July in any year.

- <sup>110</sup> Senate Finance and Public Administration References Committee 2001. *Commonwealth Contracts : A New Framework for Accountability*. Final Report on the Inquiry into the Mechanism for Providing Accountability to the Senate in relation to Government Contracts. Parliament of the Commonwealth of Australia, Canberra. September (see Appendix A).
- <sup>111</sup> Ibid. (see Appendix C)
- <sup>112</sup> Elkington, J 1999, Triple Bottom Line Revolution – Reporting for the Third Millenium, Australia CPA, November.
- <sup>113</sup> Ibid 75-77.
- <sup>114</sup> Public Audit Forum 1999, *The Principles of Public Audit - A Statement by the Public Audit Forum*, p. 2, [Online], Available: <http://www.public-audit-forum.gov.uk/popa.htm>, [9 August 2000]
- <sup>115</sup> Public Audit Forum 1999, *What Public Sector Bodies Can Expect From Their Auditors*, Consultation Paper, London, p. 2.
- <sup>116</sup> NAO, 1999, *Modernising Government – The NAO Response*, London, June, p. 3
- <sup>117</sup> Levitt Arthur 2000. *Renewing the Covenant with Investors*. Speech by SEC Chairman, New York University, Centre for Law and Business, 10 May.  
An example of Mr Levitt’s comments is as follows:  
‘And too many auditors are being judged not just by how well they manage an audit, but by how well they cross market their firm’s non-audit services.’ p.2.
- <sup>118</sup> Smitherman Laura 2001. *Fees pay for accounting tricks : study*. The Age. Business News. Melbourne p.5.
- <sup>119</sup> Ramsay, Ian Professor, 2001. *Independence of Australian Company Auditors – Review of Current Australian Requirements and Proposals for Reform*. Report to the Minister for Financial Services and Regulation. Melbourne. October
- <sup>120</sup> Meyers Larry D, Sahgal Vinod and Glaude Ernie 1995. *Strengthening Legislative Audit Institutions – A Tool for Good Governance*. Opinions, Vol. 13, No. 1, Office of the Comptroller and Auditor-General, Canada, p. 31.

- <sup>121</sup> JCPAA, 2001, *Inquiry into the Auditor-General Act 1997*, Canberra, September, pp. iii - iv.
- <sup>122</sup> ANAO 2001. *Contract Management Better Practice Guide*, Canberra. February
- <sup>123</sup> ANAO, Report No 25 2000-2001, *Benchmarking the Finance Function*, Canberra, p. 26
- <sup>124</sup> Sproule-Jones Mark, 2000. *Horizontal Management: implementing programs across interdependent organizations*. Canadian Public Administration Vol. 43 No. 1 (Spring). p.103
- <sup>125</sup> Barbaris P. 1998. *The New Public Management and a New Accountability in Public Administration*. Autumn. Also Neal A and Anderson B. 2000. *Performance Reporting for Accountability Purposes – Lessons, Issues, Futures* paper at International Public Management Workshop, Wellington, New Zealand. Quoted also in 'Holding to Account', *The Review of Audit and Accountability for Central Government*. Report by Lord Sharman of Redlynch. London. February 2001.
- <sup>126</sup> Newman, Janet 2001. *What counts is what works? Constructing Evaluations of Market Mechanisms*. Public Administration. Vol 79 No. 1. p.101.