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Whither Accountability – The Wisdom of Solomon

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Presentation by Pat Barrett, AM
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I. INTRODUCTION

This presentation is largely about determining corporate and management strategy in an era where there is a degree of uncertainty about who is accountable for what. You might think that I am actually talking about processes; that is, the way we do things. Unfortunately, many of us tend to confuse the two concepts in the same way we often talk about 'ends' when we are actually referring to 'means'. But most accept that the concepts are integral to each other and are not the same. Put simply, my task is to provide you with some insights to help you manage better in a significantly changing environment, not to attempt to tell you what to do, which would clearly be quite presumptuous.

A lot of what we all do revolves around opportunities, risks, probabilities, priorities and trade-offs. In part, what actually happens depends on who decides and on what basis. But it will also be dependent on the environment in which we find ourselves, externally, largely if not solely, by someone else and, internally, largely or solely by ourselves. For example, in Defence, the environment will be markedly different between a war and peace situation. Put less starkly, decision-makers might be faced with situations of assessed medium to high level threat or, simply, little or no threat. In a more confronting environment, Defence generally has no problem in getting the required resources, if available. In a more benign environment, the situation can be quite different, to the point of Defence having to resist cutbacks in funding. There is no longer sympathy for special circumstances.

In a public sector reform environment, such as most of us are facing today, the emphasis is very much on accountability for performance. The imperative is to achieve required results within constrained budgets. In the private sector, the equivalent imperative is largely to achieve shareholder value. The major trade-off to be managed is whether that value is reflected more in the size of the dividend cheque (immediate return) or more in the capital value of the corporation (the longer term 'wealth' view). While obtaining value for money is a major focus of a public sector manager, including in Defence uniform or civilian areas, the objectives at which that responsibility is aimed are not always as clear-cut as those confronting the private sector manager, such as just mentioned.

A value for money requirement might include promoting and/or assisting the development of local industry as well as getting the best price. Procurement may be impacted by unilateral or multilateral country agreements and/or alliances. The multi-faceted relationships with citizens and their general lack

of choice in relation to public programs contrasts with that of a client or customer whose 'rights' are largely to buy or not to buy and/or go somewhere else. And so the list of complexity and uncertainty can go on with issues of ethics, equity, openness, probity and fair play; including personal privacy and natural justice. The contrast is often simply put in terms of the differences between public and private interests.

In this world of apparent public sector complexity and often contradiction and inconsistency, we are now confronted with the increasing 'privatisation' of that sector. Even the latter notion is multifaceted with quite diverse management challenges. At one extreme, we see sales of government enterprises to the private sector often with accompanying regulatory measures notably in the areas of community services such as electricity, gas and water. We see public services being delivered by the private sector often in competition with public sector organisations. We see increasing provision of goods and services from the private sector with the move to greater outsourcing. At the very least, there is often a requirement to 'market test' public sector activities and be 'contestable'. The implicit 'threat' is that, if you do not perform, someone else will.

In a more general sense, there is a move to adopt and/or adapt private sector practices, such as in delivery of client service, as a means of improving the 'efficiency' of the public sector. Increasingly, we are required to pay government duties and taxes, insurance charges and interest on borrowings and capital. The emphasis is on cost and prices. It is therefore not surprising that we have seen the adoption of accrual accounting and budgeting by most governments in Australia as well as in an increasing number of overseas countries. It contrasts with the traditional cash accounting approach used by government where, for example, capital was accounted for only in the first year in which it was acquired and virtually regarded by managers as costless. We are now being asked to actively manage risk, both insurable and non-insurable. Agencies are required to publish their financial information in profit and loss and balance sheet formats. In short, the public sector is 'looking' more like the private sector and more of the former's activities are being conducted by the latter. But it is not simply a one-way street as I will discuss later.

A recent article in the Business Review Weekly Tabakoff Nick, 1999. '*Defence Inc.*'. Business Review Weekly, 20 August. in Australia indicated that Major General Peter Dunn (Head of Personnel for the Australian Defence Force) stressed in an exclusive interview that the military is adopting a new, corporate image, influenced heavily by the private sector. He also said that:

'The new face of Defence values economic efficiency as much as military prowess'. Ibid., (p.71).

The article's author observed that Defence is increasingly using corporate-style cost-cutting and contractual arrangements as the Government presses ahead with plans to find savings of \$A1 billion a year from its budgets. On the other hand, the article also asserted that many officers, particularly lieutenant colonels, say privately that 'economic rationalism' is defeating the entire

purpose of the military. Major General Dunn was said to have indicated that this was all part of an attempt by the Government to bring corporate values to the military. If economic efficiency is valued as much as military prowess, this raises important questions about what skills and training are needed for military officers in the future and their performance requirements. But it also raises the dual question, 'is it efficient in peace and will it work in war'.

Comment was also made recently about the trend for 'military logistics and the inner workings of armies around the world to be handed over to private contractors' Gettler Leon 1999. *'Civilians on duty at the front line'*. The Age, Melbourne, 1 September (page C2).. The Chief Executive of British Aerospace Australia was quoted as saying that:

'As more defence budgets come under scrutiny, many roles once held by military personnel would be up for grab - including logistics, catering services, aircraft and vehicle maintenance, ammunition supply, and providing infrastructure for camps including tents, toilets, transport and lighting.' Ibid., Comment attributed to Mr Peter Anstiss.

He went on to indicate that he saw Australia taking a key role in the company's global defence contracting network. My immediate thoughts were about potential conflicts of interest, including security considerations, particularly in any future situation where, he observed, civilians would be working alongside the military in areas of conflict. No doubt our British and United States colleagues could give us some examples where this has already occurred. On the face of it, there are risks and costs involved for both parties and some intractable issues such as the position of multi-national corporations and the status of contractors in conflict situations. But such issues are getting beyond the scope of this presentation.

The above observations provide a context for some further thoughts I want to put to you today which are more about awareness raising than about providing some kind of Defence management model for the future. That is largely the responsibility of the Defence executive. The issues to be discussed generally reflect the framework of a presentation I made last April to a National Public Sector Accountants Conference Barrett Pat 1999. *'The Convergence of the Public and Private Sectors - Accountability Versus Efficiency'*. Presentation to the National Public Sector Accountants Conference (ASCPAs), Adelaide, 7-9 April. which Dr Paul Monk wanted me to use as a focus for this address.

II. ACHIEVING THE 'RIGHT' BALANCE

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

management and use of techniques such as life-cycle costing, as are employed in the private sector.

The Government is accountable to its citizens for the provision of public services, in at least two interrelated ways. First, it has to ensure that the public sector provides high quality services that are appropriate, effective and equitable, at minimum cost to the taxpayer. This is a major driver behind the Government's policy of 'market testing' public services to improve their effectiveness. However, the Government also has to ensure that the accountability, and therefore transparency, of the public sector in the delivery of these services is maintained, and, indeed I would argue, enhanced over time. It is the balance between these responsibilities that is difficult to achieve. My Office's role is to provide assurance to the Parliament and the people on these two aspects, that is, public sector performance and accountability for that performance.

While various public sector reforms demand a greater focus on achieving efficient and effective outcomes for citizens, we also need to recognise that such outcomes also depend importantly on robust and credible administrative and management processes. Managing the risks associated with the increased involvement of the private sector in the delivery of government services, in particular the delivery of services through contract arrangements, will require the development and/or enhancement of a range of skills across the public sector and will be a key accountability requirement of public sector managers. In the Defence arena, most of these services will be delivered direct to the military not to the general public. This means that the military needs to be a disciplined and demanding client in order to assure citizens of an effective Defence capability.

The various public sector reforms over the last fifteen years, and particularly the recent changes to financial and industrial legislation, have seen a shift from central agency control to a devolution of authority, with enhanced responsibility and accountability being demanded of public sector agencies and statutory bodies and managers working within these organisations. As some of you would know, there have been concerns expressed by Parliamentary Committees and by individual parliamentarians in debates about appropriate accountability mechanisms in this era of devolved authority.

I would suggest that devolution of authority and accountability to agency heads, together with contracting out and contestability, has significantly increased the risk profile of agencies. As agencies increasingly have recourse to contractors, some of whom in turn employ sub-contractors, to perform what were once considered core public sector activities, the 'golden thread' of accountability that binds the public sector does become strained. At the very least it engenders a higher level of uncertainty for managers.

The public sector, which clearly includes Defence, must manage the risks inherent in this new environment if it is to achieve the levels of performance required and satisfy whatever accountability requirements have been determined. It is not just a matter of understanding the environment in which

your organisation operates, important as that clearly is, but it is also essential to understand how the various elements of that environment affect your own activities and responsibilities and their subsequent impact on the organisation's effectiveness, reputation and results achieved.

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 as well as to achieve the required results.

The growth of outsourcing

A feature of the changing public sector environment has been the increased emphasis placed on the contestability of service delivery and outsourcing of functions which, it is judged, the private sector can undertake more efficiently. Outsourcing advocates point to the opportunities offered:

- increased flexibility in service delivery;
- greater focus on outputs and outcomes rather than inputs;
- freeing public sector management to focus on higher priorities;
- encouraging suppliers to provide innovative solutions; and
- cost savings in providing services.

Industry Commission 1996, '*Competitive Tendering and Contracting by Public Sector Agencies*'. Industry Commission 1996, '*Competitive Tendering and Contracting by Public Sector Agencies*'. AGPS, Melbourne, January.

However, outsourcing also brings risks. As a number of the ANAO's recent performance audits have identified, a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and associated public concern. For example, in October 1998 I tabled Audit Report No.10 1998-99, *Sale of One-third of Telstra*. The audit concluded that, as an essential element of the outsourcing of project management for future Commonwealth public share offers, overall value for money could be improved by giving greater emphasis to financial issues when tendering for advisers; encouraging more competitive pressure on selling commissions and fees; paying fees only for services actually provided; and instituting a more effective and commercial approach to administering payment for shares by investors. The main message from this experience is that savings and other benefits do not flow automatically from outsourcing. Indeed, that process, like any other element of the business function, must be well managed. Another lesson that can be drawn from such experience is that:

'... understanding the conditions that create unhealthy levels of risk can go a long way toward preventing failure.' Simons Robert 1999. '*How Risky is your Company*'. Harvard Business Review May-June, (page 86).

In a more contestable environment, failure does not simply relate to errors of commission which, in the past, have been asserted as the main pre-occupation of the public sector but also to errors of omission which are often less visible but can have a greater impact on performance or results. Such observations have been linked to 'inherent differences' in the ownership of organisations in the public and private sectors. Bozeman Barry and Kingsley Gordon

1998. *'Risk Culture in Public and Private Organisations'*. Public Administration Review, Vol.58, No.2, March/April, (page 111).

The growth of outsourcing, and other new ways of delivering public services, do not obviate or limit the need for accountability to stakeholders. Less direct relationships through the introduction of a new player in the accountability chain - the private sector service provider - and greater decision-making flexibility strengthen that need.

Optimising the trade-off between accountability and a lower market-oriented price requires senior public service managers to ensure they are not risking the efficiency and effectiveness of their core functions by ill considered, *ad hoc*, outsourcing, the effects of which may not be confined to the particular services or activities being outsourced. To do this, *ex-ante* strategic examination of which activities should continue to be provided by the public sector (core business) and which to outsource (non-core business) is essential. This is consistent with the generally held view in the public and private sectors that outsourcing is a cost-effective way to make better strategic use of non-core business functions. Tran Minh (Senior Analyst - Gartner Group)

1999. *'Outsourcing can refocus a business'*, The Australian, 1 June, (page 2).

To maximise overall value for money, it is important that the above assessment take place in the context of the total business of the organisation in order to manage the risk that, by considering outsourcing individual activities in isolation, counter-productive and costly outcomes may result from outsourcing in the medium to longer term. In this respect, attention should also be given to the effect of outsourcing on related activities which may be delivered through another public sector agency. That is, it might sometimes be necessary to examine an outsourcing decision from an across-agency perspective to get the best public sector outcome.

A further important consideration is how this trade-off between accountability and efficiency might change in relation to core and non-core Government activities. For example, a greater level of accountability may be demanded for certain activities, as they are determined to be more important to the public interest and/or politically sensitive. Indeed, this consideration may well provide the case for maintaining current agency arrangements, rather than contracting out their delivery to the private sector. Prime Minister Howard has offered the following list of those activities that he considers fall within this realm:

'Defence, justice, a social security safety net, the monitoring of outcomes of, and alternatives to, existing policies - all these will require public service output. And there will always be a real need for high quality economic, constitutional and other policy advice.' Howard J., 1997, *'The Sir Robert Garran Oration'*, National Conference of the Institute of Public Administration Australia, September, as cited in Davis Glyn and Wood Terry, 1998, *'Is there a Future for Contracting in the Australian Public Sector?'*, Australian Journal of Public Administration, Vol. 57, No. 4, December, (page 95).

The conundrum was expressed another way late last year by an academic commentator, Jonathan Boston, in terms of the much talked about 'New Zealand Model' as follows:

*'The Model has not, for instance, generated a new or enduring consensus on the proper boundary between the public and private sectors, whether with respect to funding or provision.'*¹ Boston Jonathan 1998.

'Public Sector Management, Electoral Reform and the Future of the Contract State in New Zealand'. Australian Journal of Public Administration. Vol.57, No.4, December, (page 42).

In recent times, however, Government activities that might in the past have been considered core functions, such as policy advice, delivery of services to the unemployed, and maintenance of defence equipment have been subject to contestability and contracted out to the private sector.

The essential issue, as it often is in public administration, is to achieve an appropriate balance which can vary in differing circumstances. Achieving such a balance becomes even more of an imperative when the converging, or reconverging, private and public sectors not only focus on the similarities of issues and even responses that confront managers, but more sharply contrasts differences between the two sectors. Nowhere is this more evident, for example, than in workplace relations where the greater flexibility being provided by legislation has made public sector managers more conscious not only of constraints in public employment but also of their responsibilities to their staff in outsourcing situations. In short, the risk profile - including any possible trade-offs - is far more confronting in the more contestable environment.

Although the public sector may contract out service delivery, this does not equate to contracting out the responsibility for the delivery of the service or program. It is the responsibility of the agency and agency management to ensure that the government's objectives are delivered in a cost-effective manner. The agency must therefore specify in the contract the necessary level of service delivery and required quantitative and qualitative service standards and measures. It must also ensure that an adequate level of monitoring of service delivery under the contract is undertaken as part of the agency's contract administration and in line with its broader service delivery responsibilities, such as might be set out in a Client Service Charter. A recent KPMG survey of private and public organisations in Australia and New Zealand involved in more than \$500 million a year of outsourcing contracts indicated that:

'... performance problems were overshadowed by customers' own failure to properly define outsourcing goals and service level agreements.'

Tebbatt Dan 1999. *'Goals the main outsource issue'*. The Australian, 7 September (page O42).

More than half the survey respondents indicated they would pay more attention to defining and monitoring service level agreements in the future. The inclusion of access provisions within the contract for performance and financial auditing, as well as for sound management, is also very important in maintaining the necessary thread of accountability.

In relation to the Australian Public Service (APS), I have drawn attention to the need for standard contracts negotiated with suppliers to the Commonwealth to make provision for access to the suppliers' records both by the purchasing agency and my office. The ANAO has drafted model access clauses (reflecting the provisions of the *Auditor-General's Act 1997*) which have been circulated to agencies for insertion in contracts; these clauses give the agency and ANAO access to contractors' premises and the right to inspect and copy documentation and records associated with the contract. I understand such access has presented no problems in the Defence sector in the United Kingdom or in the United States.

The clauses are not necessary to provide me with access to information as such, but they are important in flagging to contractors that they must give full access to the Auditor-General for proper accountability. In my view it is a matter of educating both parties, whether public or private sector, to the requirements of a successful relationship or contract. Vague relationships do not assist either party; nor do they lend confidence to the partnership or use of contractual arrangements. Such accountability is an aspect of the public sector environment with which the private sector is becoming more familiar as outsourcing develops further.

Commercial confidentiality

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.

The risk to accountability associated with claims of commercial confidentiality in relation to government contracts has recently 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. A relationship about which the public is entitled to advise, consent to or object to through both their Parliamentary representatives and other forums.' Report of the Auditor-General for the year ended 30 June 1998, 'Government Contracts: A Specific Matter Raised Pursuant to Subsections 36(1)(a)(iii) and 36(1)(b) of the Public Finance and Audit Act 1987'

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

'For agencies to be in a position to support the accountability obligations of their Minister and ensure adequate performance monitoring of contracted services, it is essential there be, at least, specified minimum levels of performance information to be supplied by the contractor to the agency, and agreed arrangements which provide for access by the agency to contract-related records and information.' Australian National Audit Office 1997, Submission to the Senate Finance and Public Administration References Committee Inquiry into Contracting Out of Government Services, Canberra, 31 January.

In making further recommendations to the Committee, the ANAO 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, as follows:

'In our view, the question of whether or not commercial-in-confidence information should be disclosed to the Parliament should start from the general principle that the information should be made public unless there is a good reason for it not to be. In other words, what we are saying is there should be a reversal of the principle of onus of proof which would require that the party arguing for non-disclosure should substantiate that disclosure would be harmful to its commercial interests and to the public interest.' Senate Finance and Public Administration References Committee 1998, *'Contracting out of Government Services'*, Second Report, Canberra, May (page 70).

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.' Ibid., (page 71). Ibid (page 71).

One of the difficulties in addressing commercial confidentiality issues is that of precise definition as to what is 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. 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 provided to the ANAO under the *Auditor-General Act 1997*. Quite recently, the Australian Joint Committee of Public Accounts and Audit (JCPAA) recommended legislative provision for audit access to a contractor's premises. Joint Committee of Public Accounts and Audit (JCPAA) 1999. Review of Audit Report No.34, 1997-98 - '*New Submarine Project - Department of Defence*'. Report 368, Commonwealth of Australia, Canberra, June (page xiv).

Longer-term impacts of outsourcing

In addition to the immediate impact of outsourcing on accountability, the transition to an outsourcing arrangement can have long-term impacts on program (or output) administration. There is a particular risk, for example, that incumbency advantages may reduce the level of competition for later contracts because the existing supplier has greater information and knowledge about the task than either the Commonwealth agency or potential alternative service providers. This risk of undue competitive advantage becomes more pervasive when the outsourced activity has a significant impact on core business and/or competition in the market is limited. This issue will require increasing attention by public sector managers, as has been recognised by the Australian Joint Standing Committee on Foreign Affairs, Defence and Trade in relation to the Defence Department's Commercial Support Program:

'Frequently, the successful tenderer for the support contract relies on recruiting the trained Defence personnel who have been made redundant in the ADF because of the function's transfer to the commercial sector. Through employing these already-trained personnel, the successful civilian tenderer is able to provide a commercially attractive initial price for a support capability because there is no need to factor in staff training costs in the contract. This process becomes disadvantageous to Defence where the successful tenderer becomes the monopoly supplier of the support service, and Defence must subsequently renegotiate that contract from a position of weakness, having eliminated its own in-house capability to perform the particular function.' Joint Standing Committee on Foreign Affairs, Defence and Trade 1998, '*Funding Australia's Defence*', Canberra, (page 35).

That brings me to one of the most challenging areas of risk management all of us, that is project and contract management.

III. PROJECT AND CONTRACT MANAGEMENT

I was interested to read an article in the April issue of the Australian Stock Exchange publication, *Perspective Journal*, reporting on research in Europe and the USA into outsourcing. Willcocks Leslie P and Lacity Mary C 1999, '*Information Technology Outsourcing - Practices, Lessons and Prospects*', *Perspective Journal*, April, (pages 44-49). The article illustrates some of the risks involved in contract management, in the specific context of information technology (IT) outsourcing which is of major interest to organisations such as Defence. The authors draw on what appears to be an extensive body of recent research to identify several categories of outsourcing, the risks associated with each and some lessons for Australia. They assert that total outsourcing as practised in Australia is not so dominant a trend overseas as would appear to be the case here. Total outsourcing (which is defined as a situation in which 80 per cent or more of

the IT budget is under third-party management) they characterise as "a distinctly high risk practice." The issues identified include the following:

- the organisations involved were in financial trouble and focused on cost reduction, seeing IT outsourcing as a means of improving company position rather than as a way to leverage IT for business value and keep control of IT matters;
- problems arose with longer term (10 to 12 year) single supplier deals
The length of a contract is often a vexed issue. Many agencies are wary of such long-term contracts unless they involve options for renewal. For example, an initial three or five year contract might be negotiated with three or five year optional extensions. Of interest is the contracting technique used for support services at the US Navy Submarine Base at Bangor, Washington and the US Army's National Training Centre at Fort Irwin in California where a contract is negotiated for one year with four one-year options to renew for another year. The notion is to keep client service firmly in the contractor's mind by providing for a one year renewal where the contractor is performing well but, on the other hand, the contract can be readily terminated at any annual renewal point without the need to resort to litigation. Mutual confidence and trust are needed to provide the degree of certainty required for commitment by both parties. See Audit Report No. 2 1998-99, *'Commercial Support Program'* (pages 70-71) for more details of the US Army's National Training Centre contracts arrangements. which had been initiated by company boards with little input from IT management; and
- companies often found they incurred significant hidden costs and a degradation of service, and experienced a loss of control and exploitation by suppliers.

I might add that the article addresses itself to the outsourcing practices of Australian financial institutions and not the circumstances of the Commonwealth per se. There are, however, lessons from this experience for the Commonwealth and other levels of government.

We all know by now that outsourcing represents a fundamental change to an agency's operating environment. It brings with it new opportunities and risks, requiring managers to develop new approaches and skills, placing considerable focus on project and contract management, including management of the underlying risks involved, as I have already indicated. It is the unintended risks that can bedevil managers as the following portrays:

'If managed properly, pressure to achieve challenging goals can stimulate innovation, entrepreneurial creativity, and superior financial performance. However, such pressure can also bring unintended risk'.
Op.cit., Simons, Robert. (page 87).

One problem is that inexperience is likely to result in additional risk. Just as bad is ignorance of the potential consequences of risk taking. It is also as well to take note that:

'Sometimes risk creeps into the organisation at quite a distance from the top.' Ibid., (page 94).

The thrust of this changing environment is reflected in the Senate Finance and Public Administration Committee's recently released second report on *Contracting Out of Government Services*:

'Despite the volumes of advice on best practice which emphasise the need to approach contracting out cautiously, to invest heavily in all aspects of the process and to prepare carefully for the actual implementation, and the substantial body of comment in reports from the Auditor-General indicating that Commonwealth agencies have a very mixed record as project and contract managers, the prevailing ethos still seems to promote contracting out as a management option that will yield inevitable benefits. Resources must be made available to ensure that contract managers have the skills to carry out the task.' Op.cit., Senate Finance and Public Administration References Committee 1998, (page 33).

As well, the implementation of an accrual-based outcomes and outputs framework for managing resources in the Australian public sector, with the first accrual budget recently brought down for 1999-2000, has put further pressure on managers to define more clearly measurable performance outputs and outcomes. This requires greater attention to costing and pricing methodologies including the rediscovery, for many of us, of management and cost accounting. Importantly, it means that managers, generally at all levels, are having to become familiar with such methods and techniques as part of their management responsibilities.

In the latter respect, the ANAO noted in its report on 'Costing of Services' Australian National Audit Office Audit Report No.21, 1998-99. *'Costing of Services'*, Canberra, December. that only a small number of organisations had progressed to the stage where cost information was being used in a decision-support role. In fact none had reached the stage where full cost information played a big role in overall decision-making at the organisational level. A subsequent inquiry by the Joint Committee of Public Accounts and Audit (JCPAA) on that report Joint Committee of Public Accounts and Audit 1999. *'Reference: Review of Auditor-General's reports first quarter 1998-99'*. Hansard, Canberra 28 May, (page 43). showed concern about that finding which led to questions about charts of accounts for costing purposes, standard costs, variances, time recording, cost drivers, activity-based costing, skills development and cultural changes, particularly at all levels of management. In terms of risk assessment, as one witness put it:

'[Agencies] underestimated the impact of the government's policy on better financial management and linking that into the delivery of policy or services.' Ibid., (page 56).

To address some of the contract and risk management issues identified in recent audits my office has developed a better practice guide titled *Selecting Suppliers: Managing the Risk*. Australian National Audit Office 1998, *'Selecting Suppliers: Managing the Risk - Better Practice Guide'*, Canberra, October. The aim of the guide is to provide a framework which can be used by the public sector to assess some of the financial and probity risks associated with contracting with non-government suppliers. The guide presents a risk assessment matrix that can

be used to make an overall assessment of the ability of a potential supplier to deliver the services being contracted, in order to reduce the risk of the Commonwealth contracting an inappropriate supplier. The guide also discusses possible risk treatment options to reduce risks to a level acceptable to the agency.

As I have already mentioned, the ANAO recognises that an increasing emphasis on outcomes has been a key factor in enhancing the efficiency and effectiveness of the public sector. However, sound administrative processes and effective management are also critical to sustaining long-term performance. The message here is that it is not sufficient to focus on outcomes alone, rather that sound processes and effective management are also necessary to reduce the risk of unfavourable and often costly events.

Examples, such as the Collins Class Submarines, highlight the importance of having a strong project and contract management skills base which can be drawn upon to make decisions and to achieve the required results. This does not necessarily mean a large full time complement of skilled project and contract managers. Rather, agencies should ensure that, if the current decision makers do not have the requisite skills, sufficient external expertise is obtained. Such external expertise may be required, for example, in relation to the financial and legal aspects of contract management.

The significance of agencies having a clear understanding of the legal imperatives associated with contracting was highlighted in a recent seminar on Commonwealth sector issues ^{Blake Dawson Waldron, 1999. Seminar on Commonwealth Sector Legal Issues, Canberra, 21 April.} In particular, see Clark John, *'CTC : Managing the Legal Risks'* and Wedutenko Alexandra *'Contract Performance Management'*. which discussed among other things, the convergence of legal and commercial risks and the need for planning and sound systems for contract management, particularly over the whole life of the contract. Recent judicial decisions have also emphasised the importance of having a legally defensible tender process as an integral part of contracting out. It has always been important for the tender process to be commercially defensible. However, recent rulings have demonstrated that commercial interests are also served by what has to be done to meet legal requirements.

The notion of partnership is increasingly gaining acceptance, that is, the Commonwealth should be working in partnership with the private sector, or indeed that public sector agencies should be working in partnership with each other and with private sector firms, for example through purchaser/provider arrangements, to deliver public services ^{The United States Army's program covering command, control, communications, computers and intelligence in electronic warfare systems involves industry in the development process at a much earlier stage to ensure that what is being proposed is actually a viable commercial proposition.} Partnerships depend on common understanding, trust and goodwill not legal compulsion. However the reality is that there will be testing times even in the best of relationships. Consequently, it is good practice for such relationships to be based on sound tendering and administrative processes and an enforceable contract.

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.' O'Looney John A. 1998, 'Outsourcing State and Local Government Services - Decision-Making Strategies and Management Methods', Quorum Books, London, (page 147).

On the issue of contract preparation and management, the Industry Commission has suggested that public sector agencies tend to transfer as much risk as possible to the agent, thus increasing the risk of contract failure. Conversely, bad contract design leaves too little risk with the agent. This can lead to poor service delivery and political problems for the government. Op.cit., Industry Commission, 1996, (pages 333-335). Again, I draw your attention to an observation based on New Zealand experience on a related risk in the broader principal-agent relationship:

'... despite considerable effort to clarify principal-agent relationships, reduce agency costs and do away with multiple accountabilities, the reforms have failed to overcome the difficulties generated by the existence of complex principal-agent relations.' Op.cit., Jonathan Boston 1998. 'Public Sector Management, Electoral Reform and the Future of the Contract State in New Zealand', (page 42).

Sound contract management, and accountability for performance, are dependent on adequate and timely information. Therefore it is important that agencies consider the level and nature of information to be supplied under the contract and access to contractors' records they require to monitor adequately the performance of the contractor. However, the more detailed the performance standards, the specific requirements for rigorous reporting and monitoring and the need for frequent renegotiation and renewal, the closer the contractual arrangements come to the degree of control and accountability exercised in the public sector. See for example, Mulgan Richard 1997, 'The Processes of Public Accountability', Australian Journal of Public Administration, Vol. 56, No.1, March (page 8).. Once again, it is a matter of balancing any trade-offs in efficiency and/or accountability if optimal outcomes are to be secured.

Contracting, while providing the benefits of cost efficiency and enhanced service delivery, can expose the Commonwealth to increased risk. The Commonwealth is, in many cases, no longer directly responsible for program outputs, instead being reliant on a private sector contractor for the provision of particular services or products. Nevertheless, the relevant agency/body is still accountable for those outputs. This is also Parliament's expectation. The Australian Senate Finance and Public Administration References Committee reinforced this concern as follows:

'The Committee believes strongly that contracting-out of services should not diminish public accountability through the Parliament, the Auditor-General and what can be summarised as the administrative law - the role of statutory officers such as the Commonwealth Ombudsman, the operations of agencies such as the Administrative Appeals Tribunal and legislation such as the Administrative Decision (Judicial Review) Act. It has been suggested that contracting-out may improve accountability by requiring services to be defined more precisely and imposing service agreements on providers. That should be seen as a bonus not an alternative.' Senate Finance and Public Administration References Committee 1997, 'Contracting Out of Government Services', First Report, Information Technology, Canberra, December, (page xii).

The competent management of the contract is often the Commonwealth's key means of control over its outputs and their contribution to outcomes. This is why it is essential that we ensure our staff have the capability and capacities to manage contracts effectively if we are to achieve the results required of us. But I again stress that it is not just skills in relation to contracting that are important, there is still a high premium on knowledge and understanding of the functions/business that we are managing. Put simply, we have to be in a position to know what we are actually getting under a contract and whether it is meeting the objectives we set. If we do not, we are virtually risking the success of our agency and its very reason for being.

IV. ENHANCING OUR ACCOUNTABILITY FOR MANAGING RISK THROUGH SOUND CORPORATE GOVERNANCE PRACTICES

I have outlined some of the issues which agencies face in this new 'contestable' or 'contractual' environment. What can we do about them?

It is very clear that public sector agencies must balance complex political, social and economic objectives, which subject them to a different set of external constraints, influences and forms of accountability from those experienced in the private sector. The Chartered Institute of Public Finance and Accountability 1995, 'Corporate Governance: A Framework for Public Service Bodies', July, (page 7). Certainly, the demand by citizens and other stakeholders for openness and transparency of all aspects (not only financial status) of public sector agency governance exceeds that required of private organisations. Accountability in the areas of community service obligations, equity in service delivery and a high standard of ethics 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.

The major elements of corporate governance have been in place in the public sector for most of the last decade or so. The concept is basically about how we 'govern' our organisations to achieve required performance and satisfy our stakeholders. It is also about the control and monitoring mechanisms that are put in place by organisations with the object of enhancing stakeholders' value and confidence in the performance and integrity of the organisation. Within a

contestable environment, effective corporate governance becomes more pressing and important because of the separation between core business operations and the outsourced service delivery elements.

Principles and Practice of Good Corporate Governance

Corporate governance is largely about organisational and management performance. Effective public sector governance requires leadership from the executive management of agencies and a strong commitment to quality control and client service throughout the agency. It is concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes.

Key components of corporate governance in both the private and public sectors are business planning, risk management, performance monitoring and accountability. The framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outputs and outcomes.

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, covering shareholders, Boards and CEOs (in the private sector) versus Ministers, CEOs, and (possibly) Boards (in the public sector). 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 to 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.

The issues of openness and transparency have to be accepted as essential elements of public sector accountability. The public sector has to act both in the public interest and, in common with the private sector, avoid 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 (accountability), although the question is again one of balance according to the circumstances of the agency.

In recognition of the need for good corporate governance in the public sector, the ANAO in July 1997 circulated a discussion paper, *Principles for Core Public Sector Corporate Governance: Applying Principles and Practice of Corporate Governance in Budget Funded Agencies* Australian National Audit Office 1997, 'Principles for Core Public Sector Corporate Governance', Discussion Paper, Canberra, June. This paper was designed to fill the gap in core public sector awareness of the opportunities provided for improved management performance and

accountability through better integration of the various elements of the corporate governance framework within agencies.

The ANAO discussion paper also included a checklist designed to assist Chief Executive Officers (CEOs) to assess the strengths and weaknesses of their agencies' current governance framework. Although the paper was not meant to provide a comprehensive model for each agency, CEOs should be able to identify those elements of a governance strategy that are most applicable and useful to their particular agency. The paper identified the following key operating principles that should underpin a sound corporate governance framework in the public sector:

- **openness** is about providing stakeholders with confidence regarding the decision-making processes and actions of public sector agencies in the management of their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information leads to effective and timely action and lends itself to necessary scrutiny;
- **integrity** is based on honesty, objectivity as well as high standards of propriety and probity in the stewardship of public funds and the management of an agency's affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the agency. Integrity is reflected in the agency's decision-making procedures and in the quality of its performance reporting;
- **accountability** is the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities and roles are clearly defined through a robust organisational structure; and
- **leadership** involves clearly setting out the values and standards of the agency. It includes defining the culture of the organisation and the behaviour of everyone in it. Ibid., (pages 9-10).

In May this year, the ANAO published a related discussion paper which outlines a methodology for developing robust corporate governance frameworks for bodies covered by the *Commonwealth Authorities and Companies (CAC) Act 1997* that largely involve and/or reflect non-core public sector activities. As well, the paper broadly canvasses the legal responsibilities of CAC boards, including some comparison with similar responsibilities of budget-dependent agencies and private sector firms. As with the earlier paper, the treatment is principles-based. The application of those principles is a matter for each agency and entity to determine in their own environments.

Risk and Control as part of an Integrated Corporate Governance Framework

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. As one expert puts it:

'Essentially, control assessment and risk assessment are part of the same thing, the strategic management process.' Ibid., (page 4)

Another makes the point more broadly:

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

McNamee David and Selim Georges 1998. *'Risk Management : Changing the Internal Auditor's Paradigm'*. The Institute of Internal Auditors Research Foundation, Florida, November, (page 2).

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 as the culture under which they have operated has traditionally been risk averse. Parliament itself, and its Committees, are still coming to grips with the implications of managing risks instead of minimising them, almost without regard to the costs involved.

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

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

Australia 1995, *Risk 'Management: Australia/New Zealand Standard 4360:1995'*, Homebush, Sydney.

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.

Another important principle of an effective risk management framework is the transparency of decision-making processes. Transparency is achieved by ensuring that the decision-making process and the reasons for decisions made are adequately documented and communicated to stakeholders. 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. From an ANAO perspective, documentation of key risk management principles and management decisions is an essential element of the public sector accountability framework. As the ANAO is a central element of this framework, we have a particular need to understand the reasons behind agency decisions. As well, documenting and communicating key processes and decisions:

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

The establishment in July 1998 of insurable risk managed fund A risk managed fund is a form of self insurance which collects contributions from participating members, accumulates reserves, and meets future losses from those reserves. arrangements for the Commonwealth, called *Comcover*, is another expression of the increased attention being devoted to risk management in the public sector and the significant initiatives being developed to support it. *Comcover* replaces the Commonwealth's previous policy of non-insurance. The introduction of the new fund will for the first time require the systematic identification, quantification, reporting and management of risk across Commonwealth agencies.

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

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

- helping to protect programs and the Budget against unexpected insurable losses over time;
- achieving transparency and greater accountability in the management

- of the Commonwealth's insurable risks;
- requiring the full identification of risk exposures by each agency;
- enabling the Commonwealth to centrally accumulate risk knowledge and expertise;
- reducing costs by pooling and spreading of risk; and
- providing incentives for better risk management with the application of a claims sensitive premium.

Despite the obvious benefits of such arrangements we must remember that only those risks that can be covered as insurable losses are able to be treated through *Comcover*. (*Comcover* does not yet cover all agencies although it is expected to do so in time. There are also other eventualities such as a loss of appropriately skilled staff, for which no cover is possible.) In either case, it remains incumbent on public sector managers to manage risk actively. We should not fall into the trap of failing to manage risk simply because we have an insurance policy as a safety net. With the increasing provision of public services by the private sector, part of our accountability to the Parliament and the public for the effective delivery of public services will be to manage, rather than simply insure against, the risks associated with outsourcing.

The key message from the above discussion is that CEOs should aim to ensure that decisions made using risk management are not based on 'risky' management practices. We need to be conscious that mistakes will be made and look to ensure that management learns from such mistakes and implements effective processes to minimise the impact of errors in the future as well as reducing the likelihood of their recurrence. The following observation is apt given the more contestable environment in which the public sector is operating:

'Experimentation and innovation need to be encouraged and supported. It is important to accept that there can be no experimentation without risk. Ministers and senior officials must accept some of the uncertainty implicit in giving up a degree of control. Not every experiment will be a success. Some honest mistakes will be made. This needs to be understood and accepted. Our commitment should be to learn from these situations' Bourgon Jocelyne 1997, *'Fourth Annual Report to the Prime Minister on the Public Service of Canada'*, Ottawa, 3 February, (page 26).

While such a view is encouraging for the public sector, concerns remain, and have been expressed across Australian jurisdictions, that contracting has developed so quickly that it outstrips the capacity of government to monitor what is happening and so learn from mistakes. Op.cit., Davis and Wood, 1998, *'Is there a Future for Contracting in the Australian Public Sector?'*, (page 85).

There is no doubt that the more 'market-oriented' environment being created is inherently more risky from both performance and accountability viewpoints. To good managers, it is an opportunity to perform better, particularly when the focus is more on outcomes and results and less on administrative processes and the inevitable frustration that comes from a narrow pre-occupation with the latter. Having said that, it is important for us all to remember that the Public Service is just as accountable to the Parliament for the processes it

uses as for the outcomes it produces. That is inevitable and proper. In my experience, however, some agencies, faced with the prospect of adverse comment in an audit report about the transparency and accountability of their risk management or other processes, have argued that the report should place greater emphasis on the outputs and/or outcomes achieved by the agency.

This brings me to another element of corporate governance that I wish to address - agency controls. In an environment that promulgates the notions of contestability, outsourcing and greater efficiency, the way that agencies implement their corporate governance framework, and particularly how they conduct their risk management, including the control of those risks, will be critical in determining how well the public sector can continue to meet its accountability obligations as well as its performance measures. The private sector needs to do the same to remain viable.

Control structures to manage risk

The control structures within a corporate governance framework provide assurance to clients and the Parliament that an agency is operating in the public interest and has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture.

In a recent ANAO publication entitled 'Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control', Australian National Audit Office 1997, '*Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control*', Canberra, December. control is defined as:

'... a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency's objectives.' Ibid., (page 5).

I cannot over-stress the importance of the need to integrate the agency's approach to control with its overall risk management plan in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and emphasis on a systematic approach involving identification, analysis, assessment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively. The Commander in Chief, US Atlantic Fleet, has instituted a Controlled Inspection Program in which the process controls the standard of maintenance programmed and the quality of work provided and ensures that facilities across all Atlantic Fleet establishments are maintained to the same standard, irrespective of whether the work is done in-house or by contract. The achievement of the right balance is important so that the control environment is not unnecessarily restrictive nor encourages risk averse behaviour; on the contrary the right balance can promote sound risk management and the systematic approach that goes with it.

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 agency 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.

The need to strike a balance between the control environment and risk management is something that auditors, both internal and external, are extremely conscious of and seek to have recognised by agency audit committees.

The impact of technology on accountability and risk management

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. I know that my staff derive enormous benefit from the information about management and audit practice in Australia and elsewhere which they increasingly obtain from the Internet, amongst other sources. This increased ability to capture and store information has, however, created problems with the ability of organisations to sift, disseminate, interpret and use the vast amount of information currently available.

An example of the use of IT systems as 'enabling technology' that provides quality information to assist in decision-making can be seen in the increasing use by Commonwealth Government agencies of rulebased decision systems (or expert systems) to administer complex legislative and policy material. While the widespread adoption of rulebased systems to support administrative decision-making has been foreshadowed for some years, the recent adoption of such systems by agencies such as the Department of Veterans' Affairs, Defence and Comcare indicates that they will be increasingly used to support, control and improve administrative decision-making based on legislative or policy rules. Indeed, the introduction of such technology is being considered by the Australian Taxation Office and has been identified by Centrelink as a major part of its new welfare service delivery model.

A recent paper on this topic, presented to the Institute of Public Administration Australia Johnson Peter and Dayal Surendra, 1999, '*New Tricks - Towards Best Practice in the use of Rulebase Systems to Support Administrative Decision-Making*', paper presented to a Seminar of the Institute of Public Administration Australia, Canberra, April, (page 1)., identifies both opportunities and risks associated with the use of rulebased systems. There is a need to balance both in order to make the most effective use of this technology. Opportunities include improvements in the quality, accuracy and consistency of decisions and administrative processes, and hence improved client service. Such opportunities may be realised as a result of managing, reducing and removing different risks from aspects of the decision-making process by providing staff with access to information relevant to their

decisions. The risks involved relate to the complex IT development processes needed as well as the lead times involved in system development, the potential for a loss of staff skills and knowledge of policy over time and an over-reliance on IT systems to produce the right answer every time.

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

The greater level of access to data has also brought with it security issues, such as unauthorised access and entry of virus infected programs, which have raised the risks to agencies' computing environments and which are being addressed through so-called 'firewalls' (which are often basically software protection) or through physical separation. Data encryption systems have been, and continue to be, developed to provide a degree of assurance. These have seen a move towards some kind of public key encryption arrangement. Action is in hand for its implementation.

All Commonwealth agencies wanting to connect to the Internet are required to do so via a Defence Signals Directorate (DSD) approved firewall. To reduce the costs involved, a number of agencies access the Internet through a shared firewall, known as the Secure Gateway Environment (SGE), that is DSD certified. The SGE provides a firewall between each of the agencies (because individual agencies have different security needs) as well as an overall firewall to protect against unauthorised access from outside sources.

The move to electronic commerce and the greater use of the Internet for business purposes, will also put increasing pressure on management of our information systems and systems controls. Electronic commerce is, of course, a product of the Internet which "*opens up the possibility of global, open system electronic commerce.*" Sneddon Mark 1999, *'Electronic Commerce'*, Australian Company Secretary, May, Vol 51, No 4. I think that many people are interested in the opportunities presented by E-Commerce but constrained by their understandable reluctance to transmit unencrypted data containing credit card details across the Net. ^{Ibid.} Mark Sneddon reports on the efforts to replace early payment models that involved payment by credit card details being supplied by email or other insecure means over the Net with some more recent mechanisms which offer more but not necessarily complete security.

However, I note that, as reported by Professor Mark Sneddon, Special Counsel - Electronic Commerce for Clayton Utz, in the May 1999 issue of Australian Company Secretary, ^{Ibid.} Australian Company Secretary, (pages 190-2). new Net payment mechanisms are being developed which ameliorate these risks. Nevertheless, a recent research survey ^{Prodromou Angela 1999. 'E-Comm: the next frontier'. Information Age - Editorial, May, (page 1).} of 309 companies in Australia and New Zealand indicated that 43 per cent of respondents indicated that security

is a factor that had a high degree of influence on whether they moved into electronic commerce. The main reasons cited were identification and authentication and availability of adequate firewalls. One downside of the latter is the tendency for organisations to become complacent and not regularly review the firewall (software and/or hardware based) to ascertain its effectiveness in a changing environment.

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 forms.

Commensurate with the potential for improved service and reduction in costs is the 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 ANAO Report on financial statement audits identified several IT control issues, including the following:

- 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.

Australian National Audit Office Audit Report No 33, 1998-99, *'Audit Activity Report: July to December 1998'*, Canberra, March.

With the increased involvement of the private sector in the provision of public services, the security of agency data is a critical issue. Contracts negotiated between public service agencies and their private sector providers must include provisions which acknowledge Commonwealth IT security requirements. The Attorney-General has recently announced measures to protect the National Information Infrastructure (NII) which stresses co-operative arrangements, including development of a response capability, between the public and private sectors. The strategy also requires the

integration of electronic and physical protective security and response arrangements and the construction of a threats and vulnerability data base. Williams, The Hon Daryl (Attorney-General) 1999. *'Protecting Australia's Information Infrastructure'*. News Release (including Report of the Interdepartmental Committee on Protection of the National Information Infrastructure). Canberra, 26 August.

In addition to the technical issues associated with the protection of the data held by Commonwealth agencies from unauthorised access or improper use, there are also issues associated with the security of, for example, personal information held by Commonwealth 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.

The ANAO is seeking to bring the issue of IT controls and security to the attention of all public sector agencies and our first step in this process has been the production of a better practice guide (released in October 1998) in relation to security and control for the SAP R/3 system. Australian National Audit Office 1998, *'Better Practice Guide: Security and Control for SAP R/3'*, Canberra, October. SAP R/3 is the most widely-used financial management information system in the public sector today with 31 Commonwealth 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.

Another technology issue examined recently by the ANAO is the challenge faced by the public sector in ensuring that the information technology systems they have in place are Year 2000 compliant. A useful summary of how best an organisation sharing information about its preparedness for the Year 2000 should protect itself was recently provided by Deacons, Graham & James as follows:

'... a risk management methodology in place and an ability to convey information that accurately reflects its position. This includes identifying potential risks, carrying out technical audits, contacting critical suppliers and customers and establishing contingency plans to manage and minimise the effect of any Year 2000 difficulties.' Deacons, Graham & James 1999. *'Newsletter - Year 2000 Statement'*, Canberra, 15 June, (page 3).

V. CONCLUDING REMARKS

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

Within the APS, old paradigms are being replaced; the new paradigms require us to make substantial adjustments to what were, for some of us, the practices of many years. We are all, my agency included, on a steep learning

curve in this new environment. Public servants who may have helped deliver an acquisitions or maintenance program, or perhaps were responsible for an agency's IT requirements now find that their responsibilities have been delegated to a private sector operator. New skills and new mechanisms are demanded as agencies divest themselves of particular responsibilities but not, they come to realise, of their accountability obligations.

Public servants, usually characterised as risk averse, are perhaps more likely to focus on the risks associated with market-testing, contracting out and competitive tendering than to see the opportunities they present. My recent audit reports on contract management in the APS may well reinforce this conservatism because they accent, more often than not, the problem areas of the contestable environment. That should not be surprising but, I hasten to add, they also include recommendations for improvement as well as guidance on better practice to achieve the required results. As well, they acknowledge areas of good or better practice such as in the Defence area and, indeed, of meritorious performance in complex and demanding situations where there is no simple template to follow.

Agency heads undoubtedly feel that the accountability expected of them is greater than in previous years, as not only do they have to manage their own activities but they must also oversee the contractors now performing what were previously core public sector functions. Although their goal in employing contractors is greater efficiency, this objective, as they very quickly discover, may be confronting in relation to their obligation to adhere to expectations of accountability. The latter could be less robust, by default or deliberate decision, or require additional efforts (and cost) by the agency concerned. The accountability/efficiency trade-off goes to the very core of their heightened risk profile.

The growing convergence between the public and private sectors serves to highlight the distinctions between the two, while also offering opportunities for greater partnership and synergy between them. Private sector providers clearly feel under pressure from the openness and transparency required by the public sector's 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. In my view, there needs to be some movement towards striking a balance on the appropriate nature and level of accountability and the need to achieve cost-effective outcomes. There are a number of realities to recognise, such as the following observation:

'The private sector has no real equivalent to political accountability, for which precise measures are never likely to be found.' Hughes Owen E., *'Public Management and Administration - An Introduction'*, Second Edition, Macmillan Education Australia, Melbourne. (page 229).

However, are these necessarily roadblocks to consideration of a different kind of public accountability? This is an issue basically for the government and the Parliament to resolve. In the meantime we have to deliver the 'expected' accountability by those stakeholders and seek the cooperation of private

sector providers in doing so. Hopefully, this will be more likely to be in partnership mode where both parties understand and act on public interest and commercial imperatives that need to be met by public sector purchasers and private sector providers respectively. The key issue is how to make this happen.

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

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

These differences pose particular challenges for Defence managers because of the dichotomy between civilian and uniformed personnel and the varying cultures and responsibilities they each entail. Some might see it as simply another facet of the matrix management approach often employed by Defence departments and/or establishments which they have to fit into their management equation. But, if the military is adopting a 'new, corporate image influenced heavily by the private sector' as Major General Peter Dunn indicates, the military managers at all levels not only have to be able to adopt such a culture but also have to implement it. This brings those managers into the same kinds of apparent contradictions, risks, trade-offs and balances, particularly in achieving required results and being accountable for those results, as other public sector managers are now facing.

The more personal responsibility for all facets of management under the new accountability framework does not allow diffusion of that responsibility as might have occurred in the past, particularly in relation to non-military areas. More direct and demanding partnerships with civilian areas including, increasingly, the private sector will be a major imperative if the military is to be effective. Among other things, this imperative will require shared understanding of the evolving management framework, its concepts and

principles, a different way of doing business and the necessary understanding of the various balances that will need to be struck at particular points in time, and over time, between often conflicting demands between public and private interests and military and civilian imperatives. Some might think, so what is new. I would venture to say that I do not need to tell military personnel that they should not underestimate any task they are given. And this is likely to be a quite significant one.