

# **GOVERNANCE AND COMPLIANCE**

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## **1. INTRODUCTION**

I am pleased to be invited again to this conference which has been so successful in the past. Although the various elements of the public service reform movement have received a deal of coverage, a forum such as this does provide an opportunity to explore and discuss some important issues associated with the on-going management and operation of our agencies and businesses at a time of significant change in the public sector, and particularly transformation, in the delivery of public services.

The theme of this presentation is about compliance as an important element of our performance in the public sector context reflecting both stakeholder expectations and organisational risks that have to be managed. The focus is on how to manage our obligation to comply, for example with legislation, standards and guidance, in order to provide both assurance to stakeholders that those obligations are being met, as well as the results that are required from our organisations. While compliance is mainly a means to an end, in an environment where devolution of authority is widespread, there has been some pressure for greater Parliamentary assurance about public service adherence to the requirements of accountability for performance as well as for achievement of required results. Compliance involves both costs and benefits. As usual, the challenge is to determine the 'right' balance at any point in time and over time, particularly where we have limited management discretion. The presentation itself draws on a number of my recent papers on similar issues<sup>1</sup>.

My introductory comments briefly discuss the thrust of the public sector reforms as context for later discussion as follows; first, as to how assurance can be provided through compliance; second, how compliance can be best managed within a sound corporate governance framework taking account of risk; third, how to manage compliance in a more contractual environment; fourth, managing systems and information for compliance, including in a more networked or 'joined-up' government environment; and, finally, some concluding remarks stressing the value of a robust governance environment which not only enhances performance but also helps to provide assurance about compliance with all legislative and other requirements, not least for ethical conduct and adherence to public sector values.

### **Current public sector reforms**

As with many other democracies, Australian governments at both the Commonwealth and State levels have been focussing increasingly on achieving a better performing public sector and less costly, more tailored - or better directed - and higher quality services to citizens. A major imperative has been the successful management of change to provide a more responsive public service.

Governments have reacted to budgetary pressures on expenditure and, at the same time, strong demand from the community for the maintenance, and even extension, of government services, by seeking to make the administrative elements and structures that provide public services more efficient and effective. The Commonwealth Government's aim for the Australian Public Service (APS) has been outlined by the then Minister Assisting the Prime Minister on Public Service Matters as follows:

*The Government is looking at more effective ways of serving the Australian public. It is no longer appropriate for the APS to have a monopoly. It must prove that it can deliver government services as well as the private or non-profit sectors. This will require a new emphasis on contestability of services, outsourcing those functions which the private or non-profit sector can undertake better and ensuring APS commitment to the process of performance benchmarking and continuous improvement.*<sup>2</sup>

As you are aware, the APS has been steadily evolving towards a more private sector orientation with a particular emphasis now on:

- the contestability of services;
- the outsourcing of functions which the private sector can undertake more efficiently;
- adapting, or adopting, private sector methods and techniques;
- an accent on continuous improvement to achieve better performance in an environment of devolved authority and greater management flexibility;
- ensuring a greater orientation towards outcomes, rather than mainly on process; and
- direct participation by the private sector in providing public services, even so-called and traditionally regarded 'core services' such as policy advice and determination of citizens' welfare entitlements.

A major impetus for the changes we are seeing has been the fundamental questioning of what government does, or should do, allied with a perception of inefficient (costly) and ineffective (lacking client focus) delivery of public services due to its monopoly provision and/or other constraints of public sector administration. Implementation of the reform agenda has involved organisational restructuring, business re-engineering, outsourcing, commercialisation, privatisation and/or the transfer or abandonment of functions and services. These actions have been seen as addressing weaknesses in the more traditional, centralised and often mainly compliance-based, management systems.

A common view is that public services would be provided more efficiently and effectively, with greater client satisfaction, in a more market-oriented environment that provided greater flexibility for management decision-making and with the discipline of competition<sup>3</sup>. Indeed, history shows varying support for such a view but with reservations, for example, about market imperfections and 'public goods' arguments. Nevertheless, some consider that the political environment is about more than notions of clients and markets, as the following indicates:

*The privileges of governance and the political consequences of disappointing sufficient citizens, therefore, require that governments be more than disinterested facilitators of market exchanges. ... the limits of a government's responsibilities to its citizens are far more extensive than that of delivery performance.*<sup>4</sup>

Concerns have been expressed about the maintenance of public service values and ethics, as well as issues such as probity, privacy, security, equity and transparency. The New Zealand Auditor-General recently observed that:

*There is a special relationship between the user of a public service and the provider of that service – dependency, the force of law, and a lack of choice are all factors that distinguish public from private services.*<sup>5</sup>

These developments have given rise to a focus by many politicians, public servants and academics on what constitutes ‘core’ public sector activities as opposed to ‘non-core’ ones. The Minister Assisting the Prime Minister for the Public Service has stated that the Government’s objective:

*...has been to focus the APS on its core activities of policy development, legislative implementation and the contracting and oversight of service delivery.*<sup>6</sup>

Just how small core government can become is, nevertheless, very much open to debate. Even areas where the public sector has traditionally held a monopoly, such as the provision of policy advice, are becoming increasingly open to competition from the private sector. This action has literally meant the creation of a market for public sector service delivery, such as employment services, resulting in greater choice and more competition with adverse consequences, more recently, for the sole public sector provider. The implications of the latter depend largely on why a public sector provider is retained in a competitive environment. A broader question is what is the sustainable critical mass necessary to retain a credible and effective public sector as part of sound democratic governance in the longer term. A separate issue is how that sector can best organise and provide the goods and services involved.

The Auditor-General of Queensland, drawing on D.F Kettle, refers to six core characteristics of what he characterises as the global public sector.<sup>7</sup>

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|------------------------|--|
| 1. Productivity        | <i>How can governments produce more services with less tax money?</i>  |
| 2. Marketisation       | <i>How can governments use market style incentives to eradicate the pathologies of government bureaucracy? Marketisation seeks to replace traditional bureaucratic command-and-control mechanisms with market strategies, and then rely on these strategies to change the behaviour of program managers.</i> |
| 3. Service orientation | <i>How can governments better connect with citizens? Reformers have tried to put citizens as service recipients first.</i>   |
| 4. Decentralisation    | <i>How can governments make programs more responsive and effective? In many nations, the reform strategy has decentralised many programs to lower levels of government.</i>  |

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|-------------------------------|---|
| 5. Policy                     | <i>How can governments improve their capacity to devise and track policy?</i>   |
| 6. Accountability for results | <i>How can governments improve their ability to deliver what they promise? Governments have tried to replace top-down, rule-based accountability systems with bottom-up results-driven systems.</i> |

While this is a useful framework for considering the directions for further reforms, the subject of my presentation today reflects only part of that framework. Nevertheless, it is instructive to review compliance issues in the broader context.

In the spirit of reform that flows from the core/non-core dichotomy, in particular to achieve a more responsive and less costly public service, recent changes to financial,<sup>8</sup> public service and industrial legislation at the federal level illustrate how significantly the APS management framework has changed in the last decade. These changes have seen a shift from central agency control to a framework of devolved authority with enhanced responsibility and accountability being demanded of public sector agencies and statutory bodies. They are intended to allow the APS to manage and respond better to new challenges brought about by the changing environment. Taken together, the various public service, financial and workplace legislation, which are principles rather than process based, provide opportunities for enhanced performance and accountability in the APS. However, they can also involve greater management risks, particularly in an environment of devolved authority. The latter, in particular, has also helped to heighten public service managers' awareness of the need for good corporate governance, in part because of the focus on the overall accountability of Chief Executive Officers (CEOs) and Boards.

The legislative changes are intended to provide managers with increased flexibility, including the elimination of unnecessary bureaucratic processes; to better manage and respond to new challenges brought about by the changing environment; and to improve the performance, and results, of their organisations. The emphasis is now very much on personal responsibility starting at the level of the CEO.<sup>9</sup> The importance of 'tone at the top' is increasingly being recognised, as well as leadership at all levels of an organisation. Greater management flexibility and commensurate increases in personal accountability are the hallmarks of the ongoing public sector reform movement.

Privatisation of the public sector does not necessarily diminish, or remove, the public interest inherent in the operation of particular functional activities. Governments often regulate in order to influence or modify the behaviour of individuals or businesses in ways that are consistent with their broader social and/or economic policy goals. Regulatory action has most often been associated with the notion of dealing with 'market failure'. It is arguable as to just how successful compliance requirements have been in that respect. There is a continuing move away from traditional 'protective' regulatory regimes to ones that are more reliant upon 'self regulation' and consumer empowerment. One observation that can be made, particularly from United Kingdom experience, is that a regulator's independence, objectivity and (potentially) fairness can be impaired if it fails to recognise that the transfer of 'ownership interests' to the private sector can

fundamentally change the nature of the relationship between the regulator and the business entity. Linda Taylor, a senior New Zealand public servant, points out:

*The replacement of direct service delivery by government agencies by contracted services establishes a new locus of control for service delivery.*<sup>10</sup>

She also goes on to quote Kettl:

*Officials cannot give orders to contractors. They can only shape the incentives to which contractors respond.*<sup>11</sup>

## **2. ASSURANCE THROUGH COMPLIANCE**

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

Not surprisingly, the increased emphasis on personal responsibilities and accountabilities has focussed managers' attention on personal sign-offs to the CEO, as well as to other organisation levels, often as part of the normal hierarchical delegations for particular areas of responsibility by nominated individuals, including, but not confined to, financial performance. However, it is not the action of personal sign-off that creates the assurance for stakeholders. It is what underpins the sign-off that is important, including agency endorsement of that framework and its acceptance by those who rely on it. Instructions (such as Chief Executive Instructions), operational guidance and user-friendly information systems are essential in this respect and form part of good corporate governance with its focus on agreed objectives, strategies, controls and performance measures.

To date, there has not generally been a great degree of clarity about the extent of a public sector employee's, officer's, CEO's, Chairman's or board member's accountability for implicit or explicit action that can affect the citizen. However, the implementation of the reforms is increasingly raising awareness of, say, legal accountabilities, just as happens in the private sector. But there is also valuable recognition of the innate complexities of public accountability, with its multi-faceted approach, that have to be managed at all levels of an organisation. Processes of delegation of authority are useful, but not sufficient, to ensure awareness of such accountability requirements at those levels.

In the United States, the push for greater accountability of public servants received a sharp impetus in late 1997 when the Chairman of the Ways and Means Committee, William Archer, put forward a proposal giving citizens the right to sue the Internal Revenue Service (IRS). He declared that:

*we will make it easier for taxpayers who are wrongly accused by the IRS to recover their legal costs...*

and that too often:

*the defenseless and the weak become targets for the IRS audits.*<sup>12</sup>

Such a step is rather dramatic public recognition that not only are regulators and individual public servants accountable in theory, but that damages caused by them should be quantified and reclaimed in practice. It is certainly food for thought both in terms of risk management and insurable risk. However, what it does more starkly reflect is a greater general concern for real accountability by the public sector.

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

I should note here that the responsibilities of individual agencies are, in some instances, not always entirely clear, not least because they may not be determined or tested until a specific matter arises. However, a recent matter that eventually went to the High Court,<sup>13</sup> has highlighted the need for public sector agencies to take the widest possible view of just what their overall responsibilities may be. That is, given the functions that they are required to carry out, including under legislation, agencies must take care to be comprehensive in their determination of what could be considered to be, to use an accounting term, the 'liabilities' of the organisation.

The considerable diminution of central controls and direction has undoubtedly reinforced the need for good corporate governance in individual agencies and entities, as I noted earlier. Corporate governance provides the vehicle to integrate conformance and performance imperatives. Organisations are now responsible for their own oversight and need to develop and implement appropriate accountability and performance structures to assist them, for example, to measure their achievement against strategic objectives. Any coordination of activities, or sharing of experiences, is a matter for individual agencies to arrange between themselves. Further, reduced central oversight and coordination is problematical as agencies recognise that some interrelationships, such as 'shared outcomes', are indicative of the need for broader corporate governance arrangements across agencies. Realistically, such arrangements would take some organisation and management effort to accomplish within a reform environment of devolved authority and 'personal' accountability. I suspect that this is only being recognised gradually where several agencies are involved in 'shared' arrangements.

It is important to understand that the introduction of new approaches to delivering public services does not obviate or limit the need for accountability simply because of any assumed market discipline induced by competition. To the contrary, in a more contestable environment which is highlighted by less direct relationships and greater decision-making flexibility, it is essential that we maintain and enhance our accountability; improve our

performance; and find new and better ways of delivering public services, while meeting required ethical and professional standards.

It is essential that all public sector organisations (whether statutory authorities, government agencies, corporations or local authorities) are transparent, responsive and accountable in their activities. The public is entitled to explanations about the activities of government. 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.

Performance measurement and reporting are intrinsic to the whole process of public management, including planning, implementing, monitoring, evaluation and public accountability. Performance results included in agency annual reports provide an important record of an agency's progress towards meeting objectives and their publication makes it possible to exert pressure for improvement. Good reports can help Parliament and the public assess how well public money is being spent and what is being achieved with it.<sup>14</sup> Such reports are therefore essential for stakeholder assurance.

### ***Commonwealth Government's accrual-based outcomes and outputs framework***

The Commonwealth Government has introduced an accrual-based performance management framework focused on outputs and outcomes. The first full accrual budget was in 1999-2000. Key components of the new framework are as follows:

- agencies are to specify the outputs that will deliver and describe the planned government policy outcomes to which the outputs will contribute;
- specifying outputs will involve identifying price, quality and quantity and other key attributes;
- specifying outcomes will involve providing performance information on the achievement of planned outcomes and the contribution of outputs and administered items to those outcomes; and
- there will be a clear distinction between outputs produced by agencies and over which they have control, and items they administer on behalf of the government.

This framework includes accrual-based management (which delivers information about the full costs and benefits of new and existing activities), output (product) based management (which focuses management both on what, and to whom, services are delivered) and the outcomes to be achieved (which are often referred to simply as the 'results required').<sup>15</sup>

The framework is designed to assist agencies to decide and manage what should be produced and at what price; assess how well it is produced; and how it contributes to the Government's planned outcomes. It should also support Government decision-making in the Budget process, and provide information to Parliament and their stakeholders in a form that enables transparency and fulfills all accountability obligations. Above all, the



framework should support improved resource management by agencies and their Ministers. Specifying outcomes and outputs, and managing finances on an accrual basis, should provide:

- a clear understanding of what is expected to be achieved;
- a clear understanding of the full costs of providing goods and services;
- information required to actively manage the financial health of agencies;
- flexibility in organising agency resources to deliver goods and services; and
- a sound information base for advising stakeholders on priorities, on what is produced, and on what is being achieved.<sup>16</sup>

This framework, with its explicit focus on outputs and outcomes complements the shift to a performance culture where the APS is expected to be more responsive to the Government's objectives. At the heart of this new framework are two important and complementary developments:

- a change in how we measure finances – from cash-based budgeting to accrual budgeting, reporting and accounting; and
- a change in what we measure – to a much greater focus on outputs associated with the achievement of the Government's outcomes.<sup>17</sup>

### ***Portfolio Budget Statements (PBSs)***

PBSs are intended to play a key role in reporting and accountability arrangements because they are the main planning document available to external users. These documents should have, in terms of identifying consistent outcomes, outputs and financial information, sound and transparent links to performance reporting in annual reports. Simply put, the latter should both explain, and measure, the contribution an agency's outputs make to the outcomes outlined in the PBSs.

The Senate Finance and Public Administration Legislation Committee has observed that, whatever other functions the PBSs may serve, Parliament is the intended audience and, consequently, the PBSs must endeavour to meet Parliament's diverse needs. The PBSs are one class of the central budget documents that enable effective public scrutiny of Commonwealth expenditures. As such, they need to be in a format that is tailored to the information needs of senators and members to ensure that they can be used as a document that enhances accountability and ensures adequate disclosure. The Senate Committee noted in its report that:

*The enhancement of accountability and the ensuring of disclosure are indeed worthy goals. Whether that can be achieved by documents which report at an often fairly aggregated level on outputs and outcomes depends to a large extent on how one chooses to define 'accountability' and*

*‘disclosure’. In the Committee’s view the PBS, being ministerially endorsed documents, have always tended to highlight the good news stories and to draw a discrete veil over the bad and, as such, have always been criticised by those seeking to question less than optimum performances.<sup>18</sup>*

The Committee acknowledged in its report that some of the difficulties experienced by Senators with the 1999-2000 PBSs were of a transitional nature but others were inherent in the changed arrangements for PBSs. These changes include agency-wide expenses across several outcomes no longer being separately identifiable in the PBSs. Nor is it possible to identify separately the activities of particular offices or organisations which are subsumed in the larger framework. As well, totals only are shown for administered expenses, which in the case of some portfolios account for the major part of their activities and spending.<sup>19</sup>

The Committee’s report went on to explain that Senators use estimates hearings, and the PBSs, at least in part, for purposes other than to examine what has been achieved from the expenditure of taxpayers’ money and at what cost. In defending the estimates process, the Committee considered that it is an unrivalled opportunity to question government accountability and, in its view, that can, and will, be explored through input and process questioning of, for example, expenditure on contracts and consultancies, ministerial travel and political appointments.

Senator John Hogg (a member of the JCPAA) also emphasised, in an address last year, the important role the Senate plays in our parliamentary system, particularly through the Estimates process. He noted that:

*...there is a call, a demand by those ‘disenchanted’, for the government to be held responsible for their policies and the government/bureaucrats to be held responsible for the expenditure of public money – taxes.<sup>20</sup>*

Senator Hogg believes that it is through the Estimates process that the ‘average voter’ is reassured that the Government and the bureaucracy are being held accountable. However, in his experience, achieving ready accountability is difficult because:

*...the base documents from which I have to work, in particular, the PBS and Portfolio Additional Estimates Statement (PAES) are highly jargonised, not easily read or readable and difficult to follow from one year’s print to the next because of changed formatting.<sup>21</sup>*

The Senate Finance and Public Administration Legislation Committee also noted that DoFA had indicated its responsiveness to the need for consistency and comparability of the financial reporting framework, and will be taking steps to facilitate a continuing program of improvement and refinement. While such action is likely to enhance the level of assurance that complying organisations might provide, the real test is how to manage compliance to achieve required results. I contend that the answer lies in establishing a sound interrelated corporate governance framework.

### **3. MANAGING COMPLIANCE WITHIN A SOUND CORPORATE GOVERNANCE FRAMEWORK**

Simply put, corporate governance is about how an organisation is managed, its corporate and other structures, its culture, its policies and strategies, and the ways in which it deals with its various stakeholders. The framework is concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes/results. Key components of corporate governance in both the private and public sectors are business planning, internal controls including risk management, performance monitoring and accountability and relationships with stakeholders. The framework requires clear identification and articulation of responsibility as well as a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outputs and outcomes. This is not a simple task. It takes time, effort and commitment throughout an organisation.

In a complex operating environment, these requirements become that much more important for both accountability to, and performance for, a wide range of stakeholders, such as is evident in the APS. Corporate governance, including agency controls, is particularly important in relation to the changing, increasingly privatised and internationalised public sector. Certainly, the demand by citizens and other stakeholders for openness and transparency of public sector agency governance (including financial status) exceeds that required of private organisations. Accountability in the areas of community service obligations, equity in service delivery and a high standard of ethics within a legislatively-based values system, are particularly critical to public sector agencies. Accordingly, one of the fundamental ways to ensure that we can meet our performance and accountability requirements is through a robust corporate governance framework with its focus on both conformance and performance or, put another way, compliance and results. The challenge is to achieve the 'right' balance both at particular points in time and over time.

The notion of compliance extends well beyond legislation and rules. The language of a compliance program with its emphasis on – a culture of compliance, starting from the top, leadership, shared vision, ongoing commitment, effective mechanisms, continuous improvement, performance, transparency, and accountability, is also that of corporate governance. Indeed, as Professor Allan Fels has observed about the value of an effective compliance program:

*It is good corporate governance, reduces litigation risks and, if there is litigation, will help reduce penalties<sup>22</sup>.*

Justice Alan H Goldberg (Federal Court of Australia) suggested that:

*It (compliance) goes on to the agenda for every periodic board meeting and every periodic management meeting where the state of the organisation is overseen<sup>23</sup>.*

Justice Goldberg goes on to say that:

*Every director and every executive, indeed all staff, must be evaluating their conduct by reference to compliance principles.<sup>24</sup>*

Perhaps no less should be said of the public sector. It could be argued that compliance programs have been a feature of bureaucracies in the past as part of their close association with legislation. The question is however, whether public sector organisations are sufficiently aware, and equipped, to put such programs in place now, having regard to the Australian Standard on Compliance AS3806. For those interested, the Australasian Risk Management publication (Vol. 11, No. 2, March 2001) includes a “compliance compendium” on ways to increase the effectiveness of compliance systems.

Good corporate governance is based on a clear code of ethical behaviour and personal integrity exercised by management and staff and communicated openly to stakeholders. Such a culture of integrity and disclosure (accountability) is also essential for the establishment of sound risk management approaches and the confidence it can give to stakeholders in both the organisation itself and in what it does. Moreover, there is a mutually supportive relationship between corporate governance, risk management and achievement of objectives. A robust accountability approach that encourages better performance through sound risk management is integral to any corporate governance framework.<sup>25</sup>

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

The necessity for openness and transparency is accepted as a basic element of public sector accountability. The public sector has both to act in the public interest and, in common with the private sector, avoid unnecessary conflicts of interest. These will be particular challenges for agency managers in establishing credible corporate governance frameworks within public sector agencies that are increasingly being asked to act in a more private-sector manner. However, as with the latter sector, greater emphasis has to be placed on performance rather than mainly on conformance (compliance), although the question is again one of balance according to the circumstances of the agency, perhaps at a particular time of their corporate development and circumstances.

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

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

Regulations require agency heads to embed these values within the culture of their agencies. The Public Service Commissioner has to report annually under the *Public Service Act 1999* on how successfully this had been achieved. My own agency, to take one example, has, as its key values, independence, objectivity, professionalism, and knowledge and understanding of the public sector environment. These values are guided by the ANAO Code of Conduct, which has been developed within the framework of the new APS Values and the APS Code of Conduct, together with the Codes of Ethics promulgated by the professional accounting bodies.

### **The accountability/performance dichotomy**

It has been increasingly recognised in both the private and public sectors that appropriate corporate governance arrangements are a key element in corporate success. They form the basis of a robust, credible and responsive framework necessary to deliver the required accountability and bottom line performance consistent with the organisation's objectives.<sup>26</sup>

According to the findings of a survey conducted of over 100 major investors in the United States of America (US), good governance practice makes a difference that investors are prepared to pay for. Results indicated that US investors would be prepared to pay an eleven (11) to sixteen (16) percent premium for shares in a company that was well governed.<sup>27</sup> These findings would appear to imply that, unless particular corporate governance practices promote improved performance and the achievement of the objectives of an organisation, they are not worth pursuing. The amount paid for corporate governance will depend on the additional 'value' that it creates, and that is not always fully encapsulated in a 'price'.

An indication of value comes again from a US example where the Californian Public Employee's Retirement System (CalPERS) undertook corporate governance efforts targeted at underperformers in their investment portfolio. CalPERS assessed the companies in its portfolio against three factors: market performance; corporate governance practices; and economic performance. It then individually analysed them to determine whether, through engaging in governance discussions with the companies' board and management, CalPERS could potentially add value and improve performance.

A study of the improvements in returns from these efforts showed that sixty-two companies added \$US150 million annually to their performance at a cost to CalPERS to run the program of less than \$US500,000 per annum. The following observation was made by a Senior Board Member:

*Good governance is now something that is being institutionalised and valued.*<sup>28</sup>

A key message of the Government's reform agenda, as noted in my opening remarks, is that it is no longer considered appropriate for the APS to have a monopoly even in traditional service delivery areas such as policy advice and in the determination of welfare entitlements. It must now prove that it can deliver government services as efficiently and effectively as the private and/or non-profit sectors. This is reflected in the increasing emphasis being placed on the contestability of services; the outsourcing of functions which can be undertaken more efficiently by the private sector; and ensuring an orientation more towards outcomes, rather than processes, and to continuous improvement, to achieve required performance/results. These imperatives need to be reinforced by agency managers at all levels of the agency.

I think most would agree that, in the past, the tendency in the public sector has been to primarily focus on ensuring conformance with legal and procedural (including budgetary and financial) requirements, with attention to program outcomes and improved performance being a secondary consideration. Consequently, there have been administrative control processes put in place for government policies and procedures over many years. In particular, as public servants, we have been particularly concerned to ensure that we have met the requirements of relevant legislation. And there has also been a marked emphasis on fraud control and probity concerns in a more risk conscious environment. In short, we have been concerned to do 'things right'. The question that is being asked is whether that approach is still being applied, as well as the reform emphasis on doing the 'right thing'.

In many areas, we have not been as effective in constructing robust control structures aimed at assuring that we achieve defined outputs and outcomes, nor in providing efficient client-oriented services. More attention is now being given to addressing government programs/services directly to public sector citizens, as clients or customers. This focus has been reinforced by the requirement for Public Service Charters, which should clearly signal to all concerned just what various client groups can expect of an agency and its staff. Although the program management and budgeting framework has required us to address such issues over the last decade or so, it is likely that the move to accrual-based budgeting for outputs and outcomes will be the catalyst that ensures we have the necessary information links in place. However, this remains a major challenge of our information systems, which I will discuss in more detail later.

I noted earlier that, as the APS continues to move to a more private sector orientation, we are increasingly seeing a growing adoption, or adaptation, of private sector approaches, methods and techniques in public service delivery. Consequently, there is an issue of trade-offs between the nature and level of accountability and private sector cost efficiency, particularly in the delivery of public services and in the accountability regime itself. A sound corporate governance framework, with its focus on control and monitoring

mechanisms that are put in place by an organisation, can assist in enhancing stakeholders' value of, and confidence in, the performance, credibility, viability and future prospects of that organisation in a rapidly transforming public sector. But the issue of the nature and level of accountability is primarily one for the Government and Parliament to resolve in the first instance.

### **Making corporate governance work**

Attention to the principles of corporate governance requires those involved:

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

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

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

Therefore, the challenge for management is not simply to put the various elements of corporate governance in place but to ensure that those elements are effectively integrated; are well understood; and applied effectively throughout those organisations. As Trevor Sykes of the *Australian Financial Review* stated in an interview with the Chartered Institute of Company Secretaries in Australia:

*Expressing the sentiments of corporate governance is dead easy ... What is going to be harder is making it work, putting flesh on the bones.*<sup>29</sup>

If implemented effectively, corporate governance frameworks should provide the integrated strategic management framework necessary to achieve the output and outcome performance required to fulfil organisational goals and objectives as well as discharging their accountability obligations.

Effective public sector governance requires leadership from the Board (where applicable), the CEO and executive management of organisations and a strong commitment to quality control and client service throughout the agency. Public sector executives leading by example is perhaps the most effective way to encourage accountability and improve performance.

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

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

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

The following comment by the current Chief Finance Officer of the Australian Customs Service (ACS), is also apposite:

*All managers should understand the importance of managing risk. At Customs, it is fundamentally important that all staff understand this, too. Managing risk is integral to achieving key result areas in our corporate plan.*<sup>30</sup>

Nevertheless, the debate goes on. For example, a prominent Chairman of three major Australian corporate boards has challenged boards' 'obsession' with conformance rather than performance and their predisposition to be risk averse.<sup>31</sup> In his words:

*... there's just been too much concentration in recent times on the conformance, the governance, the ticking of the boxes, who comes to meetings and I think it's far from clear that that adds value, improves the performance of companies, delivers benefits for shareholders.*<sup>32</sup>

Such criticism needs to be addressed positively while recognising there is always an appropriate balance to be struck, as I observed earlier.



### ***Defining individual roles and responsibilities***

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

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

*It is the Board's responsibility to ensure good governance and to account to shareholders for their record in this regard.<sup>33</sup>*

In the private sector, there is a clearly defined relationship structure between the main parties. That is, the generic private sector governing structure consists of a board of directors, including the chairperson of the board, and a CEO responsible for the ongoing management of the agency.<sup>34</sup> However, this model is not readily transferable to the public sector, even with Government Business Enterprises (GBEs), because of the different roles and relationships between the responsible Minister(s), the CEO and (possibly) the Board. As well, Australian citizens (stakeholders) have no choice as to their investment.

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

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

*...the paramount duty of management and of boards of directors is to the corporation's stockholders; the interests of other stakeholders are relevant as a derivative [my underlining] of the duty to stockholders.<sup>35</sup>*

While I agree that a Board's primary responsibility should be to its shareholders, I would suggest that concepts of greater social and community responsibility are increasingly being embraced by the private sector, as a matter of course. Boards are beginning to recognise that being seen as 'good corporate citizens' is integral to the long-term viability of an organisation and, therefore, in the interests of shareholders. The shake-up of the

AMP Board in April 2000, precipitated perhaps by shareholder/investor criticism about the company's business performance and share price, seems to me to involve the corporate governance context in which that organisation was operating. It could be seen as an example of an organisation responding to public concern in order to regain an appropriate level of community and shareholder confidence in both the business and ethical nature of the company's activities.

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

The ANAO discussion paper entitled *Corporate Governance in Commonwealth Authorities and Companies*<sup>36</sup> suggests that there may be opportunities to formalise relationships between the Board, the CEO, including management, and responsible Minister(s), perhaps through the development of a Board Charter. Alternatively, a written agreement or memorandum of understanding could be prepared outlining roles and responsibilities as is done, say, in New Zealand. Consideration also needs to be given to adequate training both of the Board Members and management to ensure that there is full understanding of their requirements and obligations, legal and otherwise. A case in point is the new 'Business Judgement Rule' under Sections 180(1) and (2) of the *Corporate Law Economic Reform Program (CLERP) Act 1999*. This is a discrete area of liability and:

*... the introduction of the business judgement rule does not affect directors' liability under other areas of the Corporations Law (e.g., insolvent trading, personal director and officer liability under the trade practices, environmental and occupational health and safety regimes).*<sup>37</sup>

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

Thus, the threshold requirement of sound governance must be agreement between the key parties, whether this is the board and management (including the CEO) or the CEO and management, on the broader corporate objectives. These parties should jointly develop the corporate objectives that the CEO is responsible for achieving. In turn, these have to be communicated to, and well understood by, all other stakeholders.

The issue of corporate governance in the public sector has been taken up more recently during an inquiry conducted by the JCPAA.<sup>38</sup> As I mentioned earlier, the Commonwealth introduced revised financial legislation for public sector entities, with effect from 1 January 1998. The new *Commonwealth Authorities and Companies Act*

1997 (the CAC Act) introduced new governance arrangements for GBEs. It provided a framework for the accountability of GBEs and set out key responsibilities for both boards and Ministers. The broad objective of the JCPAA inquiry was to assess the appropriateness and effectiveness of these arrangements. Given that GBEs are publicly controlled entities, the Parliament has a continuing interest in their governance, performance and accountability.

The JCPAA's inquiry<sup>39</sup> has, in my view, added much to the consideration of appropriate accountability and corporate governance arrangements for the public sector, in this case GBEs. As an indication of the importance of this sector, the JCPAA's report notes that in 1998-99 Commonwealth GBEs accounted for approximately 24.5% of the Commonwealth's total assets of nearly \$165 billion. The Department of Finance and Administration (DOFA) has reported that, in 1998-99, GBEs generated revenues of nearly \$25 billion, provided dividends of \$4.5 billion, and controlled assets of some \$40 billion. Among other things, the JCPAA examined the appropriateness of the CAC Act and, in particular, its continued application to GBEs. It recorded the view that:

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

and concluded that

*... the Committee does not support removing GBEs from their responsibilities under the CAC Act.*<sup>40</sup>

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

### **Managing risk as part of an integrated corporate governance framework**

Managing risk is of major interest for this Conference. We are all still learning about the pro-active management of risk both in terms of minimisation and opportunity. I have already shown that clearly defined individual and collective roles and responsibilities are essential if we are to be realistically held accountable for our performance. Control structures, incorporating sound risk management, are also a particularly relevant element of an effective governance framework because of their importance in promoting effective performance and ensuring that accountability obligations are appropriately discharged.

An effective corporate governance framework assists an organisation to identify and manage risks in a more systematic and effective manner. As one expert opinion puts it, 'corporate governance is the organisation's strategic response to risk.'<sup>41</sup> Yet another suggests that:

*An effective risk management program has to be integrated into the organisational structure, management process and culture throughout all levels of the organisation.*<sup>42</sup>

The Queensland Audit Office refers to corporate governance as the ‘glue’ which holds the organisation together in pursuit of its objectives and risk management provides the resilience.<sup>43</sup> The Office deserves congratulations on its ‘self assessment programs’ in the areas of governance and risk management.

The public sector must manage the risks inherent in a more contestable environment if it is to achieve the required levels of performance and satisfy relevant accountability standards. More than ever, this situation will require a formal, systematic approach to identifying, managing and monitoring risk. The intuitive, and often reactive, approach to managing risk that has characterised public sector management in the past will not be sufficient. We all know that reacting ‘after the horse has bolted’ is often quite costly and damaging to the credibility of agencies and Ministers. A more strategic approach is required to stay contestable in such an environment. This is a significant management challenge.

I am pleased to say that there is a growing recognition and acceptance of risk management as a central element of good corporate governance. It is also being used as a legitimate management tool to assist in strategic and operational planning. As such, it has many potential benefits in the context of the changing public sector operating environment. It encourages a more outward looking review and evaluation of the role of the organisation. It thereby focuses more on customer/client relationships; directs a greater emphasis to outcomes; and concentrates on resource priorities and performance assessment as part of management decision-making. The risk management framework thereby provides greater assurance for management and confidence in their ability to be more accountable for their performance and results.

That said, the effective implementation of risk management practices is still a major challenge for public sector managers, particularly as the culture under which they have operated has traditionally been risk averse and still has much of the characteristics that made it so. As I have commented elsewhere:

*Parliament itself, and its Committees, are still coming to grips with the implications of managing risks instead of minimising them, almost without regard to the costs involved.*<sup>44</sup>

I note that one of the most significant recent additions to the risk management standard (AS/NZS 4360:1999) is the requirement to identify stakeholders and communicate and consult with them regarding their perceptions of risk at each stage of the risk management process. The results of such communication should, of course, feed into any decision-making process. It is important to understand that risk and risk-taking are relative concepts. Therefore, perceptions are vital because differences can arise, for example, simply from different understandings of what constitutes risk.<sup>45</sup>

To be effective, the risk management process needs to be rigorous and systematic.<sup>46</sup> Some still see this as a pre-occupation with process and can be, if treated as such. However, if organisations do not take a comprehensive approach to risk management, then directors and managers may not adequately identify or analyse risks. Compounding the problem, inappropriate treatment regimes may be designed that 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;
- rigorous evaluation methodologies, and
- effective management information systems.

There is no doubt that the more ‘market-oriented’ environment being created is inherently more risky from both performance and accountability viewpoints. To good managers, it is an opportunity to perform better, particularly when the focus is more on outcomes and results and less on administrative processes and the inevitable frustration that comes from a narrow preoccupation with the latter. Having said that, it is important for us all to remember that the Public Service is just as accountable to the Parliament for the processes it uses as it is for the outcomes it produces. That is inevitable and proper. However, in my experience, some agencies, faced with the prospect of adverse comment in an ANAO audit report about the transparency and accountability of their risk management or other processes, have argued that the report should place its emphasis on the outputs and/or outcomes achieved by the agency. Nevertheless, good process contributes to good outcomes. They are not alternatives. That brings me to the issue of controls and their role in risk management.

### ***Control structures to manage risk***

Complementary to a sound risk management approach is a robust system of administrative control. Control structures are particularly relevant elements of an effective governance framework because of their importance in promoting effective performance and in ensuring accountability obligations are appropriately discharged. Late in 1997, the ANAO released a publication entitled ‘*Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes : A Better Practice Guide to Effective Control*’.<sup>47</sup> Control was broadly defined as ‘a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency’s objectives.’ The emphasis should be on a more systematic approach to decision-making to manage, rather than avoid, risk.

Although reflecting the United Kingdom (UK) situation, the Internal Control Working Party (the Turnbull Committee), and its 1999 report *Internal Control—Guidance for Directors on the Combined Code*<sup>48</sup> has, in my view, provided an effective lead towards the introduction of internal control arrangements for the private sector—and, by extension, for commercial elements of the public sector. The Committee’s report provides guidance to assist UK listed companies implement the requirements in the revised Combined Code of the Committee on Corporate Governance, as the Code applies to internal control. The importance of this report, as with the 1992 Cadbury Report,<sup>49</sup> is that ‘an Australian equivalent of the Turnbull Rules will arrive here soon’.<sup>50</sup>

Interestingly, although the Cadbury Report dealt with financial risks only:

*The Turnbull Rules now require companies' boards to ensure that processes are in place to manage not just financial, but all [my underlining] the organisation's risks.<sup>51</sup>*

In effect, the Turnbull Committee has sought to reflect some of the best practices available in designing and operating systems of control, and in incorporating a risk-based approach to corporate governance arrangements. I note in particular, and support, the Committee's comprehensive statement that:

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

- facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed;*
- help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation; and*
- help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.<sup>52</sup>*

In the Australian public sector situation, I consider that we can learn from, and apply where applicable, the principles enunciated for private sector arrangements by key authorities such as the Turnbull Committee. It is axiomatic that effective control structures within a corporate governance framework are a vital element in providing assurance to clients and the Parliament that an agency is operating in the public interest, and that it has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. In contrast, weak internal controls provide an environment that increases the risk of fraud. The following are some examples of signs, signals and patterns indicating fraud:

- weak management that fails to enforce existing controls, supervises the control process inadequately, and/or fails to act on fraud; and*
- loose internal controls with inadequate separation of duties involving cash management, inventory, purchasing/contracting and payments systems which allow the perpetrator to commit fraud.<sup>53</sup>*

Mark Stock, a partner in KPMG (UK), recently provided an overview of progress on the Turnbull report.<sup>54</sup> He noted that, in the calendar year 1999, when the transitional rules were available, only five per cent of companies complied early, while 65 per cent established the necessary procedures by the year end. The indications are that for calendar 2000, less than three per cent would not be claiming compliance during the year. He also observed that the following should be part of effective systems of internal control:

- ability to respond quickly to evolving risks;
- costs and benefits must be balanced;
- prompt reporting of weaknesses;
- lead and lag indicators leading to corrective action;
- reasonable but not absolute assurance; and
- embedded in an organisation and part of its culture.<sup>55</sup>

### ***Fraud control***

One area where agencies need to ensure robust processes relates to their fraud control systems. Notwithstanding the current focus on outcomes and outputs, it is important that agencies have in place appropriate frameworks to protect public funds from loss and fraudulent misappropriation. Against this background, my Office has undertaken work on a series of fraud control audits in selected agencies as well as a survey of some 150 agencies to provide assurance to Parliament on the preparedness of agencies to prevent and/or deal with fraud effectively.

The survey findings indicated that while the majority of agencies had established suitable fraud control arrangements in line with the Commonwealth Policy, a substantial number had not. A particular concern that the survey raised was that one third of agencies had not undertaken a recent risk assessment. Given the changing nature of fraud this is likely to mean that agencies are not identifying emerging risks in a timely manner. As well, a number of agencies (13 per cent) had developed a fraud control plan that was not based on a current risk assessment, raising questions regarding the usefulness of these plans.<sup>56</sup>

Our audit findings highlight the importance of integrating fraud risk management within organisations' corporate governance framework. In particular, agencies should be reviewing their approach to dealing with fraud because of the changing nature of the risk of loss of public funds resulting from, among other things, new service delivery methods such as outsourcing and electronic service delivery and the growing use of the Internet. In many instances it may no longer be appropriate to rely solely on established systems to prevent and detect fraud in the current public sector environment.

The management challenge is to put in place an appropriate corporate governance framework (embracing, of course, the various fraud control strategies and measures) to

manage the risk as effectively as possible – to reduce its incidence and/or mitigate its effect. On this point, I note that the revised Fraud Control Policy of the Commonwealth encourages agencies to take an holistic approach to managing the risks they face in line with modern corporate governance principles. That is, the revised Policy enables agencies to manage fraud alongside the other risks faced by the agency.

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

Specifically, under the proposed new standard:

- *... auditors will be required to quiz managers and boards of directors about what systems they have to detect fraud and glaring errors.*
- *Auditors will also need to check whether incorrect statements in the company books, including omissions of amounts and disclosures, are simply honest mistakes.*
- *Businesses will not only have to notify auditors, in writing of any fraud or suspicious activity; they will also be required to produce any financial statements that turn out to be incorrect and that management claimed were immaterial.*
- *Auditors will be required to pass these details on to those in charge of governance at the company that is being audited.*<sup>57</sup>

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

*It is the responsibility of management to establish and maintain policies and procedures that would contribute to the orderly and efficient conduct of the entity's business.*

*This responsibility includes implementing and ensuring the continued operation of accounting and internal control systems which are designed to prevent and detect fraud and error.*



*Further, it is the responsibility of those charged with governance to ensure, through oversight of management, that these systems are in place.<sup>58</sup>*

It would seem appropriate to put the onus on managers and directors, including those in public sector agencies, to ensure that their organisations have internal controls to prevent and detect fraudulent activity as well as any undue errors that can result from lack of vigilance, skills, or even care. My audits do not set out to detect fraud but do strenuously check all entity systems bearing on financial management and reporting. We have limited forensic audit skills. Any apparent fraud is referred to the Australian Federal Police for investigation. Contrary to the perception of some managers and directors, financial statement audits, in particular, do not set out to determine if there is fraud. A major issue is whether we can depend on organisational systems to deal with fraud and provide reliable information on which we can base an audit opinion.

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

An effective audit committee can improve communication and coordination between management and internal as well as external audit, and strengthen internal control frameworks and structures to assist CEOs and boards meet their statutory and fiduciary duties. An audit committee's strength is its demonstrated independence and power to seek explanations and information, as well as its understanding of the various accountability relationships and their impact, particularly on financial performance. In particular, it can ensure that accepted audit recommendations are followed up and properly actioned, which greatly improves both internal and external audit effectiveness.

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

I cannot overemphasise the importance of the need to integrate the agency's approach to control with its overall risk management approach in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively.<sup>59</sup>

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

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

### **Performance assessment**

Under the current public sector reforms, the public sector is subject to increased levels of scrutiny of its performance and effectiveness. The focus is now very much on achievement of outcomes as well as outputs. A culture of ongoing performance assessment is therefore important to maintain Parliamentary and public confidence in the public sector. The establishment of a performance culture supported by clear lines of accountability is an essential part of the government's approach to reform in the APS. Such a culture will provide the discipline and integrity required to undertake credible benchmarking, market-testing and pricing reviews for agency and entity outputs in the budget context as part of resource and performance assessment.

Performance information is a critical tool in the overall management of programs, organisations and work units. It is important not as an end in itself, but in the part it plays in managing effectively and has an expanded role in the new ways of delivering public services as a means of protecting Commonwealth and public interests. It is therefore a key component of good corporate governance. Performance information fits within the wider management framework that includes objectives, strategies for achieving objectives and mechanisms for collecting and using such information. The latter is essential for assessing the impact of identified risks as well as to assist management to take timely action to deal pro-actively with identified risk whether by turning it to advantage or implementing credible preventative measures. In a recent report the Western Australian Auditor-General noted that:

*In a rapidly changing environment, public sector managers will face challenges of simultaneously complying with policies designed to achieve fairness and value for money and providing effective performance.*<sup>60</sup>

One initiative that has been introduced for Government Business Enterprises (GBEs) to strengthen the management framework and parliamentary oversight in terms of performance is the requirement for GBEs to prepare and table in Parliament, annually,

Statements of Corporate Intent (SCIs). SCIs are brief, high level, forward looking documents, expressed in terms of outputs or outcomes. They normally contain a statement of accountability (including reporting obligations), business descriptions, objectives and broad expectations of financial and non-financial performance. They do not, however, contain commercial-in-confidence information. SCIs are intended to provide greater clarity for Parliament, the responsible Minister(s), the board and management as to the framework within which a GBE is to operate, and about its operating activities. As such, SCIs complement the usual ex-post performance information provided in, say, annual reports.<sup>61</sup> Similar statements have been included, or could be considered for inclusion, in other agency and entity reports, for similar reasons.

Having developed the mechanisms to allow the assessment of performance, it is important that we use our performance information for ongoing monitoring as well as for 'point in time' assessment and reporting. Ongoing monitoring at different levels in the organisation assists to ensure that our program is on the right track and that we are using our resources to maximise outputs and related outcomes. Such checks also provide assurance to top management as well as allowing them to take timely, strategic action if performance is not satisfactory. However, we need to keep in mind that some situations need particular care as the following indicates:

*The use of performance targets may induce counter-productive behaviour on the part of agencies, where outputs or outcomes are hard to specify ex ante and to measure ex post and where there are significant information asymmetries. For example, specifying targets for less critical but more easily measurable performance dimensions can result in dysfunctional behaviour.*<sup>62</sup>

In reporting on outputs and outcomes, say to the CEO/Board or to the Parliament, performance reports should be balanced and candid accounts of both successes and shortcomings. They should have sufficient information to allow the Board and the Parliament (and the general public) to make informed judgements on how well an organisation is achieving its objectives. Reports should include information on performance trends and comparisons over time rather than just a snapshot at a point in time which may be misleading. The Senate Finance and Public Administration Legislation Committee, mentioned earlier, has made a similar point.

I see the move towards both accrual budgeting and reporting as an important element in assisting departments and agencies to develop useful performance information systems. It will help agencies to become more outcome-focussed in reporting, providing improved information to both agency management and the Parliament and encouraging an effective Corporate Governance framework.<sup>63</sup> As well, it should assist agency management to judge between alternative advice delivery modes. This heralds the need for management to develop more sophisticated information systems that will incorporate improved forecasting and decision-support tools.

Despite the greater involvement of the private sector, performance assessment in the APS continues to be more than just about a financial bottom line. Assessments typically cover a range of measures, both quantitative and qualitative. For example, an agency or entity has to be accountable for the implementation of the Government's requirements with

respect to public sector reforms and for meeting relevant legislative, community service and international obligations; for equity in service delivery; and for high standards of ethical behaviour. This point has been recently emphasised by Max Moore-Wilton, Secretary, Department of the Prime Minister and Cabinet, as follows:

*Ministers and Departments do have an obligation not just to achieve the bottom line that is often the key outcome sought by private companies. We owe it to the community to establish public trust that we work with integrity and put public interest ahead of personal gain. Ensuring the transparency of our processes can focus our minds on the need for each individual decision we take to be justifiable in terms of strict propriety.*<sup>64</sup>

In order to assess performance accurately, we will need to identify both the financial and non-financial drivers of agency business. This will involve the use of techniques such as the balanced scorecard approach promoted in the then Management Advisory Board's (MAB) publication *Beyond Bean Counting Effective Financial Management in the APS – 1988 & Beyond*. In MAB's words:

*The scorecard...complements the financial measures with operational measures on customer satisfaction, internal processes, and the organisation's innovation and improvement activities - these operational measures are drivers of future financial performance.*<sup>65</sup>

The scorecard approach underlines the importance of the various linkages and their understanding and management such as between strategy and operations, budgets and performance. It also requires that attention be given to measuring performance where practicable and to articulating a credible basis for assessing qualitative or so-called 'soft' indicators of success. A parallel is the distinction between price and value for money.

Australia is not alone in grappling with the development and use of sound performance information, particularly in the light of the rapidly changing operating environment. Significant developments have been occurring in New Zealand, the United States of America, Canada, the United Kingdom and in a number of European countries such as France and Sweden. Many countries are now actively sharing experiences on deriving suitable performance information for accountability purposes. Moreover, we would do well to heed comments such as those made by the Clerk of the Privy Council and Secretary to Cabinet in her Annual Report to the Prime Minister on the Public Service of Canada:

*Public servants want to meet citizens' expectations and are ready to remove barriers to more effective service delivery, but it must be done in a manner that is true to the roles and values of the public sector.*<sup>66</sup>

Linda Taylor, in the article quoted earlier, also referred to the conflict of goals and ethics between government agencies and the voluntary sector that was contracted to provide community services. Voluntary organisations were founded on the principles of participation, voluntarism and self-help usually in the context of a target client group. In contrast, government goals tend to focus on accountability for public money, efficiency and effectiveness of service and consistency of delivery. The overall context is the policy

of the government of the day and its strategic direction mandated through the democratic process. While both parties may ultimately seek the same outcome for clients and society as a whole, the conflict arises in the underlying context and lines of accountability.<sup>67</sup> A similar conflict is pointed out in another recent article as follows:

*Voluntary non-profit organisations fear they lose their legitimacy in the eyes of their users or clients.*<sup>68</sup>

The focus of public sector reform is very much on results but it also matters how those results are achieved. A major challenge for the public sector in the future, including for Audit Offices, is performance management. If we are successful in achieving a credible, trusted performance management framework, we will earn the confidence and support of all our stakeholders, including those who work, and want to work, in the public sector. From an accountability viewpoint, which is also a major on-going audit concern, the following observation by the Comptroller General of the United States is apposite:

*Performance management ensures accountability because it generates valid and reliable data on program impact on the allocation of resources and on the economy, efficiency, effectiveness and integrity with which the government's finances are run.*<sup>69</sup>

Of interest in this respect, is the observation made by the Victorian Public Accounts and Estimates Committee on the implementation of a performance monitoring and management system, based on lessons learned from 7,500 outsourcing situations, that the quality of service improved by 38 per cent after the system was implemented.<sup>70</sup>

With the greater convergence of the public and private sectors there will be a need to focus more systematically on risk management practices in decision-making that will increasingly put demands on suitable cost, quality and financial performance. Similar pressures will come with the advent of the move to electronic commerce and the greater use of the Internet for business purposes, which I will discuss later. In turn, these will put increasing pressure on management of our information systems and systems controls. Good corporate governance should ensure that not only are the needs of individual managers for useful information met effectively, but also that timely and relevant corporate information is provided to allow an assessment as to whether results are consistent with agreed corporate requirements and add to overall corporate performance.

#### **4. MANAGING COMPLIANCE IN A MORE CONTRACTUAL ENVIRONMENT**

At the Federal level, the objective of the Government's reform agenda, as I observed earlier, has been to focus the APS on its core activities, that is, policy development, legislative implementation, and the contracting and oversight of service delivery. As a consequence of the greater use of outsourced services as components of program delivery, contract management has become a more critical element in public administration. While the move towards outsourcing of government services has been gathering momentum for a number of years, the trend now encompasses not just the support service contracts, with which most organisations are familiar, but also elements

of agencies' 'traditional' core business. This trend is unlikely to reverse in the foreseeable future. It is therefore incumbent on APS managers to refine their skills and knowledge to embrace their role as managers of outsourced (contractual) arrangements, as well as being the developers of policy.

Two surveys conducted by the Institution of Engineers, Australia, in 2000 and 2001 looked to quantify the cost and frequency of inadequate contracting practices by government. Both industry and government respondents considered public servants were often below-average buyers (broadly in the range of 20 to 40 percent). The author of the survey, Athol Yates, a Senior Policy Analyst in the organisation, noted that being an uninformed buyer puts at risk the ability to:

- select and justify the option which offers best value for money;
- select and justify an innovative solution;
- reduce contractor risks by providing relevant technical details in tender documents; and
- prevent unscrupulous contractors taking advantage of the buyer's lack of knowledge.<sup>71</sup>

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

### **Managing Contracts**

It is important to recognise that managing an outsourcing contract starts before any decision has been taken on the selection process, let alone about the service provider. For this reason, proper project planning is essential to a successful outsourcing partnership. Indeed, a previous Australian Government Solicitor observed that:

*There is often an inverse relationship between the amount of time spent in preparing tender and contract conditions and the resources required to deal with problems in contract administration and disputes after the contract has been formed.*<sup>72</sup>

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

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

However, the more rigorous the selection process is, the more protracted the contract negotiation process is likely to be; the more clear and quantifiable the performance standards are, the less likely that there will be an unsatisfactory outcome. In essence, the issue is a trade-off between administrative and accountability processes (or simply 'bureaucratic red tape' in the eyes of some) and their impact on costs and prices. Put another way, the challenge of contract management is to maintain accountability and transparency throughout the process, with the ultimate end of achieving cost efficiencies and value for money outcomes. What also needs to be kept in mind is the cost associated with contract management which partially, at least, offsets value for money considerations as many studies of outsourcing have shown. Key transaction and compliance costs are associated with negotiating, monitoring and reviewing contracts; assessing and managing risk; and enforcement/encouragement of contract results. An assessment of social security contracts in New Zealand indicated:

*The risks associated with [the move to contracting] are adverse selection and moral hazard. Both arise from information asymmetry: the first when an agent is selected on the basis of insufficient information being available to the principal before a contract is negotiated; the second when the principal is unable to observe the behaviour of the agent after negotiation. Both situations present challenges to public managers in terms of accountability and transparency of process. The reality of social service contracting is often that purchasers have little information about what outcomes are resulting from contracts, competition is low, and the need to ensure service continuity tends to result in effective monopolies for providers.<sup>73</sup>*

Crucial to meeting the challenge is the contract itself and how it is subsequently managed. The Joint Committee of Public Accounts and Audit (JCPAA) reinforced the latter, in particular, last year by observing:

*... the search for excellence in contract management as one of the pressing challenges for the Australian Public Service.<sup>74</sup>*

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

The contract must clearly specify the service required; the relationship between the parties needs to be clearly defined, including identification of respective responsibilities; and mechanisms for monitoring performance, including penalties and incentives, set in place. There should not be any equivocation about required performance nor about the obligations of both parties. I stress that this is as much about achieving the desired outcome as it is about meeting particular accountability requirements. Both require sound, systematic and informed risk management which recognises that:

*... managing contract risk is more than a matter of matching risk-reducing mechanisms to identified contract risks; it involves an assessment of the outsourcing situation.*<sup>75</sup>

It must be emphasised that effective contract administration goes beyond just holding contractors to account for each minute detail of the contract, as some would have it. Important elements of an effective contractual framework include:

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

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



*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>76</sup>

On the issue of contract preparation and management, the (then) Industry Commission (now the Productivity Commission) has suggested that public sector agencies tend to transfer as much risk as possible to the agent, thus increasing the risk of contract failure. Conversely, if too little risk is left with the agent, this can lead to poor service delivery and resulting political problems for the government.<sup>77</sup> I will come back to the issue of risk transfer when discussing private financing. Such political problems reflect the rights of service recipients as citizens who are not party to the principal-agent relationship. This can create other problems as indicated in the following observation:

*Probably the greatest accountability weakness, from the standpoint of service recipients and other third parties affected by the actions of a contractor, is the limitation of private contract law in dealing with the interests of parties not covered by the privity of contract between the government agency and the contractor.*<sup>78</sup>

In this context, it needs to be recognised that each step in the contract management lifecycle requires management of the business risks associated with that step and management of the performance of that step to maximise the potential benefits to accrue to the organisation. This involves managing risks and resources both internal and external—at all stages of the contract, namely:

- specifying the activity;
- selecting the acquisition strategy;
- developing and releasing the tender documentation;
- evaluating the tender bids;
- decision and implementation;
- ongoing management; and
- evaluation and succession planning.

Nevertheless, contracts should not be a daunting process for either party. From the point of view of an effective public sector manager, the ideal contracts are the ones that you can leave in the bottom drawer but at the same time you are confident that, if a challenge were to arise, the Government's interests are well protected. Such an ideal reflects the establishment of a genuine partnership between the public and private sectors. It is an arrangement whereby the parties operate in tandem rather than at arm's length and where there is room for some give and take. But the boundaries have to be clear enough that

each request for a service or product does not result in either or both of the parties scrambling for the contract to settle differences.

The audit of the Implementation of the Whole of Government Information Technology Infrastructure and Outsourcing Initiative, among other things, called into question the benefits claimed for the Initiative as the outcomes of the contractual arrangements.<sup>79</sup> As a response to the audit, the Government commissioned the recent review of IT outsourcing conducted by Richard Humphry, Managing Director of the Australian Stock Exchange. Mr Humphry remarked:

*While it is always the prerogative of Government to set central policies, the responsibility for implementation and management lies with agency Chief Executives and Boards in accordance with the legislative requirements of the [relevant] Acts.*

*A key response to the perceived unwillingness of agencies to implement the Initiative was the adoption of a compulsory, centralised approach under the direction of OASITO. It was felt that an agent of change... was needed, at the beginning, to help deliver the Initiative's goals.*

*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>80</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
- insufficient consultation with key stakeholders.<sup>81</sup>

These reflect both governance and assurance issues that need to be addressed in order to achieve the results required.

On the topic of lessons learned, the ANAO has recently released a Better Practice Guide on Contract Management. The Guide was developed from the experiences gained in a Financial Control and Administration (FCA) audit on the management of contracts for the delivery of business support processes. The results of this audit were presented to Parliament in 1999 in *Audit Report No. 12 1999-2000*, titled *Management of Contracted Business Support Processes*.

The audit concluded that elements of the control framework operating over the contract administration, monitoring and succession phases of the contract lifecycle required improvement in most of the organisations examined. In particular, management attention and action were required in relation to aspects of risk management, the control environment, information and communication, monitoring and review and performance measures for the quality of service delivery.

In addition to the above findings, the audit identified a number of better practices in the management of contracts in public sector organisations, as well as the need for guidance to assist organisations in the achievement of effective contract management, particularly in the application of risk and measurement of supplier performance.

The Contract Management Better Practice Guide has been developed to provide better practice examples for the ongoing, day-to-day management of contracted services and evaluation of the overall performance of the contract to enable effective succession planning. These stages in the contract management lifecycle are addressed in terms of the application of practical risk management approaches and techniques. The Guide includes practical examples drawn from public and private sector experiences and examples of these identified issues to consider in ensuring effective contract management which bear directly on the topic of this address.

Additionally, the Guide includes a list of Internet sites that provide useful reference material on contract management and are further linked to other related and useful sites.

I would now like to take the opportunity to provide a little more detail about some of the key messages the Guide is delivering on contract management which bear directly on the topic of this presentation.

The contract management lifecycle has been broken down into seven steps as follows:<sup>82</sup>

<i>Step</i>	<i>Lifecycle Activity</i>
<i>Step 1</i>	<i>Specifying the activity</i>
<i>Step 2</i>	<i>Selecting the acquisition strategy</i>
<i>Step 3</i>	<i>Developing and releasing the tender documentation</i>
<i>Step 4</i>	<i>Evaluating the tender bids</i>
<i>Step 5</i>	<i>Decision and implementation</i>
<i>Step 6</i>	<i>Ongoing management</i>
<i>Step 7</i>	<i>Evaluation and succession planning</i>

The Guide does not attempt to address issues associated with tender and contract negotiations, but rather focuses on providing guidance on the transition or implementation of the contract, ongoing management and succession planning. The early stages of the contract management lifecycle dealing with contract negotiation and

tendering have been well documented in publications such as *Before you sign the dotted line*, MAB/MIAC Report No. 23, May 1997 and the ANAO Better Practice Guide on *Selecting Suppliers*, published in October 1998. However, as the Guide indicates, there is an important relationship in the lifecycle that needs to be kept in mind:

*One factor which experience shows can benefit all parties is to ensure at least some continuity between those involved in the tender stage and the contract negotiation stage and with (sic) the actual contract management.*<sup>83</sup>

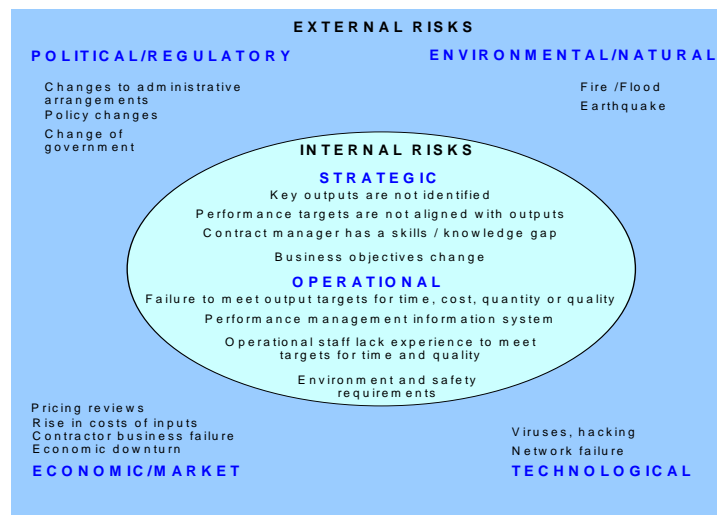
The following areas in the Guide are key to contracting success.

### ***Dealing with risk in contracts***

The competent management of the contract is often the Commonwealth's key means of control over its outputs and their contribution to outcomes. The Guide discusses in some detail the steps in the risk management process with specific regard to the risks involved in contracting, including how to establish the context, the process for assessing risks, the implementation of treatments and ongoing monitor and review. It also identifies characteristics of both internal and external risk (see Figure 1). The following observation in the Guide is well illustrated from both Australian and overseas experience:

*The difference between a contract delivering benefits, and one that does not, can be often attributed to the way that the risks associated with the delivery of those services are managed.*<sup>84</sup>

Figure 1: External and Internal Risks



The application of risk to contract management is also presented in relation to the impact of risk on the most appropriate relationship style for the contract. This recognises the need to not only look at contract management as enforcement of the contract but to take a more holistic approach to delivering the goods or services. Contract relationships form a continuum from traditional to non-traditional, with the most effective mix dependent on

the risks to the organisation in failure of the service provision and the likelihood of failure. I will discuss the importance of relationships in more detail later.

Potential risks which might arise from contracted arrangements with private sector interests, include:

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

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

The Guide emphasises the importance of considering levels of poor performance and mechanisms to address such an issue in the early stages of negotiation. These mechanisms should then be built into the contract and agreed operating procedures. It is simply no longer sufficient to threaten cessation of the contract when poor performance is detected. Agencies need a more robust framework for working through the issue to ensure successful resolution and continuance of the service, including a better basis for future discussion and settlement of performance requirements. Such resolution might include the public sector agency having to take back particular risks which were previously allocated to the private sector provider. For example, a UK National Audit Office Report concerning the Royal Armouries Museum in Leeds<sup>85</sup>, noted that the latter had to assume the demand risk from the private sector partner, that visitor numbers would be insufficient to ensure the Museum’s future survival.

### ***Transition to the contractor***

The Contract Management Better Practice Guide begins with the transition phase, the first stage after signing of the contract. The objectives of transition are to establish a strategy to manage the transition to contracted service delivery, minimising the chances of a loss of service delivery and the impact on clients and other stakeholders.

It is during the transition, as accountability arrangements and changed organisational structures are bedded down, that the greatest risk to effective decision-making arises. This was particularly apparent in the audit of the implementation of the IT outsourcing initiative, where it was found that both agencies and tenderers had underestimated the complexity involved in managing the delivery of services to a group of agencies, particularly in simultaneously transitioning those services to an outsourced provider.<sup>86</sup> This lack of appreciation by the parties concerned contributed to service delivery failures and significant delays in the provision by the service providers of reliable invoicing and performance reporting.<sup>87</sup>

The latter problem also related to a gap in expectations between the agencies and the private sector providers as to the level of documentation and substantiating material needed to support public sector accountability requirements. This created difficulties for agencies in satisfying their own accountability requirements in terms of the expenditure of public resources and the achievement of agency outcomes. The ANAO hopes to alleviate such problems with the section in the Guide on procedural manuals and documentation.

A substantial part of the Guide is devoted to the ongoing management of the contract (Part 2.2). This stage of the contract lifecycle largely tests the success of the contract arrangement and is generally seen as being the most resource intensive. One of the most important players in this stage will be the contract manager. During the transition phase the organisations must ensure the contract manager is appropriately selected and fully involved. The Guide provides some suggestions on the skills required in a contract manager (Part 2.1).

The key objectives discussed in the Guide for this stage include developing appropriate service level agreements, managing performance of the contract and the contractor through a performance measurement system, management of day-to-day issues and dealing with possible dissatisfaction with service delivery. During our audits of contract arrangements in the Commonwealth, application of risk and measurement of performance were acknowledged as key concerns, particularly as contracted goods and services become more complex. I will discuss performance management and standards briefly below.

### **Service standards and performance measurement**

During the day-to-day management of the contract the risks become more focused and any problems with the establishment stages become more evident.

*Any contract must clearly specify the service required; the relationship between the parties needs to be clearly defined, including identification of respective responsibilities; and appropriate arrangements for monitoring and reviewing contractors' performance need to be put in place. These should all be addressed giving consideration to the identified risks the organisation is facing in relation to the specific contracted good or service and contract arrangement.*

It has been the experience of agencies involved, in at least one contract we reviewed, that poorly framed or overly stringent service standards or requirements become unnecessary cost drivers that distract the service provider's resources and their focus away from the areas of most importance to the achievement of agencies' overall objectives. Alternatively, they may cause the price tendered by contractors to be unnecessarily increased. Equally, the service standards originally contracted for were found to not provide appropriate incentives for the provider to focus on the areas of service most important to agencies' business. Again turning to a UK example, the NAO audit found that:

*Bidders are incentivised by a payment mechanism to meet ... targets and they incur penalties if performance declines.*<sup>88</sup>

Performance based contracts can include sanctions for non-performance, such as a percentage fee for late completion or flat rate for substandard levels of performance. Any sanctions have to be seen to be 'fair'. There should not be any equivocation about required performance nor about the obligations of both parties. I stress that this is as much about achieving the desired outcome as it is about meeting particular accountability requirements.

For example, the outsourcing contracts reviewed in the IT outsourcing audit placed certain obligations on the private sector service providers in regard to ensuring that agency data held on the outsourced IT infrastructure was protected to identified security and privacy standards. That audit<sup>89</sup>, and a subsequent audit of fraud control in the Australian Taxation Office<sup>90</sup>, found that agencies had not developed adequate strategies for monitoring the providers' compliance with those obligations, and recommended improvements in this regard.

Sound contract management, and accountability for performance, are dependent on adequate and timely performance information. As noted above, it is important that agencies consider the level and nature of information to be supplied under the contract and the access they require to contractor records to monitor adequately the performance of the contractor. The more detailed the performance standards, the specific requirements for rigorous reporting and monitoring and the need for frequent renegotiation and renewal, the closer the contractual arrangements come to the degree of control and accountability exercised in the public sector.<sup>91</sup> Once again, it is a matter of balancing any trade-offs in efficiency and/or accountability if optimal outcomes are to be secured. I should add that any such trade-off should be subject to Parliamentary and/or Executive Government guidance.

The main message from the public sector's contracting experiences is that savings and other benefits do not flow automatically from their adoption. There is always the upfront cost of contracting out that needs to be taken into account, such as the initial legal costs involved in negotiating and drafting contracts. Other costs which also need to be taken into account in making a decision to contract out functions, include the cost of monitoring the contractor's performance and the need for legal advice as to how to interpret particular clauses in the contract.<sup>92</sup> Indeed, the contracting out process, like any other element of the business function, must be well managed and analysed within an overall business case which includes an assessment of its effect, either positive or negative, on other elements of the business.

### **Commercial confidentiality**

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

I consider that the question as to whether or not commercial-in-confidence information should be disclosed to the Parliament should start from the general principle that information should be made public unless there is a good reason for it not to be. In other words, there should be, in effect, a reversal of the principle of onus of proof, which would require the party that argues for non-disclosure to substantiate that disclosure would be harmful to its commercial interests.

Nevertheless, in the context of the Auditor-General's responsibilities, I am sensitive to the need to respect the confidentiality of genuine 'commercial-in-confidence' information. In our experience, we have found that, almost without exception, the relevant issues of principle can be explored in an audit report without the need to disclose the precise information that could be regarded as commercial-in-confidence. In this way, the Parliament can be confident it is informed of the substance of the issues 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.

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

Virtually all traditional accountability mechanisms rely on the availability of reliable and timely information. As a result of contracting out to the private sector, the flow of information available to assess performance and satisfy accountability requirements has, on the whole, been reduced. This situation has arisen where performance data is held exclusively by the private sector or through claims of commercial confidentiality that



seek to limit or exclude data in agency hands from wider parliamentary scrutiny. Thus accountability can be impaired where outsourcing reduces openness and transparency in public administration. For this reason, the issue of commercial confidentiality is likely to be of increasing importance as the extent and scope of outsourcing grows. Dr John Uhr, who has written extensively on the question of ethics in public policy, captured the concern as follows:

*The test case is the accountability challenge posed by alternative service providers and their claims that their contracts with government lessen their liabilities of public accountability because of the 'commercial-in-confidence' nature of their performance information.*<sup>93</sup>

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

*This defence (that papers were commercially sensitive and should not be released) is over-used by governments trying to avoid scrutiny and embarrassment and often represents arrogance of the first order; a democracy elects its representatives to act on behalf of the electorate as a whole, not of vested interests. The system requires the utmost transparency and direct accountability from its Parliamentary representatives. Lack of transparency and limiting the capacity of Parliament to review government decisions weakens our democracy.*<sup>94</sup>

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

*Some private and public sector bodies are instinctively apprehensive and protective about the disclosure of any commercial information. But such views often overstate the implied risks to an entity that might be occasioned by the release of commercial data. After-the-event commercial information has significantly less value than commercial information concerning events that have yet to occur. But even where commercial information might have commercial value to others, there are often overriding obligations that require it to be released. This is so for commercial information held in the private sector and, a fortiori, it applies to the public sector.*<sup>95</sup>

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

Parliament. For example, the then Auditor-General of New South Wales has observed that:

*... it appears to me that governments just don't want to be accountable and are using private sector participation and so are reducing the amount of information that's available.*<sup>96</sup>

More recently, the Victorian Public Accounts and Estimates Committee stated that it:

*... believes that the use of confidentiality clauses should be kept to an absolute minimum and that contracts should instead contain specific terms stating that their contents are prima facie public.*<sup>97</sup>

At the heart of this debate is the on-going problem of clearly defining the 'public interest'. The public interest is, of course, fundamental to democratic governance and is an issue that public officials, including auditors, continually grapple with. Again, the challenge is about striking the right balance between public and private interests. Legislation precludes publication by my Office of information whose disclosure would, among other things, be contrary to the public interest for reasons including unfair prejudicing of commercial interests of any body or person. Those reasons are more fully described in section 37 of the *Auditor-General Act 1997*.<sup>98</sup>

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

*In situations where government contracting results in a long term transfer of material government responsibility to the private sector, the right of the people to know the extent and terms of that transfer must take precedence over less persuasive arguments in favour of confidentiality. Not only is the public affected by the transfer of what is government responsibility but it is further affected by the creation of a new relationship (often long term) between government and a private entity. (sic) A relationship about which the public is entitled to advise, consent to or object to through both their Parliamentary representatives and other forums.*<sup>99</sup>

This issue was addressed also by the Senate Finance and Public Administration References Committee in a 1998 report following its Inquiry into Contracting Out of Government Services.<sup>100</sup> My submission to that Inquiry noted that:

*For agencies to be in a position to support the accountability obligations of their Minister and ensure adequate performance monitoring of contracted services, it is essential there be, at least, specified minimum levels of performance information to be supplied by the contractor to the agency, and agreed arrangements which provide for access by the agency to contract-related records and information.*<sup>101</sup>

In making further recommendations to the Committee, we suggested, as did the Commonwealth Ombudsman, that in relation to commercial confidentiality claims by

private sector contractors, a reverse onus of proof test should be applied.<sup>102</sup> The Committee agreed and in addressing matters of commercial confidentiality concluded that:

*The Committee is firmly of the view that only relatively small parts of contractual arrangements will be genuinely commercially confidential and the onus should be on the person claiming confidentiality to argue the case for it. A great deal of heat could be taken out of the issue if agencies entering into contracts adopted the practice of making contracts available with any genuinely sensitive parts blacked out. The committee accepts that some matters are legitimately commercially confidential. If Parliament insists on a 'right to know' such legitimately commercially confidential matters, the most appropriate course to achieve this would be the appointment of an independent arbiter such as the Auditor-General to look on its behalf and, as a corollary, to ensure that he has the staff and resources to do it properly.*<sup>103</sup>

One of the difficulties in addressing commercial confidentiality issues is that of precise definition as to just what is being covered. While there is broad understanding of the kinds of information which contractors might regard as commercially confidential, the question is how to ensure adequate accountability for the use of public funds while ameliorating any justifiable 'confidentiality' concerns. Such concerns were evident in a recent recommendation for draft guidelines to be prepared for the scrutiny by Parliamentary Committees of commercially confidential issues relating to Government Business Enterprises.<sup>104</sup>

Recent legal decisions have reiterated the importance of maintaining 'proper confidentiality' of tendering proposals.<sup>105</sup> With the growing convergence between the private and public sectors referred to earlier, and the considerable increase in contracting, the issue has become a matter of practical importance and some urgency. A particular concern is that agencies may too readily agree to treat contractors' documents as confidential, notwithstanding the wide access powers that may be provided to the Auditor-General.

A related, but separate matter has been brought to my attention following a recent audit undertaken by the ANAO into the use of electronic commerce or business in Australian federal agencies.<sup>106</sup> While I will cover some relevant audit findings elsewhere in this presentation, there is one aspect that arose during analysis of survey returns that should be mentioned here. This is the finding that agencies surveyed by the ANAO expected that information about their contracts with the private or community sectors would remain as commercial-in-confidence. Individuals' concerns were expressed about the broader concept of an individual's rights to influence the way personal information was collected and used.

My Office has recently completed a performance audit, of the use of confidential provisions in the context of commercial contracts, arising out of a draft Senate motion which lead to a Senate inquiry on a 'Mechanism for Providing Public Accountability to the Senate in Relation to Government Contracts'<sup>107</sup>. 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>108</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>109</sup>

The audit report made three recommendations which 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>110</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>111</sup> and examples of what would be considered confidential.<sup>112</sup>

### **Privacy considerations**

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>113</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>114</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>115</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>116</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>117</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 Act as currently constituted, privacy monitoring of outsourcing arrangements falls into the following 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>118</sup>

The Office of the Federal Privacy Commissioner has received no complaints to date about the handling of personal information by contractors under outsourcing.<sup>119</sup>

### ***Contract relationships***

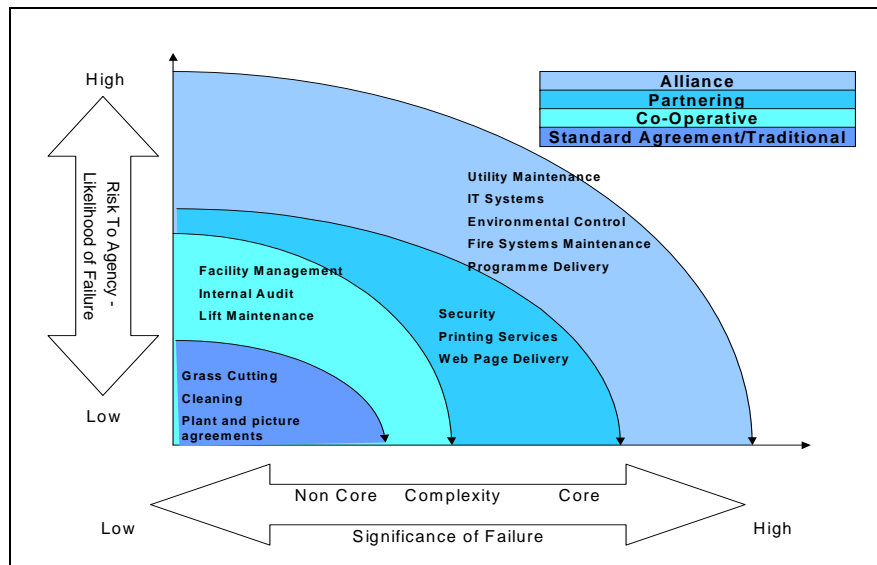
As I have already noted, contract management is more about effective delivery of goods and services than about ticking off the details of the contract. One of the most important aspects of this will be development of the most appropriate contract relationship style. The four common relationship types are on a continuum from traditional to cooperative, partnering and finally alliancing.

The Guide discusses each in detail in Part 2.3 and provides guidance on the key features of each style, issues to consider in selecting the most appropriate style and some examples of the services best suited to each relationship.

As the four relationship styles exist along the continuum of relationship styles different features may be ‘mixed and matched’ to develop the most appropriate relationship style for the organisation and the particular contract.

In designing the most appropriate relationship, the risks of providing the service are critical to the decision process. The likelihood and consequence of failure affect risk. The relationship chosen is part of the treatment of the identified risk, that is, a means by which the risk will be controlled. The following figure demonstrates the link between risk and the relationship type. While the figure provides some examples of the type of goods or services that may be provided under the various relationship styles, the choice depends on the organisation’s specific needs.

Figure 2: Contract Risk and Service Complexity as Determinants of Relationship Style



Whatever the choice, the relationship must fit the objectives of the service and the values and experience of both provider and purchaser.

The notion of partnerships and alliances within and between the public and private sectors and concepts such as ‘relational contracts’<sup>120</sup> are challenging the current public management view of accountability.

In a recent audit of the management of the construction of the new National Museum and Australian Institute of Aboriginal and Torres Strait Islander Studies facilities, the ANAO considered the operation of an alliancing agreement. The objectives of the audit were to examine the project’s compliance with the Commonwealth requirements for the procurement of public works (that is, the Commonwealth Procurement Guidelines) and the effectiveness of project management. The ANAO was particularly interested in the openness and transparency of the selection process and the probity of those involved in selection panels and the fairness shown to proponents.

The ANAO found that the processes for the appointment of the Architects, Building and Services Contractors and Museum Exhibition Designers (‘the commercial alliance partners’) substantially complied with the Commonwealth Procurement Guidelines. The ANAO also found that the Department and the commercial alliance partners had sound

processes and procedures in place to monitor appropriately the progress of construction and manage the cost, time, quality requirements and other project risks in a timely manner. Successful project alliancing depends importantly on skilful management of the particular risks involved. With respect to this project, the ANAO considered that appropriate financial incentives were in place to encourage ‘best for project’ behaviour from the Department and the commercial alliance partners.

### ***Developing more networked arrangements***

In my view, audit offices should be able to work positively with public sector managers to explore different partnership/cooperative arrangements that can accommodate both public and private interests. In that latter respect, I found the ideas underlying the seven principles of the “New Public Service” suggested by two academics in a recent volume of the Public Administration Review<sup>121</sup> to be worthwhile considering for discussion. Of course, whatever is attempted needs the support and endorsement of the Government and Parliament if it is to succeed. The ongoing challenge for all of us will continue to be meeting our various stakeholder performance and accountability expectations, whatever the approach taken to our changing public sector environment.

Such arrangements are likely also to be encouraged through the increased adoption and impact of e-commerce with its focus on coordination and collaboration in the business environment in particular and with shared databases as well as greater electronic integration in a virtual ‘one-stop’ service delivery environment. Between agencies, these arrangements are quasi-contractual and tend to be based on ‘relational’ rather than ‘legal’ agreements. Nevertheless, as discussed later, 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 one prominent researcher in public administration puts it:

*... co-operation vies with competition as the organizing principle of service delivery.*<sup>122</sup>

He goes on to observe that networks are a distinctive way of coordinating and, therefore, are a separate governing structure from markets and hierarchies. In such situations, contracts acquire the characteristics of networks.<sup>123</sup>

Key features of ‘relational’ contracts are:

*... the need for trust, flexibility and generality in contract specifications due to uncertainties in the environment (political or financial), and the difficulty of specifying targets and measuring results.*<sup>124</sup>

On the other hand, it has to be said that, by their very nature, networked arrangements do raise concerns about clear lines of responsibility and accountability as the following illustrates:

*Managers in public services who have had experience of marketization, competitive tendering arrangements and a contract culture may even*



*express some dismay at the thought of having to operate within the context of a loosely coordinated and informal network of providers.*<sup>125</sup>

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 networking concept is gaining favour as a means of delivering more responsive public services to citizens. For example, a recent ANAO report<sup>126</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 subsequently expanded such that the particular Commonwealth agency, Centrelink, now delivers services on behalf of a total of four agencies under formal purchaser-provider arrangements.<sup>127</sup> Centrelink's partnership agreement with the now Department of Family and Community Services reflects their emphasis on building trust; maintaining productive relationships and legal limitations.<sup>128</sup>

A further indication of a possible move towards network bureaucracies is the renewed focus on the needs of clients. This is, at least partly, a consequence of a Government decision in March 1997 to introduce Service Charters in order to promote a more open and customer-focused Commonwealth Public Service. All Commonwealth Departments, agencies and Government Business Enterprises that have an impact on the public must develop a Service Charter. These Charters are to represent a public commitment by each agency to deliver high quality services to their customers. Where relevant, the charters will guarantee specific standards for service delivery. The importance of such performance has been stressed by the Senate Finance and Public Administration Legislation Committee, in the context of agency Annual Reports, as follows:

*The Committee will continue to monitor the results of implementation of charters to ascertain the extent to which identified customer needs and quality of services are being met and that any problem areas are addressed.*<sup>129</sup>

Again, the notion is to make the public sector more accountable to the general Australian community and more outcomes-focused. The New Zealand Auditor-General has published recently a comprehensive report on service delivery including best practice criteria and a discussion of what distinguishes public from private services.<sup>130</sup> As well, the report included an analysis of service delivery over the Internet.<sup>131</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 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 control for agreement.

It has been recognised that more networked approaches to service delivery that envisage more sophisticated and cooperative approaches to cross-cutting issues will stress the importance of partnerships, coordination and joint working agreements. This is increasingly occurring at the inter-agency level and 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 redefine the relationship between government and the community.

The aim should be to deliver services that appear seamless to the recipient.<sup>132</sup> 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 clear governance framework and accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants, may be required. 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.

More networked or partnered arrangements can also overcome the inflexibility of a contract. Partnering and strategic alliancing are increasingly being adopted in the private sector as a means of coordinating economic activity. Such networked arrangements are seen to enable a greater exchange of ideas and information and allow partners to gain access to knowledge and resources of the other parties. The Victorian Public Accounts and Estimates Committee, quoted earlier, observed that a partnering approach could be warranted where:

- *service providers are encouraged to be innovative in the delivery of services;*
- *the nature of the services is highly variable or evolving, leading to poor predictability of demand and service content; and*
- *the services will be using leading edge practices/technology in which a high degree of flexibility on the part of both parties will be required to make it work.*<sup>133</sup>

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 supplanted by results-oriented ones. This is consistent with the Federal Government’s outputs/outcomes approach to public administration and budgeting. Individual agencies, operating as virtual silos or islands of accountability but with overlapping functions and operations, will not only have to

become more integrated organisations but will also have to become more externally focused if they are to meet the needs of their ‘shared’ clients. What is needed is a positive and encouraging framework for building relationships, dialogue and negotiation that can lead to:

- *clearer and more realistic performance measurements;*
- *more buy-in on both sides to the results;*
- *a basis for ongoing dialogue throughout the year to improve the likelihood of achieving results; and*
- *capacity for learning and improvement.*<sup>134</sup>

As I noted earlier, such a framework will require new skills and knowledge of both project and contract managers.

Another important aspect of developing networked solutions is the availability of information to clients. Information technology is providing significant opportunities for government to ensure that existing and potential clients have access to the information they require. Information technology can also be an effective tool for improving the cost-effectiveness and quality of services provided to citizens. It is also central to improving accountability. It is not unrealistic to suggest that the effective networking of information technology systems will be crucial to implementing integrated public services. On this issue, I have noted that the Central IT Unit in the UK is establishing common standards and infrastructure to enable interoperability across government departments and the wider public sector.<sup>135</sup>

### **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.

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. This funding shortage has resulted in lengthy delays before projects can proceed, or projects proceeding only incrementally over a number of years. Delayed access to needed infrastructure can be costly to the community while budget constraints can lead to sub-optimal project outcomes. The encouragement of private sector investment in public infrastructure by governments is one response to these fiscal pressures. It has also given rise to additional challenges and demands for public accountability and transparency because the parameters of risk are far different from those involved in traditional approaches to funding public infrastructure. Indeed, the potential liabilities accruing to governments may be significant.

Extensive use has been made of private financing in the United Kingdom (UK). The Private Finance Initiative (PFI) was introduced in 1992 to harness private sector management and expertise in the delivery of public services.<sup>136</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>137</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>138</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>139</sup>

It is readily apparent that the PFI in the UK is being driven heavily by the objective to transfer risk.<sup>140</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.

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>141</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.

Mr Bob Le Marechal CB, Deputy Controller and Auditor-General of the UK NAO, noted in private correspondence with me on related matters that:

*In practice, on IT projects in particular, we have seen considerable naivety on the part of government departments as to the extent to which they can actually transfer risk.*<sup>142</sup>

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

*Under heavy public and political pressure to get systems working properly, departments are then reluctant to take a hard line on their contractual rights and so sour relationships with the very contractors whose cooperation is essential.*<sup>143</sup>

It is difficult 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 because of governments’ capacity to raise taxes and because of the absence of default by most sovereign borrowers. Accordingly, delivering financial benefits from private financing requires cost savings in other aspects of the project and/or the effective

transfer of risk. Clearly, any savings that are assessed from these aspects are sensitive to the benchmarks and assumptions used as follows:

- The initial benchmark for comparison purposes is often the incumbent public service provision of similar goods or services. However, it is not uncommon for such benchmarks to be adjusted to improve comparability. This introduces further assumptions and subjectivity to the evaluation process.
- Unless risk is transferred to the private sector, private financing may achieve little other than provide the private sector with the benefit of a very secure income stream, similar to a government debt security, but with the private sector able to earn returns above those available from investing in government debt securities. However, the transfer of risk to the private sector is only really cost-effective where the private sector is better able to manage and price these risks. Even where the risk has been transferred, there can remain a residual risk that the public sector may have to step-in in the event the private sector contractor experiences difficulties in meeting its obligations. This is because, where the provision of public services or goods is involved, private financing does not equate to contracting out ultimate responsibility.

In relation to the transfer of risk, the UK NAO has observed that:

*Appropriate risk allocation between the public and private sectors is the key to achieving value for money on PFI projects. If the private sector are asked to accept responsibility for a risk that is within their control, they will be able to charge a price for this part of the deal which is economically appropriate. However, if the Department seeks to transfer a risk which the private sector cannot manage, then the private sector will seek to charge a premium for accepting such a risk, thereby reducing value for money. The Department should therefore have sought to achieve not the maximum but rather the optimum transfer of risk, which allocated individual risks to those best placed to manage them.<sup>144</sup>*

In Australia, most of the activity in private financing initiatives has occurred at the State government level, particularly in relation to infrastructure projects such as roads. Prominent examples include the Sydney Harbour Tunnel and the M2 Motorway in Sydney<sup>145</sup> and the City Link project in Melbourne. Of note is that these high profile projects have been the subject of external scrutiny that has raised concerns about the exact distribution of risk and financial benefits between the public and private sectors, for example as indicated by the following audit observations:

- The New South Wales Auditor-General has consistently commented that, although private sector owners have been given long-term rights over important road networks, there has not been a proper comparison of the cost-effectiveness of private sector involvement and the traditional public sector approach. Accordingly, the Auditor-General was unable to conclude that the projects that have been undertaken were in the State's best interests from a financial viewpoint.<sup>146</sup> In particular, the opportunistic and ad hoc use of private finance was criticised as it was considered

unlikely to improve the overall efficient use of the road network and reduce the total costs of road maintenance and management.<sup>147</sup>

- The Melbourne City Link project is one of the largest infrastructure projects ever undertaken in Australia with an estimated total cost of around \$2 billion. It involves around 22 kilometres of road, tunnel and bridge works linking three of the Melbourne's most important freeways. A report by the State Auditor-General found that, while the users of the City Link via toll payments will, in substance, be the financiers of the project, the private sector has accepted substantial obligations associated with the delivery and operation of the City Link, including traffic and revenue risks. However, the auditors also found that the decision to establish the City Link as a toll road was not supported by a financial model which compared project costings on the basis of private sector financing versus government borrowings.<sup>148</sup>

Significantly, there have also been concerns raised about public accountability for privately financed projects. These have stemmed from difficulties Parliaments have experienced in gaining access to contract documents. For example, in relation to the aforementioned M2 Motorway in New South Wales, the Parliament was denied access to the contract deed between the public sector roads authority and the private sector counterpart.<sup>149</sup>

At the national level, the 1996 National Commission of Audit observed that the private sector has a significant capacity for a greater role in infrastructure services. The Commission also concluded that the role for government could be reduced and suggested that the identification of good opportunities for private sector investment in infrastructure could assist the goal of increased national saving.<sup>150</sup> Accordingly, there has been increasing interest in private financing initiatives at the federal level, although to date there has been limited actual adoption.

One example is the Cooperative Research Centres Program which involves collaborative research between industry, federal and State governments and universities and other research organisations. Funding of activities is shared between the participants and the distribution of any revenue from the commercialisation of commercial property is also negotiated.<sup>151</sup>

In another example, the agency responsible for funding and managing the development of Australian government office and diplomatic properties has adopted private financing for a number of projects but has since discontinued private financing arrangements. My Office has examined one of these projects, within the context of risk management of foreign exchange dealings.<sup>152</sup> 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.

The Department of Defence has committed itself to examining the merits of using private financing in the delivery of Defence services, with an aim towards 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 many as 25 to 35 per cent of all future acquisition projects,<sup>153</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’, Mick Roche, Under Secretary of the Defence Materiel Organisation, 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>154</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), that may otherwise feel that the opportunities presented by such initiatives are only within the scope of larger, national and international defence industry players.<sup>155</sup>

Of course, any such move towards private financing of Defence activities would need to consider what core business the Department needs to maintain in order to manage effectively the longer-term risks that are involved in any outsourcing. With this in mind, the Department has indicated in a 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>156</sup>

The Defence Discussion Paper identified a number of lessons drawn from case studies arising from the UK Ministry of Defence’s experience as well as lessons from two State Governments<sup>157</sup>—these may be of interest to other audiences, who are required to deal with similar private financing issues, albeit involving different subject matter.

In view of the growing interest in and use of private financing initiatives and the important financial, risk transfer and accountability issues raised, it can be expected that Auditors-General will increasingly focus their attention on examining such activities. It is hoped that such scrutiny can assist in optimising outcomes and providing assurance to the public and Parliaments about the processes adopted and outcomes achieved. In this context, I commend the work done by the 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>158</sup>

## **5. MANAGING SYSTEMS AND INFORMATION FOR COMPLIANCE**

### **Information technology risk and business continuity**

The past decade has seen a radical transformation take place in the role of information technology (IT) within organisations worldwide, not to mention the impact it has had on individuals’ lives. This brings into sharp focus a range of access, security, privacy,

storage and retrieval issues. Put plainly, organisations and individuals are significantly challenged in their capacity to effectively access, interpret, manage, apply and disseminate the volume, diversity and often uncertain origin of information enabled by IT (and the Internet in particular).

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

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

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

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

Commensurate with the potential for improved service and reduction in costs is increased risk in the following areas:

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



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

- system access rights found to be excessive or unauthorised;
- inadequate review and approval of users' access to systems;
- an external service provider having unlimited access which was not monitored; and
- inadequate review, approval and testing of changes to applications.<sup>159</sup>

Similar issues were identified for the 1998-99 statements.<sup>160</sup>

The need to focus on effective systems controls is further highlighted by a report of the Australian Institute of Criminology, which indicates that the increased usage of information technology will lead to a major rise in white collar crime against governments.<sup>161</sup> Allied to this concern are warnings about growth in the use of e-mail. This is not just in terms of adequate systems controls to prevent compromising network performance and the efficient conduct of functions or business but also the possibility of litigation where communications are not subject to executive review but could involve liability for the organisation.<sup>162</sup>

The ANAO has recently completed an audit of the use of electronic commerce or business in Australian federal government agencies.<sup>163</sup> This audit was undertaken in recognition of the increasing pressure on management of APS information systems and systems controls that the move to electronic commerce and greater use of the Internet has brought about for Commonwealth agencies. The audit was conducted largely through a survey of agencies on their use of technologies, such as the Internet, to conduct business and their expectations of what will be their position in 2001.

Ideally, agency planning for Internet use should include arrangements for monitoring, review and performance evaluation of agency outputs and outcomes. Effective planning would enable agencies to begin to monitor the effectiveness and efficiency of such use from the outset. Agencies' review of reliance on the Internet for program delivery is also warranted because Internet service delivery is not necessarily of higher quality than available alternatives, particularly at this stage of the Internet's development. The ANAO survey referred to above, showed that agencies have adopted a wide range of measures involving use of the Internet. Promoting a set of common measures that agencies use to assess the success or otherwise of their efforts would facilitate further understanding of Internet service delivery from a whole-of-government perspective with benefits for all agencies. Relevant to this concern, I note that the Central IT Unit in the UK is establishing common standards and infrastructure to enable interoperability across government departments and the wider public sector.<sup>164</sup>

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

To fully address such concerns, a Better Practice Guide, recently prepared by the ANAO,<sup>165</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>166</sup> The risks involved in broadening networks and Internet use also raise issues associated with who has access to the 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.

While it clearly has provided benefits, technology has also presented new risks not only for an organisation's control environment but also for its knowledge base and the skills composition of its workforce. Of specific interest to auditors has been the recent Auditing Guidance Statement (AGS 1050) on 'Audit Issues in Relation to the Electronic Presentation of Financial Reports'.<sup>167</sup> The AGS identifies specific matters which may be addressed by the auditor with management to reduce the risk that the audit report on an entity's financial report is inappropriately associated with unaudited information on the entity's Website.<sup>168</sup>

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

Government agencies need to come to terms quickly with the potential applications of Public Key Infrastructure (PKI) technologies to encrypt, decrypt and verify data. In public key technologies, each user of the system has two keys, a public key and a private key, to ensure the privacy, authentication, non-repudiation and integrity of information contained in messages. PKI is of importance to all agencies wishing to embark on

initiatives that do more than just disseminate information. It is a core enabler. Key issues addressed by PKI are as follows:

- each person communicating electronically needs to ensure that the recipient is who he or she thinks it is, so that one cannot later deny being the sender of a particular electronic message or transaction. This ability to rebut a party's denial of sending a message is called non-repudiation; and
- the ability to encrypt data transmissions over an open or public network (such as is used by the Internet), so that those transmissions can be read only by the intended recipient.

GATEKEEPER is the Commonwealth Government's strategy for implementing a government PKI.<sup>169</sup> An important element of on-line transactions with the Commonwealth is the ABN-DSC (Australian Business Number – Digital Signature Certificate) which will be used to verify electronic signatures. I was interested to read a recent newspaper article<sup>170</sup> referring to the agreement by four major Australian banks to comply with the stringent Gatekeeper accreditation process. The article observed that the federal government's stringent approach to e-business security has been validated 'after a subterfuge hit two of the leading proponents of on-line commerce'. Government and industry sources said the identification procedures required by Gatekeeper would have detected the 'unknown fraudster'. However, there are also reported concerns about deficiencies in the current law relating to the relationship between parties involved in the use of PKI and which need to be resolved, preferably before agencies arrange to meet their e-government obligations.<sup>171</sup>

The ANAO is seeking to bring the issue of IT controls and security to the attention of all public sector agencies. Our first step in this process was the production of a better practice guide (released in October 1998) in relation to security and control for the SAP R/3 system.<sup>172</sup> SAP R/3 is the most widely-used financial management information system in the APS today with over thirty Australian federal government entities currently using it. The areas covered by the guide include the amount of time and investment necessary for effective implementation of the system to minimise the risk of future security problems. While the guide deals specifically with SAP R/3, generic risk management controls are discussed which can be applied to other financial management information systems.

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

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

they will be increasingly used to support, control and improve administrative decision-making based on legislative and/or policy rules.

A paper on this topic, which was presented to an Institute of Public Administration Australia seminar,<sup>173</sup> identified the opportunities and risks associated with the use of rulebase systems. It is clear that there is a need to balance both opportunities and risks in order to make the most effective use of this technology. Opportunities include improvements in the quality, accuracy and consistency of decisions and administrative processes, and hence improved client service. Such opportunities may be realised as a result of managing, reducing and removing different risks from aspects of the decision-making process by providing staff with access to information relevant to their decisions. The risks involved relate to the complex IT development processes needed as well as the lead times involved in system development; the potential for a loss of staff skills and knowledge of policy over time; and an over-reliance on IT systems to produce the right answer every time.

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

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

There appears to be an increasing tendency for policy and administrative decisions to be communicated and confirmed through e-mail communications. This is a function of our changing expectations about the speed of communications, a growing emphasis on timely management of the 'political' dimensions of policy, and the appropriation by the public sector of a 'commercial paradigm' in which 'deals are done' (which is given added impetus by the involvement of private sector 'partners' in various aspects of government operations). Nevertheless, as better practice private sector firms demonstrate, good record keeping is an integral part of a sound control environment and subject to a regularly reviewed risk management strategy that is integral to their required outcomes. This is a lesson that I commented on in a presentation to the National Archives of Australia Advisory Council last year.<sup>174</sup>

The increasing use of e-mail poses significant challenges in terms of our traditional evidentiary standards (which customarily hinge on paper-based records) and the skills

base of our auditors. We are already confronting situations in which traditional forms of documentary evidence are not available. Technological change has resulted in a degree of ‘de-skilling’ in traditional public sector audit practice but a commensurate ‘re-skilling’ in decision-making systems. As the Director-General (National Archives) has pointed out:

*... there is increasing evidence that significant decision-making is taking place in the electronic environment. It is not just email, although this is an important element. It has been technically possible for some time to have electronic files instead of the traditional paper files we are still accustomed to using for deliberative and policy-making work.*<sup>175</sup>

Auditors are already confronting situations in which they are having to make links in the chain of decision-making in organisations which no longer keep paper records, or having to discover audit trails in electronic records, desktop office systems or archival data tapes.

The problem is that we do not always have on hand the range of skills necessary to do the job and we need a strategy to overcome this deficiency. Essentially, auditors are expected to possess a level of forensic IT skills they have not traditionally had to have at the Commonwealth level. To these forensic skills they also need to add evidentiary standards appropriate to these forms of information—in other words, how does the auditor establish whether communication has occurred and obtain assurance about the records they have found? In this respect, the following observation is applicable to all of us:

*Attention will need to be paid to the management of electronic documents, and in particular, the need to be able to recover, authenticate and read important business documents perhaps after years in archive.*<sup>176</sup>

Perhaps we need to look to the example of our colleagues in the areas of prudential assurance or criminal investigations who are continually refining investigatory methodologies to keep pace with offences such as insider trading, corporate fraud or misuse of drugs. If we go down this path, we may have to consider whether there is need to harmonise more closely evidentiary standards for audit with those of the criminal or civil justice systems in our respective jurisdictions. For the moment it might be that the technology is evolving far more rapidly than governments can respond with legislative or statutory controls. This is of particular concern for the management of Commonwealth records by National Archives of Australia.

We will need to address the ‘Pandora’s Box’ represented by the boundary between official and personal communications. Electronic records—especially e-mail records—are likely to contain both official records and personal communications. A separate, but just as important, issue is the inappropriate use of e-mail. A recent ‘Legal Briefing’ from the Australian Government Solicitor noted that:

*Departments and agencies have responsibility for administering their computer systems and are at risk if they do not regulate e-mail and internet use.*<sup>177</sup>

An IT legal specialist has also warned that use of e-mail and internet logs to monitor staff activities may put many organisations in breach of the new privacy laws referred to earlier.<sup>178</sup>

Any position taken on personal communications on official systems should have regard to the organisation's internal communications policy as well as of any applicable legislative framework. In any event, it would seem prudent for an auditor to consult early with the organisation's management to determine an appropriate protocol for extracting required electronic records which not only protects the auditor's right to access such records but also provides protection against unnecessary infringement on personal records and personal privacy.

These last comments reflect my experience as the Chief Executive of an auditing practice. The task for management however, is to ensure that this important evidentiary chain remains unbroken and available for scrutiny. In essence, that is what is meant by transparency and accountability.

## **6. CONCLUDING REMARKS**

Public sector reforms require public servants to be more responsive and meet changing client needs; to be more efficient, effective and ethical; to be more flexible in responding to internal and external change; and to support national economic and other imperatives. Often the preferred policy responses have embraced strategies of public sector downsizing, privatisation, commercialisation and corporatisation. They bring with them new challenges such as market-testing and competitive tendering and contracting out, all of which may be considered to present opportunities for, as well as risks to, public services that have traditionally said to be risk averse. These new elements are central to improved business performance and accountability in the current program of reforms to the public sector.

Bob Sendt, my counterpart in New South Wales, has remarked:

*Governments in Australia have been privatising, corporatising, contracting out and engaging in various forms of partnership with the private sector.*

*Such developments have been justified in many ways:*

*Corporatisation is said to focus management's attention on acting commercially and efficiently and achieving appropriate 'bottom line' results and return on investment;*

*Privatisation and contracting out are said to utilise the comparative advantages the private sector has in certain areas, to take advantage of innovation, to reduce risks to government and the taxpayer and to allow governments to focus on core public services.*

*These arguments have a strong logic to them. However, these developments raise further important questions as to the continuing right of the public –*

*and indeed Parliament – to know that their interests are being met and protected.*

And

*The delivery of public services does not become ‘riskier’ simply because private sector entities become involved. The notion that ‘in-house’ provision is risk-free is illusory. The over-riding ‘risk’ with in-house provision is the failure to recognise that it does have real risks<sup>179</sup>*

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

*... continue to question, in estimates and in annual report or other agency operating processes, such matters as the delivery of services when contractors go to the wall, legal costs, the immediate and longer term costs and benefits of the use of contractors, the probity of tender processes, et cetera.<sup>180</sup>*

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

The privatisation of the public sector does not obviate the need for proper accountability for the stewardship of public resources including for compliance with legislation, standards, guidance and better practice. Furthermore, it is my view that accountability, including compliance within a risk management regimen, can assist to improve performance because many of the requirements are based on better practice and because of the discipline involved which usually ensures that ‘things get done’.

Private sector providers clearly feel under pressure from the openness and transparency required by the public sector accountability relationship with the Parliament and the community. Public sector purchasers for their part are under pressure to recognise the commercial ‘realities’ of operating in the marketplace. A recent paper has drawn attention also to differences in legal responsibilities, particularly in the context of the *Corporate Law Economic Reform Program (CLERP) Act* and the *Commonwealth Authorities and Companies (CAC) Act 1997*.<sup>181</sup>

Corporate governance provides the integrated strategic management framework necessary to achieve the output and outcome performance required to fulfil organisational goals and objectives. Risk and control management are integrated elements of that framework. There is really no point in considering each in isolation. A sound corporate governance framework offers some worthwhile protection against risk. More particularly, the framework offers the opportunity to improve agency performance, including on its compliance obligations.

The growing recognition and acceptance of risk management as a central element of good corporate governance and as a legitimate management tool to assist in strategic and operational planning has many potential benefits for the public sector. However, the effective implementation of risk management practices is a major challenge for public sector managers, particularly given the public sector culture. Parliament itself, and its Committees, are still coming to grips with the implications of managing risks instead of minimising them, almost without regard to the costs involved. It is a reflection of the notion of taxpayers' funds held in trust.

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

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

There is no doubt that an environment with greater management flexibility and private sector involvement is inherently more risky from both performance and accountability, including compliance, viewpoints. Contracting out, shared management and new technology (both computing and communications) not only create new and different risks but also raise the risk profile from all these viewpoints. Nevertheless, it has been noted that performance contracting has been used in Australia, Canada, New Zealand and the United Kingdom to:

*... increase the clarity of goals and accountability relationships in the context of decentralisation and a devolved management environment<sup>182</sup>.*

It has also been argued that greater contestability induces better performance.

Well-managed contracts can deliver significant benefits to an organisation. The difference between a contract delivering benefits and one that does not can be often attributed to the way that the risks associated with the delivery of those services are managed. Unfortunately, experience indicates that organisations may apply the principles of risk management to core business processes, but often do not effectively apply those same principles to contract management. Risk management, through structured decision-making and comprehensive analysis of business processes, provides opportunities for innovation and enhances outputs and outcomes.



To good managers, the public sector environment being created is an opportunity to perform better, particularly when the focus is more on outcomes and results and less on administrative processes and the inevitable frustration that comes from a narrow pre-occupation with the latter. Having said that, it is important for us all to remember that the Public Service is just as accountable to the Government and to the Parliament for the administrative processes it uses as for the outcomes it produces. That is inevitable and proper. As experience shows, good processes contribute to good outcomes. They are not alternatives. The secret of success is to achieve the 'right balance' between conformance and performance in order to meet the demands of all stakeholders successfully. Such an achievement does not come by accident. In relation to a 1997 survey of the United States Government's *Performance and Results Act*, the General Accounting Office (GAO) stated that:

*Significant performance improvements are possible when an agency adopted a disciplined approach to results-oriented goals, measuring its performance, and using performance information to improve effectiveness.*<sup>183</sup>

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

A well governed organisation will provide to its CEO, its Board, its responsible Minister(s) and other stakeholders, reliable and well founded assurances that it is meeting its performance targets. Above all, a well governed organisation can achieve better performance and it will have a robustness, as well as the internal cohesion and direction essential to successfully drive the organisation forward and to respond quickly and coherently to changing external conditions. The latter may demand better networking and development of 'real' partnerships, both internally and externally, with other public sector entities and, increasingly, with the private sector. As already noted, such a development poses significant challenges for both public and private sector organisations and management.

Sound corporate governance frameworks will enhance the development of such networks and partnerships and facilitate overall management so that opportunities can be taken to be more responsive and improve performance while minimising risk. This is not the responsibility of a few. It involves all of us working cooperatively and sharing experiences and information. In this way we can be more confident about delivering

defined outcomes and being accountable for the way in which our results are achieved. These requirements are integral to the more market-oriented approach being taken to public administration in recent years, often under the heading of New Public Management.

Public Sector reforms have focused greater attention on performance management and accountability for that performance. Devolution of authority has likewise focused similar attention on individuals' responsibility and accountability for both compliance and results. However, a robust corporate governance framework will both support and enhance the ability of the individuals concerned to produce the required outputs and outcomes cost effectively, as well as to provide assurance about compliance with all legislative and other stated requirements, not least for ethical conduct and adherence to public sector values. We can learn from private sector experience in relation to the former and I would like to think that the private sector would learn from us in relation to the latter. With greater convergence of both sectors, in an environment of greater global competition and other pressures, such mutual understanding and cooperation are essential to our national economic and social well-being. That said, the fundamental imperative can be expressed quite simply:

*For there to be adequate corporate governance in any entity, there must be an establishment of policies and procedures and demonstration (my underlining) that the procedures have been observed.<sup>184</sup>*

Otherwise, we can have no credibility with our various stakeholders.

Finally, I should observe that, within the Australian private and public sector communities, much is being done to establish the current status of risk management, particularly as part of good corporate governance. For example, CPA Australia, through the Public Sector Centre of Excellence, commissioned PriceWaterhouseCoopers to assess and report on the extent to which public sector agencies within each level of government have; understood, considered, accepted and/or implemented the concept of risk management. The objective of the project is to develop a series of case studies based on leading practice public sector organisations to assist risk management practitioners, public sector managers and academics to understand the better practice risk management in the Australian public sector.

The CPA study will look at the philosophy and operation model used, the form of risk management adopted and the types of risks identified. It will also evaluate how far the concept is built into an organisation's processes and accepted as part of general management practice. The analysis will also consider the extent of integration of risk management into business processes, business decision-making, control risk management and performance reporting. The framework being used is the Australian/New Zealand Risk management Standard AS/NZS 4360 1999 and relevant public sector material issued by the Commonwealth, state or local governments. The existence of "local" regulation or policy, which requires organisations to adopt a risk management framework will also be taken into account.

Output of the CPA Australia project will include a report, case studies and the potential development of a better practice guide. The first report should be available on the CPA Australia web site in the latter part of May.

Comcover is also currently undertaking a risk management benchmarking project to address what it sees as a limited understanding on how advanced Commonwealth agencies were with risk management. It is also a means of drawing attention to the need for management to take risk management seriously. The project will address managers' need for tools to measure their risk management performance.

The project has been developed with Cogent Business Solutions and in collaboration with CPA Australia. The project is concentrating on the strategic level of risk management in Commonwealth public sector agencies. It is an attempt to actually measure and benchmark risk management performance and the project will look to measure the key principles of risk management that can be applied to all organisations.

Outcomes of the Comcover survey include: evolving a risk management culture; implementing a risk management system; continuously improving risk management practices; and audit and report on the results. Comcover intends to repeat the project annually.

Standards Australia, in cooperation with Arthur Andersen, has recently published a new 'case study' handbook on risk management practices. It looks at the experience of leading Australian organisations - QANTAS, Telstra and AMP - with the objective of assisting 'organisations and individuals develop their own approaches to and capabilities for managing risk'<sup>185</sup>. The ANAO is represented on two Standards Australia working parties dealing with risk management, one looking at the quality of assurance processes and the other at the 'slow uptake' of good risk management practices in Australia. The latter is interested in how we might use a fresh approach to continue the dialogue and increase successful implementation in both the public and private sectors. As well, Standards Australia is again organising its very successful 'Risk Management in the Public Sector' workshops around Australia from 18-28 June, with the assistance of Kevin Knight.

Earlier in the year, I spoke at the launch of the Australasian Risk Management Unit at Monash University. The Unit's charter is to establish the concept of risk within an academic context and to build bridges from the university to industry and ensure that risk management evolves as a formal discipline in the future. The training programs being offered will focus on the development of workplace competencies needed by people working on risk management. The competencies are aligned to national risk management standards, Australian Standards and current acts, regulations and state and federal guidelines associated with risk management. The establishment of this unit and other educational initiatives indicates that risk management is becoming part of the management mainstream.

Organisations such as the Association of Risk and Insurance Managers of Australasia (ARIMA), are active in the development of risk management standards and education through the sharing of information and experience in the field as this Conference well demonstrates. These organisations thus provide a useful basis for developing a

professional approach to risk management. They deserve our support and congratulations on their endeavours. I am confident this conference will be another useful contribution to our shared interests in this important area of management and our corporate governance.

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  - (b) the *Financial Management and Accountability Act 1997* sets down the financial regulatory, accountability and accounting framework for Commonwealth bodies such as departments that have no separate legal financial existence of their own (ie they are simply agents of the Commonwealth); and
  - (c) the *Commonwealth Authorities and Companies Act 1997* provides standardised accountability, ethical and reporting provisions for Commonwealth bodies that have a separate legal existence of their own (eg Commonwealth-controlled companies and their subsidiaries and those statutory authorities whose enabling legislation gives them legal power to own money and assets).
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- (a) *it would prejudice the security, defence or international relations of the Commonwealth;*
  - (b) *it would involve the disclosure of deliberations or decisions of the Cabinet or of a Committee of the Cabinet;*
  - (c) *it would prejudice relations between the Commonwealth and a State;*
  - (d) *it would divulge any information or matter that was communicated in confidence by the Commonwealth to a State, or by a State to the Commonwealth;*
  - (e) *it would unfairly prejudice the commercial interests of any body or person;*
  - (f) *any other reason that could form the basis for a claim by the Crown in right of the Commonwealth in a judicial proceeding that the information should not be disclosed.'*
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- <sup>111</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>112</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.
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- The seven principles of the New Public Service suggested are:
- 1) Serve, rather than steer. An increasingly important role of the public servant is to help citizens articulate and meet their shared interests, rather than attempt to control or steer society in new directions.
  - 2) The public interest is the aim, not the by-product. Public administrators must contribute to building a collective shared notion of the public interest. The goal is not to find quick solutions driven by individual choices. Rather, it is the creation of shared interests and shared responsibility.

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- 3) Think strategically, act democratically. Policies and programs meeting public needs can be most effectively and responsibly achieved through collective efforts and collaborative processes.
  - 4) Serve citizens, not customers. The public interest results from a dialogue about shared values, rather than the aggregation of individual self-interest. Therefore, public servants do not nearly respond to the demands of “customers” but focus on building relationships of trust and collaboration with, and among, citizens.
  - 5) Accountability is not simple. Public servants should be attentive to more than the market; they should also attend to statutory and constitutional law, community values, political norms, professional standards, and citizen interests.
  - 6) Value people, not just productivity. Public organisations and the networks in which they participate are more likely to succeed in the long run if they are operated through processes of collaboration and shared leadership based on respect for all people.
  - 7) Value citizenship and public service above entrepreneurship. The public interest is better advanced by public servants and citizens committed to making meaningful contributions to society rather than by entrepreneurial managers acting as if public money were their own.
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- *Know what you want, but avoid over prescription. Specify outcomes and standards rather than process.*
  - *Long term contracts, defined as at least 7 years, but usually in the 15 to 35 year range, are needed for the private sector to recoup investment.*
  - *Assessment of projects should be based on the private sector’s cost of capital rate, which in turn is based on the project risk.*
  - *Projects need to be aggregated to an economic size, rather than a number of small ‘packets’, taking into account the benefits of proposals over the life of the asset and the benefits to the organisation as a whole.*
  - *Private financing involves higher initial transaction costs, and higher cost of finance, than traditional procurement, which need to be offset by whole of life savings and benefits. For this reason, private finance and traditional tendering processes should not normally be carried out in parallel.*
  - *Contracts have generally led to improvements, either through savings or through an improved level of service.*

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- *Risk assessment and management is critical to success.*
  - *A centre of expertise is necessary in private financial policy and practice, as is ready access to external financial expertise, to effectively manage and assess privately financed projects.*
  - *Competition needs to be retained in the marketplace as much as is practicable.*
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