

DEETYA International Services

Department of Employment,
Education, Training and Youth Affairs

**© Commonwealth
of Australia 1998**

ISSN 1036-7632

ISBN 0 644 39176 6

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Australian National Audit Office. Requests and inquiries concerning reproduction and rights should be addressed to the Publications Manager, Australian National Audit Office, GPO Box 707, Canberra ACT 2601.

Canberra ACT
2 March 1998

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit of the Department of Employment, Education, Training and Youth Affairs. In accordance with the authority contained in the *Auditor-General Act 1997* I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *DEETYA International Services*.

Yours sincerely

P. J. Barrett
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the Audit Act to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

Auditor-General reports are available from Government Info Shops. Recent titles are shown at the back of this report. For further information contact:

The Reports and Publications Officer
Australian National Audit Office
GPO Box 707
Canberra ACT 2601
telephone (02) 6203 7537
fax (02) 6203 7798

Information on ANAO audit reports and activities is available at the following internet address:

<http://www.anao.gov.au>

Audit Team

Ann Thurley
Malisa Golightly

Abbreviations

ANAO	Australian National Audit Office
APS	Australian Public Service
DEETYA	Department of Employment, Education, Training and Youth Affairs
DIS	DEETYA International Services
DoFA	Department of Finance and Administration
IFI	International Financial Institution

Part One

Summary and Recommendations

Summary

Background

1. The Department of Employment, Education, Training and Youth Affairs (DEETYA) International Services is a consultancy-based business which is concerned with establishing and running employment, education and training programs. DEETYA International Services (DIS) operates as a branch with DEETYA and has thirteen staff. Not all these staff were involved in commercial consulting work, but provide other services such as the Australian International Recruitment Service. While DIS' work in the consulting area began in an opportunistic manner (that is, by invitation from an overseas employment service to submit tenders for World Bank funded projects) the formal establishment can be said to have occurred in June 1993 with the establishment of the section 35 agreement¹ providing for the retention of fees earned.

2. DIS' objective, as stated in the 1996-97 Business Plan, is 'to promote and expand export opportunities on a commercial basis in the fields of employment services, education and training, particularly where DIS has expertise unique to its organisation and services'.

3. The main services offered by DIS cover:

- project related consultancies;
- study tours of Australia;
- specialist advisory secondments;
- feasibility studies, which promote Australian education and training expertise as part of broader joint venture initiatives with industry for overseas markets; and
- operating an international recruitment service, aimed at increasing the number of Australians employed in international organisations and increasing Australia's share of international procurement by multinational agencies.

¹ Section 35 agreements may be established by an authorised officer of an agency with an authorised officer of the Department of Finance and Administration setting out the extent to which receipts raised by that agency may be made available to them as a net annotated appropriation as defined in section 35 of the Audit Act 1901 and the conditions that will apply to such receipts.

Audit objective

1. The objective of the audit was to examine the operations of DIS with a view to identifying the administrative issues and difficulties experienced by DEETYA in establishing a commercial entity and its subsequent operation within the framework of the Australian Public Service (APS).

Audit methodology

2. The methodology for this audit was developed in consultation with DEETYA. The audit fieldwork was undertaken by the PSI Consulting Group for the ANAO. They were requested to:

- establish a normative model of the key processes for a commercial business including covering such issues as identifying markets, attracting and managing business projects and reporting results;
- adjust the model taking into account the operating requirements in the APS including the necessary accountability arrangements, APS terms and conditions of employment, and so on;
- compare and assess the operations of DIS against the key principles established in the first two steps taking into account the requirement for DIS to operate in an international context; and
- identify any aspects of the arrangements which require improvement.

3. Key criteria were then drawn from the adjusted model and from work undertaken in relation to planning and performance management and the establishment of accountability and control frameworks in other audits. The three major areas covered by these criteria were:

- corporate management processes;
- core service processes; and
- support processes.

4. The key findings are discussed under these major headings.

Audit conclusion

5. In examining the administrative issues and difficulties faced by DIS in establishing and operating a commercial entity in the APS, the ANAO found that most elements of DIS' business were operating satisfactorily. These elements included the management of service provision where DIS has comprehensive processes in place for the development of proposed services, monitoring their delivery and assuring quality. This will have contributed significantly to the level of success DIS has had in winning tenders and in overall client satisfaction with services delivered.

6. However, DIS clearly had not operated in the commercial manner required by its business orientation. While DIS' mission statement and planning documents indicated that it was meant to be a commercial operation, it had not clearly defined its business purpose in that the level of commerciality to be achieved had not been determined. As well, it had not identified tasks which were in the nature of community service obligations (CSOs) nor had it separated the funding for these CSOs to allow a clearer focus on its commercial performance, among other matters.

7. As a result of this lack of a defined business purpose, there was a number of areas where DIS was not operating successfully. These areas included the need for significant improvements in:

- the financial planning framework in order to provide a sound basis for business decisions;
- the management of risk so that a comprehensive risk management plan can be developed to cover, among other things, risks in relation to foreign currency exposure and debt management; and
- the costing methodology in order to provide an adequate reflection of the full costs of production.

8. Due to the shortcomings in the costing methodology used, DIS has not been able to identify reliably the full costs of production. As well, the true financial position cannot be determined because DIS does not manage on an accrual basis.

9. Based on the current methodology and available cash records, DIS has recorded an accumulated cash deficit of \$1.4m since the commencement of its operations. This means that the business has been subsidised by other departmental operations.

10. A sound understanding of costs is fundamental to business success whatever the level of commerciality. In addition, a more appropriate

method of quantifying costs and incorporating these in fee-setting considerations is considered to be essential.

11. As well as ensuring that an appropriate financial framework is implemented, the definition of the business purpose will also impact on planning and performance management. While DIS had established the basis of a planning and performance management regime this will need to be reviewed once DIS has defined its business purpose and obtained the appropriate approval for its operations on the basis of this business purpose.

12. This audit has specifically focussed on DIS and has aimed to engender a business-like approach, including in relation to risk management, marketing, financial planning and management, and review. A business-like approach is important for other APS agencies in similar circumstances in order to deliver cost-effective and quality outcomes. They would also benefit from examining the findings and recommendations of this report to ensure that their approach is appropriate.

13. As well, agencies could benefit from an examination of the Industry Commission's research report 'Export of Government Services', December 1997 which discusses similar issues to those raised in this report.

Recommendations

14. The ANAO has made nine specific recommendations aimed at improving DIS' operations in relation to those areas identified above as being in need of improvement, particularly in terms of:

- clarifying its business purpose and identifying CSOs;
- making improvements to planning and performance information through building on the sound base already established. This would also assist with monitoring business functions;
- developing an accrual-based financial planning framework which supports DIS' business purpose;
- reviewing the costing methodology in a way which ensures that the full costs of production are properly determined and taken into account to provide a sound basis for decisions on appropriate pricing strategies; and

- establishing a debt management policy appropriate to its business operations.

DEETYA response

1. DEETYA agreed with all the recommendations and noted:

As a general comment, we would like to express our welcome for and appreciation of the report. We are glad to note the thrust of the recommendations is to provide strong support for the reforms which we have already initiated in this program as a result of our internal review of it, together with a number of recent changes in program costing and financial management areas. In some cases, across the board changes taking place in the management of the export of Government services are also relevant, including those discussed in the Industry Commission's December 1997 report, Export of Government Services.

A new DIS operational framework has been developed in response to that review, and it was approved by the DEETYA Executive in October 1997. It is based on a cost-recovery model which identifies and clarifies those activities which relate to Community Service Obligations and those services for which costs must be recovered in full. DIS is now revising its business plan in the light of its new operational framework. The revised plan will take into account feedback from the ANAO and will focus on continuous improvement linked to output-based budgeting and reporting. DIS will also now move to develop a comprehensive risk management plan.

Key Findings

Corporate management processes

2. In examining the corporate management processes (discussed in Chapters 2 and 3 of this report) for DIS the ANAO sought to determine whether DIS had:

- defined its business purpose and identified tasks that were in the nature of CSOs;
- established an appropriate planning regime; including the setting of goals;
- developed appropriate financial plans; and
- managed performance.

Definition of business purpose

1. The ANAO found a number of corporate documents which included statements regarding the mission/objective of DIS. However, these statements gave inconsistent indications of the level of commerciality DIS was to achieve. Therefore the ANAO considers that DIS had not clearly defined its business purpose, and had not identified the relevant CSOs nor sought to separate the funding for them to allow a clearer focus on the business objective.

The planning regime

2. The overall plan for 1996-97 included a mission statement and covered both short and long-term objectives. The ANAO considers that the plan provides a sound basis on which to build. However, DIS could improve its planning and performance management regime by ensuring that its objectives, strategies and performance indicators are separately specified throughout the plans and that indicators are included in all cases. These indicators should be measurable to the greatest extent possible. These indicators may be qualitative as well as quantitative.

3. In addition, once the business purpose has been defined and received appropriate approval from the DEETYA Executive, DIS will need to review its plans to take that purpose specifically into account.

4. While risk assessments were undertaken for each individual tender, an overall risk assessment has not been done. DIS does not have a comprehensive risk management plan to guide its operations.

5. DIS has also developed operational plans (referred to as Action Plans) and these are included in the 1996-97 Business Plan. As a separate exercise DIS has also developed Functional Statements which describe the responsibilities of each area. However, the Action Plans and Functional Statements could be improved by clearly stating where responsibility for particular action lies and by including priorities, resources required and key milestones to be achieved. This would assist effective monitoring and review and improve accountability for the results.

Financial plans

6. DIS has not developed soundly based financial forecasts to support the strategic direction of the business. Such forecasts provide a key basis for business decisions. The financial planning framework is currently a more basic model for the management of existing work and tenders submitted, rather than an indication of the financial parameters necessary to deliver the broader planning objectives such as the particular level of profitability to be achieved or the revenue targets to be met over time. Improvements to financial planning along these lines would be beneficial to assist DIS to achieve business success.

Managing performance

7. DIS has established the basis for a performance management regime. However, because the business purpose has not been clarified and objectives, strategies and indicators are not identified separately, in most instances, it is difficult to fully assess the overall effectiveness of the regime. In particular, the performance information could be improved by:

- setting indicators for each objective/strategy and ensuring indicators can be measured cost effectively;
- ensuring there is a balance of indicators that is, a range of indicators which measure inputs, outputs and outcomes including client service; and
- establishing appropriate milestones, targets, standards or benchmarks consistently throughout the Business Plan.

8. Performance indicators were established for the first time in 1996-97. The ANAO acknowledges that developing indicators is not easy and they

are likely to require improvement over-time. Nevertheless they are critical for effective monitoring, decision-making review and public accountability for results.

Core service processes

9. The ANAO examined the following elements of DIS core service processes (discussed in Chapters 4 and 5):

- development of the market and customer strategy, including promotion strategies;
- development and monitoring of proposed services; and
- strategies in place to assure quality.

Market and customer strategy

1. The marketing plan demonstrates an appropriate understanding of current and potential customers and the environment. However, it could be improved by the development and inclusion of performance indicators and targets which would assist DIS to determine how successful, or otherwise, the promotion strategies turn out to be.

Developing and monitoring proposed services

2. DIS has comprehensive processes in place for developing proposed services and monitoring their delivery. These processes focus on establishing a consulting solution based on the needs of the client and building on the available skills within DEETYA, supplemented as necessary with external resources. Each contract clearly identifies:

- the required outcomes; and
- respective responsibilities in client and sub-contractor contracts.

3. As well, DIS has thorough briefing arrangements for the project team and uses comprehensive project management. All these factors have contributed to the level of success DIS has achieved in winning tenders and the overall client satisfaction with the services delivered.

Assuring quality

4. DIS has established a good reputation with its clients which forms an important foundation for DIS to obtain future work. The development of a process for measuring customer satisfaction for introduction in 1997-98 provides a basis for the ongoing formal assessment of consulting service quality. However, DIS' processes for assessing quality could be further enhanced by;

- documenting the processes for the collection, monitoring and reporting on all tender outcomes, and the reasons behind them;
- obtaining feedback from DIS' project partners as well as in relation to clients' satisfaction; and
- regular reporting of all projects and tenders against key performance indicators such as whether the deliverables have met clients' needs, requirements of the contract have been met and time-frames and budgets have been achieved.

Support processes

1. The ANAO examined the following areas of support processes (discussed in Chapter 6):

- costing of proposed services;
- management of budgets and resource allocations; and
- management of financial risk.

Costing proposed services

1. In seeking to accurately cost proposed services, DIS used, as a starting point, a Department of Finance and Administration formula which estimates full costs by applying a multiplier² to direct salary costs. However, DIS did not apply this multiplier to all the relevant direct salary costs. As well, there was no indication that DIS had sought to determine whether the multiplier it was using was appropriate, given its particular circumstances.

2. Deficiencies in the costing approach may have lead to inappropriate pricing decisions and/or the inability to adjust the cost structure in

² This multiplier covers such elements as superannuation, compensation and legal expenses and accommodation expenses.

accordance with commercial requirements. In DIS' case a cash deficit of \$1.4m has accumulated since the commencement of commercial operations.

Management of budgets and resource allocations

3. A sound understanding of the full costs of production is important in managing budgets, particularly financial reporting and resource allocation. Recently, DIS has developed financial systems to enable it to monitor actual project expenditure against budgeted project expenditure. However, the effectiveness of the management of financial performance is affected by a number of limitations in the departmental and DIS financial systems.

4. The ANAO considers that, without systems based on accrual accounting and which enable full cost attribution to reveal properly the impact of all financial transactions in a particular accounting period, ongoing commercial operations, or effective management of a full cost recovery regime, are made more difficult. DIS has recognised the need to further develop its capacity in these areas.

Management of financial risk

5. In addition to the risks posed to DIS' financial position by the inadequate costing methodology discussed above, the other key financial risks DIS faced related to foreign currency exposure and debt management. DIS has not had procedures in place to manage financial risk in terms of foreign currency exposure. The ANAO notes that DIS currently is exploring the use of hedging arrangements to reduce its foreign currency exposures.

6. DIS has put in place a limited business-specific debt recovery policy statement, that is, setting a performance indicator that aged debt would not exceed ten per cent of total debt at any point in time. However, DIS has not defined what it means by an 'aged debtor' and has not met this target. DIS has relied on the department's general policy (which has been developed for domestic operations) in relation to debt management. This is another area which has been affected by the lack of a clearly defined and agreed business purpose. A clear business purpose is essential in order to tailor the debt management policy to suit the approved business objective.

Recommendations

Set out below are the ANAO's recommendations with Report paragraph reference and DEETYA's abbreviated responses. More detailed responses are shown in the body of the report. The ANAO considers that DEETYA should give priorities to Recommendations Nos 1, 3 and 8.

**Recommendation No.1
Para. 2.17** The ANAO recommends that DIS clarifies, and seeks approval from the DEETYA Executive for its overall business purpose including the identification and funding of CSOs.

DEETYA response: Agree

**Recommendation No.2
Para. 2.31** The ANAO recommends that DIS:

- clearly specifies objectives, strategies and performance measures for the various elements of its plans to improve the focus on, and assessment of, its achievements;
- separately identifies strategies and performance measures for each objective ensuring that those various elements are clearly linked as part of a cohesive business framework; and
- establishes a comprehensive risk management plan to help guide and effectively manage its business planning and operations.

DEETYA response: Agree

**Recommendation
No. 3
Para. 2.39**

The ANAO recommends that DIS develops an accrual-based financial planning framework which supports its business plan and identifies the financial parameters necessary to facilitate the delivery of the objectives contained in this plan cost-effectively.

DEETYA response: Agree

**Recommendation
No. 4
Para. 2.46**

The ANAO recommends that, to assist effective monitoring, management and accountability, DIS improves its operational plans by:

- clearly specifying where responsibilities for particular outputs and outcomes lie in all cases;
- including priorities, resources required and key milestones in the plans; and
- linking objectives, strategies and performance indicators in the Functional Statements.

DEETYA response: Agree

**Recommendation
No. 5
Para. 2.50**

The ANAO recommends that DIS ensures that its various planning documents are linked so that they effectively guide DIS business operations.

DEETYA response: Agree

**Recommendation
No. 6
Para. 3.23**

The ANAO recommends that, in order to obtain sound information about actual performance to guide future operations, DIS improves its performance management regime by:

- setting performance indicators for each objective/strategy and ensuring indicators can be measured cost effectively;
- ensuring there is a balance of indicators, that is, a range of suitable indicators which allow an assessment of inputs, outputs and outcomes, including client service; and
- establishing appropriate milestones, targets, standards and benchmarks consistently throughout the Business Plan to allow effective monitoring and review.

DEETYA response: Agree

**Recommendation
No. 7
Para. 4.19**

The ANAO recommends that DIS establishes and includes in its marketing plan those performance measures and targets which would allow it to monitor and determine the success of its promotion strategies.

DEETYA response: Agree

**Recommendation
No. 8
Para. 6.18**

The ANAO recommends that DIS reviews and improves its costing methodology in a way which ensures that the full costs of production are properly determined and taken into account and therefore provide a sound basis for decisions on appropriate pricing strategies.

DEETYA response: Agree

**Recommendation
No. 9
Para. 6.36** The ANAO recommends that DIS establishes a debt management policy appropriate to its operations in order to maximise the recovery of costs in a way which meet its business objectives.

DEETYA response: Agree

Part Two

Audit Findings & Conclusions

1. Introduction

This chapter describes the background to the audit and DEETYA International Services and sets out the objective and methodology.

Background

1.1 Many agencies in the Australian Public Service (APS) deliver programs and/or provide services to the public. Services can be provided on a number of bases, such as a profit-making basis, full or partial cost recovery or at no charge to the client.³ These methods of service provision range from providing them on commercial basis to a non-commercial basis. Whatever the means chosen to provide a particular service, it should be established, operated, monitored and overall performance assessed so that quality services are provided to clients in the most cost-effective way to meet government objectives. In particular, the business objective must be identified and agreed, and the contribution that each part of business is to make to achieving the objective should be specified in a way that allows performance for the business as a whole to be properly assessed.

1.2 The ANAO has examined the provision of services on a commercial basis using the Department of Employment, Education, Training and Youth Affairs (DEETYA) International Services as a case study. In late 1996 the ANAO conducted a preliminary study of the International Division of DEETYA to examine the functions and operations of the division. During the course of this study the ANAO identified that the division had experienced difficulties in the development of commercial operations within the APS framework. Given the emergence and increasingly widespread use of commercial operations the ANAO considered that there would be benefit in assessing the implementation of commercial arrangements for one of the business units.⁴

³ It should be noted that these bases for delivering services are not necessarily mutually exclusive.

⁴ The other business unit within the division, the Australian International Education Foundation, was the subject of a separate departmental review at the time of the audit and was not therefore included in this audit.

DEETYA International Services

1.3 DEETYA International Services is a consultancy-based business, within the International Division of DEETYA. It is concerned with exporting expertise in establishing and running employment, education and training programs. The International Division had existed prior to the establishment of DIS and its activities had included, among other things, monitoring, evaluating and providing advice on the employment, education and training activities of international organisations of which Australia was a member. In November 1992 the Russian Federal Employment Service invited DEETYA to submit a number of tenders for World Bank funded projects aimed at restructuring Russia's employment operations. As one of these tenders was successful, DEETYA decided that its expertise and experience would have value in the international market place. A unit was established to facilitate the development of future tenders, explore and pursue opportunities for international consultancies and coordinate DEETYA's involvement in export activities. This unit, DIS, operates as a Branch within the International Division and has thirteen staff, not all of whom are involved in commercial consultancy work.

1.4 The formal establishment of DIS can be said to have occurred with the setting up of its Section 35 agreement⁵ in June 1993 for the 1993-94 financial year. DIS competes, often in conjunction with external (to the Department) consultants, against non-Australian public and private consultancy organisations for projects where they have relevant expertise. DIS advised the ANAO that it aims not to compete with other Australian organisations.

1.5 DIS' mission, as stated in the 1996-97 Business Plan, is:

'to promote and expand export opportunities on a commercial basis in the fields of employment services, education and training, particularly where DEETYA has expertise unique to its organisation and services'.

1.1

⁵ S35 arrangements are agreements established by an authorised officer of an agency with an authorised officer of the Department of Finance and Administration on the extent to which receipts raised by that agency may be made available to them as a net annotated appropriation as defined in section 35 of the Audit Act 1901 and the conditions that will apply to such receipts.

1.6 The Business Plan also states that DIS:

'generates significant revenue for the government by selling DEETYA expertise and skills in a internationally competitive environment. DIS also provides services of a non-commercial nature through Australian International Recruitment Services and provides opportunities for other Federal and State government agencies and private sector companies in the international consulting field.'

1.7 The following table shows a summary of DIS financial results on a cash basis since its commencement in 1993-94.

Table 1
DIS' financial performance 1993-94 to 1996-97

	1993-94	1994-95	1995-96	1996-97
Receipts	921 000	2 158 000	3 973 000	2 597 813
Payments	1 224 000	2 877 000	4 425 000	2 508 119
(Deficit)/Surplus	(303 000)	(719 000)	(452 000)	89 694
Cumulative (Deficit)	(303 000)	(1 022 000)	(1 474 000)	(1 384 306)

Note: The above table includes only direct cash receipts and payments. DEETYA was not operating on an accrual based accounting system during this period.

1.8 Detailed discussion on DIS' financial performance and other aspects of its operations are included in the relevant areas of the remaining chapters in this report.

Audit objective

1.9 The objective of the audit was to examine the operations of DIS with a view to identifying the administrative issues and difficulties experienced by DEETYA in establishing a commercial entity and its subsequent operation within the framework of the Australian Public Service (APS). The ANAO sought to identify any lessons learned and better practices from the implementation of the commercial arrangements in DIS.

1.10 In undertaking the examination of administrative issues the ANAO has also commented on and made recommendations for areas of DIS operations which could be improved.

Audit methodology

1.11 The methodology for this audit was developed in consultation with DEETYA. The audit fieldwork was undertaken by the PSI Consulting Group for the ANAO. At the same time DEETYA also conducted a review of related matters of policy and strategic business issues for DIS. The PSI Consulting Group also conducted this work for DEETYA through a separate contract and under their direction.

1.12 In order to compare and assess DIS' commercial operations the PSI Consulting Group was requested to:

- establish a 'normative' model of the key processes for a commercial business including such issues as identifying markets, attracting and managing business projects and reporting results;
- adjust the model taking into account the operating requirements in the APS including the necessary accountability arrangements, APS terms and conditions of employment, risk management principles, costing arrangements, mechanisms to monitor operations, reporting requirements and so on;
- compare and assess the operations of DIS against the key principles established in the first two steps, taking into account the requirement for DIS to operate in an international context; and
- identify any aspects of the arrangements which require improvement and make appropriate suggestions in relation to business management including such matters as international banking, funds transfer and currency exchange.

1.13 DEETYA was provided with the opportunity to comment on the model as it was developed and adjusted. As well, an informal reference group of senior public servants (outside DEETYA), academics and business people provided comment during the development of the model. In adjusting the model to take account of the operating requirements of the APS, consultations were undertaken with the Chief Executives of DEETYA, the Public Service and Merit Protection Commission and the Departments of Finance and Administration, Industrial Relations and Social Security to provide a perspective on the future directions of the APS.

1.14 In addition, the model draws upon a range of documents including MAB/MIAC Reports, the June 1996 Report of the National Commission of Audit, the Minister for Industrial Relations' November 1996 discussion paper 'Towards a Best Practice Australian Public Service, the 1996-97 Budget Papers, the Kakabadse Report - 'Leadership in Government', the 1996

Financial Management Bill, and Advisings of the former Department of Industrial Relations.

Key areas for DIS' assessment

1.15 The description of activities in the normative model provided the basis for determining the key criteria⁶ for the assessment of DIS as a discrete business unit. These criteria were established taking into account the nature of DIS' operations and activities. Specifically, the audit focussed on:

- in the corporate management processes;
 - definition of the business purpose and strategy;
 - the planning process, including the setting of goals;
 - development of financial plans; and
 - managing performance;
- in the core service processes;
 - development of the market and customer strategy;
 - development of strategies to promote services;
 - managing service provision through the development of the proposed services for inclusion in tenders; and
 - assuring quality in service provision;
- in the support processes;
 - costing proposed services;
 - managing budgets and resource allocations; and
 - managing financial risk.

1.16 One issue which was not examined is the assessment of the processes in place to protect intellectual property. However, the nature of DIS' service business means that the intellectual property of DEETYA takes the form of 'policy capacity' or 'administrative experience', which cannot easily be licensed or otherwise protected as can for example, computer software. Other APS businesses should, however, consider this issue and take the necessary action to protect their intellectual property including opportunities for royalty payments as circumstances allow.

1.17 In considering the core service processes, the audit was informed not only by the 'normative' model (developed by PSI) but also by the outcomes of work carried out concurrently for DEETYA which, among other things,

⁶ The development of the key criteria also drew on work undertaken in relation to planning and performance management and the establishment of accountability and control frameworks in other audits.

identified a generic best practice model for the development of an exporting strategy. Where relevant, reference is made in the report to this work, with the agreement of DEETYA.

1.18 The audit was conducted in conformance with ANAO standards at a cost of \$174,000.

This report

1.19 Chapter 2 of this report discusses the need to establish a clearly defined business purpose and the related issues of planning. Chapters 3 to 6 examines performance management, marketing services, managing service provision and accounting and financial management. A more detailed discussion of the various elements of the 'normative' model (developed by PSI) is included at Appendix 1.

1.1

2. Planning

This chapter discusses the need to establish a clearly defined business purpose and the related planning issues. The ANAO identified the need for improvement in clarifying the business purpose. As well, DIS needs to develop a comprehensive risk management plan, improve its financial planning and specify more clearly its objectives, strategies and indicators. The ANAO has made a number of recommendations aimed at making improvements in these areas.

Introduction

2.1 Appropriate planning, including financial planning, is essential for the effective operation of any organisation. However, such planning must be based on, and flow from, a clear definition regarding the agency's business purpose, including the extent to which the business will be commercial. In establishing the business purpose, agencies should also determine whether all activities are commercial or whether some activities are to be undertaken to meet community service obligations (CSOs). If CSOs are identified then desirably they should be separately funded to allow a clearer focus on the business objective. In this respect there are lessons to be learned from the development of government business enterprise policy.

2.2 DIS operates within DEETYA's divisional and corporate planning processes. Its mission and business plan are developed in the context of the broader departmental international activities. DIS has been, according to the mission statement included in its 1996-97 Business Plan, operating as a commercial entity. The ANAO examined how well planning had been developed to guide these commercial operations.

Key criteria

2.3 In the corporate management area (of the model) the ANAO examined whether DIS had:

- clearly defined its business purpose and sought approval/agreement by the Executive (and Minister) for that purpose;

- developed an overall plan, including a mission statement integrated with short and long-term objectives. The plan should be based on sound risk management⁷ and an understanding of customers and the environment;
- developed suitable medium to long-term financial forecasts which support the strategic direction of the business; and short-term plans that determine the financial implications of the business plan and establish the appropriate budget parameters for each accounting period; and
- developed operational plans identifying key responsibilities and activities, resource allocations and timeframes for completion of specific tasks.

2.4 There should be links specified between the various planning documents to guide all levels of operation. These plans should be monitored, reviewed and updated regularly. Each of these areas is discussed under separate headings below.

Definition of business purpose

2.5 DIS had developed plans to guide its operations and these plans contained a mission statement. The 1996-97 Business Plan included the following statement:

'Our mission is to promote and expand export opportunities on a commercial basis in the field of employment services, education and training particularly where DEETYA has expertise unique to its organisation and services'.

2.6 This statement indicates that DIS operates a commercial business. As well, in a paper dated March 1997 proposing DIS for an award for innovation, it stated that it

'operates in a commercial environment ... and ... clearly not only had to cover ... costs, including all administrative and staffing resources, but ... had to return revenue to the Department.'

2.7 However, in a range of other written material the ANAO found that DIS also stated that it:

- pursued international work on a fee-for-service basis;
- operated in a commercial environment on a cost-recovery basis;
- had a commercial focus; and
- aimed to become a self-funding operation within three years.

⁷ Guidelines for Managing Risk in the Australian Public Service, MAB/MIAC Report No.22 October 1996.

2.8 These different approaches do not reflect a focussed view by DIS of the nature of its business operations to be conducted on a commercial basis.

1.1

2.9 As well, DIS provides a number of services on a non-commercial basis. These are operating the International Recruitment Service, maintaining links to the World Association of Public Employment Services, non-commercial study tours and corporate support. However, these services were not identified as CSOs and they were not funded separately.

1.1

2.10 The ANAO acknowledges that, in deciding on the business purpose and identifying CSOs, there are a range of issues to be considered. In DIS' case, the export of public sector services and intellectual property may have had a number of positive outcomes (see figure 1).

2.11 An examination of these possible outcomes may assist in clarifying the business purpose and in the identification of CSOs.

Approval of business purpose

2.12 Approval should be sought for the business purpose including the level of commerciality to be achieved.

2.13 In DIS case, each specific project undertaken by DIS receives the approval of the Secretary prior to its commencement.

2.14 In addition, in a range of documents examined during the audit the ANAO noted that, for example,

- in March 1997 DIS stated 'It has been only with the full support of the Executive that DIS has been able to be successful.';
- a circular of July 1993 stated 'Recently the Secretary announced his intention to create an International Projects Branch to manage DEET's increasing involvement in international consultancy and project work'; and
- meeting notes of December 1992 'General support was expressed for DEET's involvement with international consultancies on a business basis'.

2.15 However, the ANAO was not provided with any documents which indicated that overall approval had been given by the Secretary for a defined business purpose or the identified CSOs.

Figure 1

Possible outcomes of an Export Business

Foreign policy objectives are satisfied

The export of government services may be seen as an appropriate contribution to the achievement of Australia's foreign policy.

Private sector exports are enhanced

A significant issue in assessing government exports is whether the possible displacement of private sector exports by government agencies (possibly at subsidised prices where the financial management regime is inadequate) is outweighed by the positive impact public sector exports have on private exports. This could happen in two ways. First, the successful public sector export can provide international recognition of the quality and capacity of Australian enterprise and open up the market for an Australian 'label' - public and private. Second, there are opportunities for joint venturing in projects that are won principally through the involvement of government.

Public sector productivity is increased

The export of public sector services may be an important means of improving the performance of the participating agencies in that:

- public sector skills may be sharpened through competition;
- exposing public servants to other cultures and technology may result in an increase in skill levels;
- officers may gain personally in terms of professional development, international recognition and network development;
- the newly acquired skills and international recognition can lead to further export success;
- recognition of capabilities by the export market may enhance the domestic credibility of the public service and adds to the morale and good governance ethic of its staff; and
- export activities may add depth to already active overseas departmental relationships.

A return is generated on taxpayer investment in a special system, skill or procedure

Export activities may provide agencies, and therefore governments, with a commercial return on their existing investments in highly trained and experienced personnel, infrastructure and capital facilities, and research and development.

Foreign revenue is raised and public sector profits are earned

Public sector resources, having considerable demonstrable export potential, may earn profits, foreign exchange and contribute to Australia's international trade.

Source: draws on the viability and appropriateness of commercial export of services by Government.⁸

⁸ This paper was developed for DIS as part of the separate review being undertaken at the same time as the audit.

Conclusion

2.16 DIS had not clearly defined its business purpose, including identifying any CSOs. As well, the ANAO was not provided with documentation which showed approval by the Executive (or the Minister) for DIS' business purpose. It is from such decisions that planning, management frameworks, support systems, monitoring and reporting arrangements are delivered. It is therefore important for DIS, and any other APS 'business', to establish an agreed purpose to underpin the way in which it will operate. This should take place as early as possible in the life of the business given that any commercial business takes time to develop fully and may make initial losses. Without this clarification the risk that DIS will not meet its objectives and be appropriately focussed on the commercial outcomes significantly increases.

Recommendation No.1

2.17 The ANAO recommends that DIS clarifies, and seeks approval from the DEETYA Executive for its overall business purpose including the identification and funding of CSOs.

DEETYA response

2.18 DEETYA has established new operational framework for DIS so that it operates on a cost recovery basis. Appropriate Executive level approval has been obtained.

Overall plan

2.19 The ANAO examined DIS' overall planning, including whether it was based on a sound risk assessment. The ANAO found that DIS had developed a business plan for 1996-97. Notwithstanding the fact that DIS' business purpose had not been clarified, the ANAO found that the plan provided a mission statement and both short and long-term objectives. As such, it is a reasonable basis on which to develop the plan further to build a coherent strategy to guide the DIS business. However, there is a clear need to ensure that the mission statement reflects the agreed business purposes. As a result of the absence of a description of the agreed purpose, there were a number of other areas where the plan could be improved to assist in future operations.

2.20 The plan included a number of objectives which were linked to the mission statement. As well, other objectives were listed along with strategies and performance indicators. Set out below is an extract from the business plan which has been used to identify areas in the plan which could be improved. Each section of the plan dealt with a strategic issue, in this case Sales and Marketing.

Figure 2

Strategic Issue: Sales and Marketing

<p>The continuing success of DIS operations is dependent upon its capacity to identify adequately, and action, sales and marketing opportunities. A sharper focus on marketing activities, leading to increased lead generation and tender success will be a key priority for the business.</p> <p>Our research shows that identifying trends and market niches in the industry is difficult. Personal contact and a proven track record are the key to success. International project work involves long lead times, therefore it is necessary to allocate sufficient resources to maintain up to date tracking and a high level of personal contact ensuring that we have the best chance of winning available projects.</p> <p><i>How can we improve the chances for ourselves and our partners to win international work?</i></p>	
Objectives	Strategies and Performance Indicators
1. Significantly increase the number of tenders submitted while maintaining appropriate quality control and high success rate.	Increase by four times the number of tenders submitted during 1996-97 while maintaining a high success rate (50%) target
2. Identify and target market segments for the purpose of increasing business levels with IFIs.	Undertake regular quarterly contact with identified clients, files to be notated
3. Broaden base of potential clients in line with market research.	Develop marketing strategies, driving the allocation of funds to key priorities (research completed by December)
	Identify five counterpart ministries by December with potential to fund consultancies in their own right (proposals by May)
4. Implement a thorough and comprehensive project opportunity tracking system.	Implement computer based project tracking mechanisms by October with 95% of leads followed up within one month
	Produce new DIS pamphlet by December

2.21 In this example the question: 'How can we improve the chances for ourselves and our partners to win international work?' provides an indication of the objective. The four points listed as objectives and some elements of the second column are strategies although these would be improved in a number of cases by specifically stating the means by which the objective would be achieved. For example, the point listed as objective number 3 could read 'broaden the base of potential clients by using results from market research to identify new clients'.

2.22 In the section headed 'Strategies and Performance Indicators' many statements are strategies, namely undertake regular contact with identified clients (a more appropriate description may be targeted); however DIS has not identified performance measures for each objective/strategy. The issue of performance information is discussed in more detail in the performance management chapter.

2.23 As well, in the example above, objectives, strategies and performance measures were generally not separately specified. By separately specifying these it will be easier to ensure that strategies do actually provide the means by which objectives can be achieved and that appropriate performance measures are in place to allow such an assessment. It would also assist with monitoring, reviewing and reporting of achievements against objectives.

Risk management

2.24 The business plan does not indicate that a comprehensive risk assessment had been undertaken by DIS in the development of the Plan. DEETYA advised that, at the time of the audit fieldwork, the Department did not have an overall risk management plan. Rather, specific areas of risk within the Department were being identified and addressed. In addition, a fraud control plan had been developed.

2.25 DIS also advised that risk assessments were undertaken at the time individual tenders were lodged. For example, it drew on material from the Department of Foreign Affairs and Trade to identify risks to staff. Given the commercial nature of DIS' operations and that its projects concern the export of services, the ANAO considers that this is an area which requires explicit attention by DIS. As part of the separate DEETYA review of DIS some potential risks which needed to be considered by DIS were also identified.

2.26 Because departments do not frequently encounter exporting operations, DEETYA's definition of the nature of exporting risks provides a checklist that may, when required, be a useful tool in the development of a risk sound management strategy.

Figure 3

Exporting risks⁹

The nature of exporting risks, which require specific consideration in the development and management of an exporting strategy include:

- buyer insolvency;
- project implementation/completion delays;
- delays in payment; repudiation of contract;
- exchange transfer delays;
- professional error;
- public liability;
- currency fluctuations;
- imposition of controls on repatriation of profits and/or capital;
- expropriation;
- property losses from war and/or civil disturbance; marginal;
- political risk (internal and external);
- cultural differences; and
- occupational health and safety.

Source: draws on DIS best practice export strategy.¹⁰

⁹ Not all these risks will apply to every commercial business in every situation.

¹⁰ This paper was developed for DIS as part of the separate review being undertaken at the same time as the audit.

Understanding customers and environment

2.27 The 1996-97 business plan contains a situation analysis with a brief 'Market Assessment'. This assessment discusses opportunities available to DIS. A more detailed discussion of customers and environment is included in the marketing plan and discussed in Chapter 4.

Conclusion

2.28 The overall plan for 1996-97 included a mission statement and covered both short and long-term objectives. The ANAO considers that the plan provides a sound basis on which to build. However, DIS should ensure that objectives, strategies and performance indicators are separately specified in the plan and that indicators are included in all cases. These indicators should be measurable to the greatest extent possible and could be qualitative or quantitative. In addition, once the business purpose has been defined DIS will need to review its plans to take that purpose specifically into account.

2.29 DIS does not have a comprehensive risk management plan to guide its operations. While risk assessments were undertaken for each tender, an overall risk assessment has not been done. The need to identify and manage risks systematically is important for all agencies and is an integral part of sound business practice.

2.30 The business plan contained some reference to understanding customers and the environment. These issues are covered in more detail in the marketing plan which is discussed in Chapter 4 of this report.

Recommendation No.2

2.31 The ANAO recommends that DIS:

- clearly specifies objectives, strategies and performance measures for the various elements of its plans to improve the focus on, and assessment of, its achievements;
- separately identifies strategies and performance measures for each objective ensuring that these various elements are clearly linked as part of a cohesive business framework; and
- establishes a comprehensive risk management plan to help guide and effectively manage its business planning and operations.

DEETYA response

2.32 Following agreement by the Departmental Executive to the new DIS Operational framework, DIS is revising its current Business Plan. The revised plan takes into account feedback from the ANAO and focuses on continuous improvement linked to output-based budgeting and reporting.

2.33 As well, following approval of the new DIS Operational Framework, DIS will now move to develop a comprehensive risk management plan.

Financial planning

2.34 DIS' 1996-97 business plan incorporates monthly budgets that address the direct salary and administration cost of DIS' operational support team and projected receipts and expenditure for contracted and likely projects. The budgets are reviewed and adjusted each six months. Strategies for the management of cash flows, for example through control of the level of debtors, are also addressed in the business plan.

2.35 DIS has recently (April 1997) developed financial systems which enable it to monitor actual project expenditure against planned project expenditure.

2.36 DIS has indicated that it uses broad estimates of future cash flows in planning. However, processes were not sufficiently well developed to be able to use cash flow projections as a key basis for business decisions in relation to target markets, clients and types of work. DIS advised that its "financial planning is based on being fee-for-service rather than developing the detailed budget required by commercial operations". There are also no measures of, or targets for, the fundamental commercial measure of profitability (either at the organisational or project level) in DIS' planning.

Conclusion

2.37 DIS has not developed soundly based forecasts which include projections for future cash flows. Such forecasts provide a key basis for business decisions. The financial planning framework is currently a more basic model for the management of existing work and tenders submitted, rather than an indication of the financial parameters necessary to deliver broader planning objectives such as the particular level of profitability to be achieved and sales targets over time. Improvements along these lines to financial planning are important to assist DIS to achieve business success.

2.38 Irrespective of the extent to which profitability remains important in DIS' objectives, or whether other, non-commercial objectives apply, it is appropriate

for DIS to consider implementing a financial planning framework that encompasses targets based on achieving objectives as well as budgets that reflect the actual work on hand and anticipated new business.

Recommendation No.3

2.39 The ANAO recommends that DIS develops an accrual-based financial planning framework which supports its business plan and identifies the financial parameters necessary to facilitate the delivery of the objectives contained in this plan cost-effectively.

DEETYA response

2.40 In the early years of DIS operations, accrual-based accounting was not a requirement for the APS. Accrual-based accounting is not yet service wide, and DIS will move to full accrual based financial management in step with DEETYA's transition to a full accrual accounting system in 1999-2000.

2.41 Within the DEETYA portfolio, DIS is piloting its introduction and will move to reporting, from December 1997, on both an accrual and cash basis.

Operational planning

2.42 As part of the 1996-97 business plan, DIS has included an action plan for each objective. This fulfils the role of an operational plan. An extract from the Action Plan is set out below.

Figure 4

DEETYA International Services business plan 1996-97

STRATEGIC ISSUE - SALES AND MARKETING			
<i>The following action plan shows how we propose to tackle the objectives and strategies shown on the previous page. To make our task simple we have divided these actions into three sub-categories:</i>			
Products This includes materials we intend to produce to assist ourselves and our colleagues with hard copy material in marketing what we do.			
Liaison: These are things we can do individually and collectively to promote DIS			
Sales Support: This essentially refers to actions required to support products and liaison activities.			
Focus	Item	Responsibility	Timing
Products	1. review and update marketing material, as necessary	Director Marketing and Planning	Sept Qtr
	2. identify additional consultants and update register		Mar Qtr
	3. provide counsellors with DIS project information and marketing material and seek to identify Ministries who may be interested in DIS commercial activity		Sept Qtr
	4. submit a DIS article for every second edition of DEETYA Times		Ongoing
	5. review IFI and other government publications and the Internet to provide more detailed information on the size and scope of the consultancy market		Ongoing
	6. use Internet for DIS marketing		Ongoing
Liaison	7. coordinate and streamline written and personal approaches, particularly in regard to contacts with International Financial Institutions		October
	8. make personal contact with key agencies who may be interested in consortium approaches		Ongoing
	9. maximise the contact with study groups by providing information on DIS services		Ongoing
	10. improve contacts with other Branches who have international dealings in order to gather better market information and market DIS services		Ongoing
	provide counsellors with marketing kits		
	leads to be followed up in a timely manner		March
Sales Support	11. provide counsellors with marketing kit		Ongoing
	12. leads to be followed up in a timely manner		Ongoing

The action plan provides details of activities which will be undertaken to deliver the objectives in the business plan. The ANAO considers the action plan could be improved by:

- stating specifically for each area where responsibility lies for actions, for example, in Liaison and Sales Support. It could be assumed that the Director, Marketing and Planning is responsible for all matters on this page but it is not clearly stated;
- setting priorities for tasks so that those tasks which are most critical for the success of the business receive sufficient attention;
- identifying resources required to complete particular tasks in a given timeframe. This should assist DIS by providing a framework for ongoing monitoring; and
- reviewing the timeframe for completion of various tasks to identify key milestones.

2.44 As well as the above action plans, DIS has established, separately, a functional statement for each section. This is useful in that it assigns responsibilities for achieving particular activities which in turn contribute to the achievement of objectives. However, the following problems with these statements were identified. The plans:

- do not link performance indicators to strategies and objectives; and
- contain performance indicators for which measurement is difficult either because it would not be possible to determine if the target is achieved (for example 'maximising' revenue) or because the measure is subjective (for example 'quality of bids'). The ANAO acknowledges that performance measures can be qualitative and quantitative but to the greatest extent possible measures should exist which can be measured cost effectively.

Conclusion

2.45 DIS has developed operational plans referred to as action plans and these are included in the 1996-97 business plan. As well, DIS has developed separately, functional statements. However, the Action Plans could be improved by clearly stating where responsibility for particular action lies and by including priorities, resources and key milestones. This would assist effective monitoring and improve accountability. The functional statements could be improved by ensuring that objectives, strategies and performance indicators are inter-linked.

Recommendation No.4

2.46 The ANAO recommends that, to assist effective monitoring, management and accountability, DIS improves its operational plans by:

- clearly specifying where responsibilities for particular outputs and outcomes lie in all cases;
- including priorities, resources required and key milestones in the plans; and
- linking objectives, strategies and performance indicators in the functional statements.

DEETYA response

2.47 Future operational plans will be refined as recommended by the DEETYA internal and ANAO reports. The plans will be based on an output/outcomes resources management framework being implemented across the portfolio.

Links between plans

2.48 The action plans are integrated into the business plan and this could assist establishing links between plans developed to guide operations at different levels. However, because objectives, strategies and performance indicators are not clearly and separately specified, establishing the links is problematic.

Conclusion

2.49 As discussed above, DIS has developed a number of planning documents and has sought to improve the overall planning framework in successive rounds of planning. The ANAO considers that there is scope for DIS to rationalise its planning documentation in order to more clearly establish the necessary links between higher level plans and the more detailed operational/action plans. This would also assist in ensuring that appropriate performance indicators are included in plans and that these are appropriately linked.

Recommendation No.5

2.50 The ANAO recommends that DIS ensures that its various planning documents are linked so that they effectively guide DIS operations.

DEETYA response

2.51 DIS has moved to rationalise its planning documentation by incorporating detailed operational plans into its Business Plan. These planning documents reflect and are linked to corporate planning documents.

Update and review

2.52 DIS revises its business plan, which includes the action plans, on an annual basis. This review was underpinned by information gained from:

- assessing work undertaken on individual projects; and
- preparation of reports on progress to the Executive.

2.53 The ANAO acknowledges that recently, DIS has undertaken a consultancy which aims to provide better information to improve the review and update of plans. The ANAO considers that the basis for reviewing plans would benefit from information such as:

- a more clearly defined business purpose;
- better financial data; and
- reports on performance against key milestones, timeframes, and so on.

Conclusion

2.54 The ANAO notes that the business plan, which includes action plans, is reviewed annually. However, this review is currently based on limited information about actual performance. In order to provide a sound basis for this review, DIS' performance information needs to be improved. This issue is discussed in detail in the following chapter.

3. Performance Management

This chapter discusses DIS' management of performance. While DIS has established the basis for a performance management regime the ANAO has recommended improvements to ensure that DIS has sound information about actual performance to guide its future operations.

Introduction

3.1 Performance management, along with planning, is essential for the effective operation of any organisation. Performance management is important in ensuring that the organisation is working towards longer-term objectives through the use of appropriate strategies.

Key criteria

3.2 As part of examining the corporate management processes, the ANAO sought to determine if DIS had established an appropriate performance management regime. Further advice on establishing appropriate performance information can be obtained from Performance Information Principles, a Better Practice Guide November 1996 developed jointly by the ANAO and DoFA. Such a regime should include:

- performance indicators which are measurable;
- a balance of measures which allows the assessment of efficiency, effectiveness and quality, particularly of client service;
- the use of milestones, targets, standards and benchmarks to provide a basis for comparison and to underpin continuous improvement;
- ongoing monitoring of programs; and
- providing public accountability by reporting on both the successes and shortcomings of a program.

3.3 For the purposes of this part of the assessment the ANAO used the DIS business plan for 1996-97. Performance indicators were established by DIS for the first time in this plan. It should be noted, however, that the functional statements also contained performance indicators. Many of the performance indicators included in the functional statements were either the same as, or similar to, those contained in the business plans; and therefore separate comments have not been provided here or the indicators included in

the statements. The marketing plan, discussed in Chapter 4 did not contain any performance indicators.

Measurable performance indicators

3.4 In assessing the performance indicators included in the 1996-97 business plan the ANAO used the same example shown at Figure 4 above. Part of this Figure has been reproduced below to make it easier to illustrate some areas where DIS' performance information needs to be improved.

Figure 5
Strategies and performance indicators

A,B	Increase by four times the number of tenders submitted during 1996-97 while maintaining a high success rate (50%) target
C	Undertake regular quarterly contact with identified clients, files to be notated
D	Develop marketing strategies, driving the allocation of funds to key priorities (research completed by December)
E	Identify five counterpart ministries by December with potential to fund consultancies in their own right (proposals by May)
F	Implement computer based project tracking mechanisms by October with 95% of leads followed up within one month
G	Produce new DIS pamphlet by December

3.5 As already discussed above, DIS' performance information could be improved by separately specifying strategies and related performance indicators. As well, not all strategies (listed as both objectives and strategies/performance indicators) included relevant performance indicators. Examples of specific areas where there can be improvement are detailed below with the letters for each point corresponding to that indicated in the above Figure:

A and B This indicator appears to assume unrestricted growth as there is no indication of the base level from which an increase of four times is to occur (unless this target is to be changed each year). As well, the basis for choosing 'four times' would need to have been justified in the light of the level of business needed to meet the objective. The

50 per cent target is stated in the Functional Statement as 60 per cent;

- C There is no performance indicator to assess the effectiveness of this strategy in achieving the objectives. A performance indicator for this strategy could be the number of contacts made. There would also need to be reference to the quality of that contact;
- D and E These appear to be strategies but do not have indicators to assess their effectiveness;
- F This point covers a strategy, that is: implement computer based tracking system, and an indicator which is expressed as a target. While this provides a strategy and associated performance indicator, it would be improved if performance indicators were specified separately both in this example and in the rest of the plan. This would enable DIS to determine if all strategies have appropriate indicators to ensure that the strategies are effectively achieving the objectives.
- G This appears to be strategy which relates to the higher level objective 'improving chances for ourselves and our partners to win international work'. However, this could be better framed if the strategy read 'by keeping DIS information and publicity material relevant and up-to-date' (strategy). Furthermore, performance indicators could be more easily identified. Some possible examples of performance indicators are set out below to illustrate this point. These are:
- DIS pamphlet produced annually;
 - increased distribution from X to Y; and
 - gauge, through client feedback, the usefulness of material distributed.

3.6 The suggested measures of the type indicated above, which cover both outputs and outcomes, would allow a better understanding of achievements in this case. A good test of such measures is the use of monitoring/review processes which will indicate quickly to those involved their limitations and possible improvements that should be made.

A balance of measures

3.7 A balanced set of performance indicators is important because it allows a credible assessment of the interactions and inter-relationships between factors which influence outcomes. As well, if only one aspect of performance is measured, it is likely that this is what managers will (generally) concentrate on. As a result overall performance could deteriorate.¹¹

3.8 The ANAO found that DIS' performance information did not provide a suitable balance of measures. That is, the existing performance information did not always cover reasonable measures of inputs, processes, outputs and outcomes including quality client service. While the following figures include a range of performance measures there are gaps that minimise their usefulness to managers. For example, in figure 6 there is no measure of efficiency.

Figure 6
Possible performance indicators

Objective: How can we improve the chances of ourselves and our partners to win international work?			
Strategy	PI - Type	Current PIs	Possible PIs
Significantly increase the number of tenders submitted while maintaining appropriate quality control and high success rate	Input		Average cost of tender preparation not to exceed \$x, on time spent on preparation should not exceed y hours.
	Process	Bids submitted on time	Bids submitted on time
	Output	Increase by four times the number of tenders submitted during 1996-97	Increase by four times from the 1995-96 level the number of tenders submitted during 1996-97
	Outcome	Maintain a success rate of 50%	Maintain a success rate of 50%

3.9 In the following example, there is no measure of outcome and therefore no measure of effectiveness. Also, the absence of an input measure precludes an assessment of efficiency (for example, cost per marketing contact).

¹¹ Further information on establishing performance information can be found in 'Performance Information Principles', A Better Practice Guide, November 1996, produced jointly by ANAO and DoFA.

Figure 7

Possible performance indicators

Objective: How can we improve the chances of ourselves and our partners to win international work?			
Strategy	PI - Type	Current PIs	Possible PIs
Identify and target market segments for the purpose of increasing business levels with the IFIs	Input		Marketing expenditure attributable to IFIs of \$X
	Process	Develop marketing strategies driving the allocation of funds to key priorities	Develop marketing strategies driving the allocation of funds to key priorities
	Output	Undertake quarterly contact	Marketing contact by IFI (in accordance with priorities)
	Outcome		Business with IFIs increased to X% of total

The use of milestones, targets, standards benchmarking

3.10 The business plan included some examples of the development of targets, that is, 'implement computer based project tracking mechanisms by October (milestone) with 95 per cent of leads (target) followed up within one month'. Establishing milestones is clearly important because their achievement indicates that the business is following the appropriate strategies and moving towards the achievement of its objectives.

3.11 The action plans included in the business plan did not make widespread use of standards or benchmarking but did identify some targets.

3.12 The use of targets is important for DIS because they will assist DIS identify when it has been successful in meeting its objective. In setting targets DIS needs to determine the level of activity required to meet its objective, for example in relation to the number of consultancies, the volume of revenue and in-country presence.

Monitoring and reporting

Ongoing monitoring

3.13 The monitoring of individual projects, which is discussed in more detail in Chapter 5, is generally undertaken to a satisfactory standard.

3.14 The ANAO found that ongoing monitoring of the health of the business was mostly undertaken in an informal way with discussions on activities being held at branch meetings but generally not formally recorded. Given that performance indicators were established for the first time in 1996-97, monitoring performance (particularly undertaking comparative assessments over time) will have been difficult. The continued collection of performance information over time and its use to monitor business performance will assist DIS to make better business decisions.

3.15 DIS has produced internal reports to the DEETYA Executive. These reports cover the activities and tasks of DIS to date, that is number of projects being conducted. However, there is no performance information included in these reports to allow assessment of the achievement of the objective.

Reporting

3.16 Reporting is important to ensure that public accountability requirements are met and operations are transparent. The ANAO examined internal and external reports to determine if they provided an appropriate assessment of DIS' achievements.

Performance report

3.17 DIS produced a performance report for 1995-96. This report did not provide an assessment of performance against performance indicators; but, rather, listed the projects currently being conducted and those which had been tendered for, including whether DIS had been successful or not in gaining the work. The ANAO notes that the 1995-96 business plan did not contain performance indicators against which reporting could take place.

Annual report and portfolio budget statement

3.18 The ANAO acknowledges that in a large department it is difficult to include detailed information in the annual report regarding a relatively small program area. In the 1996-97 annual report there was no performance information included for DIS, information about which was included under the heading International Education and Training Promotion (Sub-program 6.3 component 1). The number of projects in which DIS was involved and the number of tenders and bids submitted (and their success) were provided.

Mention was also made of the number of study tours conducted. The report indicates that 'DIS invoiced \$3m from its operations in 1996-97 ...'. To provide a more balanced view of DIS operations, costs of operations should also have been reported. The issue of costing is discussed further in Chapter 6.

3.19 As well, the annual report is the main vehicle for reporting on outcomes. However, this would have been difficult because performance indicators which would provide a measure of outcomes were first established in 1996-97.

3.20 The portfolio budget statement discusses strategies for DEETYA's international education and training activities but does not indicate performance to be reported for the current year.

Conclusion

3.21 DIS has established the basis of a performance management regime. However, because the business purpose has not been clarified and objectives, strategies and performance indicators are not identified separately in most instances, it is difficult to fully assess the overall effectiveness of the regime. In particular, the performance information could be improved by:

- setting performance indicators for each objective/strategy and ensuring indicators can be measured cost effectively;
- ensuring there is a balance of indicators, that is, a range of indicators which measure inputs, outputs, outcomes and client service; and
- establishing appropriate milestones, targets, standards and benchmarks consistently throughout the business plan.

3.22 Performance indicators were established for the first time in 1996-97. The ANAO acknowledges that developing indicators is not easy and they are likely to require improvement over time. They are nevertheless critical for effective monitoring, decision-making and public accountability.

Recommendation No.6

3.23 The ANAO recommends that, in order to obtain sound information about actual performance to guide future operations, DIS improves its performance management regime by:

- setting performance indicators for each objective/strategy and ensuring indicators can be measured cost effectively;

- ensuring there is a balance of indicators, that is, a range of suitable indicators which allow an assessment of inputs, outputs and outcomes and client service; and
- establishing appropriate milestones, targets, standards and benchmarks consistently throughout the business plan to allow effective monitoring and review.

DEETYA response

3.24 As acknowledged by the DEETYA and ANAO reports, performance management is a complex process which DIS has attempted to refine over its years of operation. DIS has reviewed its performance indicators and appropriate milestones, targets, standards and benchmarks and is incorporating them into its Business Plan.

1

1

4. Marketing DIS' Services

This chapter discusses the DIS marketing plan, which indicates a sound understanding of customers and the environment. The plan did not include performance indicators or targets and the ANAO has made one recommendation aimed at addressing this.

Introduction

4.1 The identification of customers and knowledge of the environment in which a business is operating are important factors in determining the nature of the services to be provided, the way they will be provided and to whom they will be provided. There are differences in the approach used by a private business and one which operates within the APS. In particular, marketing strategies used within the APS, while being based on market research, may also be affected by the interaction between analytical assessment and government policy objectives. It is likely that, in order to ensure consistency with overall government policy, services or levels of service provided will not only be guided by market research. However, a business operating within the APS should have a marketing plan or strategy which demonstrates an understanding of the environment in which the business is operating and the customers, current and future.

DIS' services

4.2 The main services offered by DIS cover:

- project related consultancies;
- study tours of Australia;
- specialist advisory secondments;
- feasibility studies, which promote Australian education and training expertise as an part of broader joint venture initiatives with industry for overseas markets; and
- operating an international recruitment service, aimed at increasing the number of Australians employed in international organisations and increasing Australia's share of international procurement by multinational agencies.

4.3 The operation of the international recruitment service and some study tours are undertaken as non-commercial operations on behalf of DEETYA as a whole.

1.1

4.4 The project related consultancies represent the largest commercial activity undertaken by DIS. From early on in its development, the majority of these consultancies were undertaken by DIS for the major International Financial Institutions¹² in labour market areas such as labour market analysis and planning and employment service delivery and program management.

4.5 Increasingly, there has been a shift in the demand by the IFIs from the labour market areas to education and training and an increase in demand from central government ministries, in various countries, for education and training expertise.

Key criteria

4.6 In examining the core service processes the ANAO sought to determine whether DIS had developed a marketing plan which demonstrated an understanding of its customers and the environment. As well, we examined whether an appropriate range of promotion strategies had been developed by DIS to action its marketing plan.

Development of a marketing plan

4.7 The early development of DIS was opportunistic in that the department responded to a specific request for the provision of services in relation to labour market adjustment. The early operations were not therefore informed by a strategic assessment of the market.

4.8 However, from December 1993 when the first business Plan was developed, reference was made to a 'market review' and 'promotion strategy'. Similar references, which indicate a level of assessment of the market, customers and environment were present in subsequent business plans.

4.9 In 1996-97 DIS developed both a business plan and a marketing plan. The business plan makes reference to sales and marketing objectives with related strategies, performance indicators and activities. It also contains a

¹² International Financial Institutions include institutions such as the Asian Development Bank, and the World Bank.

situation analysis. This situation analysis discusses possible market segments and opportunities within DIS' area of expertise.

4.10 In developing the marketing plan DIS drew on the knowledge and experience gained from past projects and general information available to those operating in this field, for example, market intelligence from IFIs.

4.11 The plan is comprehensive in that it covers:

- a situation analysis;
- a marketing strategy; and
- the role of information technology.

4.12 It demonstrates an understanding of customers, that is, the need to diversify from and/or move away from a focus on Eastern Europe to the Asia-Pacific Region. As well, an understanding of the environment is demonstrated in that demand has shifted away from services in relation to the labour market to a greater emphasis on the areas of education and training. The plan indicates a number of strategies to improve DIS' marketing and also nominates the responsible officer to take relevant action. Strategies are discussed in more detail below.

4.13 More recently DIS, as part of the review being conducted at the same time as the audit fieldwork undertook a survey¹³ of clients to gauge their satisfaction levels with services provided by DIS. The majority of clients who had responded to the survey rated the overall performance as good.

Promotion strategies

4.14 Both the business and the marketing plan for 1996-97 contain marketing strategies. However, as mentioned previously (Chapter 2) there is confusion between objectives, strategies and performance indicators in the business plan which need to be clarified so that the plan is more useful. Such clarification will mean that strategies are better articulated.

4.15 While the marketing plan contains strategies which are linked to the various objectives it does not contain performance indicators and targets to measure the success of these marketing strategies. It will therefore be difficult for DIS to assess whether it is meeting its objectives in this area and whether its marketing strategies are appropriate and which are the most successful.

¹³ This survey was part of the DEETYA review of policy and strategic business issues discussed earlier in paragraph 1.13.

The ANAO acknowledges that assessing the effectiveness of marketing strategies may need to be done by undertaking a survey and that this can be time consuming and costly. However, it is important to monitor performance and to use information gained to improve performance over time and to guide future marketing activity.

4.17 Some examples of possible performance indicators linked to existing strategies are set out in the table below:

Figure 8
Possible performance indicators

Strategy	Possible performance indicators milestones
Prepare capability statement highlighting DEETYA expertise...	Capability statement completed by xxx date Updated regularly, that is, yearly Distribution to Y number of existing/possible clients Obtain information from clients on influence of capability statement on their decision
Regular communication and personal contact with Asian Development Bank	Number of contacts by phone, letter, fax, recorded Number of visits, documented Feedback on quality of contact Number of opportunities for new projects which arise as a result of contact

Conclusion

4.18 The marketing plan demonstrates an appropriate understanding of customers and the environment. However, it could be improved by the development and inclusion of performance indicators and targets which would assist DIS to determine how successful, or otherwise, the promotion strategies turn out to be.

Recommendation No.7

4.19 The ANAO recommends that DIS establishes and includes in its marketing plan those performance measures and targets which would allow it to monitor and determine the success of its promotion strategies.

DEETYA response

4.20 DIS has a revised marketing plan reflecting its new operational framework which has been incorporated in the business development component of its Business Plan.

1.

5. Managing Service Provision

This chapter discusses the development and monitoring of service delivery as well as the mechanisms DIS has in place to assure the quality of its services. DIS has comprehensive services in place in this area which will have contributed to its success in winning tenders and to overall client satisfaction.

Introduction

5.1 The management of service provision is important for both a privately operated business and one operating within the APS. It is a fundamental determinant of client satisfaction and profitability. The type of services provided and the level of service to be given by the public sector may be influenced by:

- decisions by government on the selection of products or services and community service obligations which at times may not fully align with the demands of the market place; and
- the need for products or services which align with government priorities which may lead to a compromise between analytical assessment and the limits set by fiscal policy.

5.2 Another important factor in assuring profitability and client satisfaction is to have a good understanding of costs and therefore a well developed pricing strategy. This is discussed in Chapter 6.

Key criteria`

5.3 The ANAO examined the management of service provision, a key core service process in the model, to assess whether DIS had processes in place for:

- developing the proposed services for inclusion in the tender, including drawing together an appropriate team;
- monitoring service provision to ensure satisfactory completion of tasks; and
- assuring quality, particularly in relation to obtaining customer feedback and reporting on quality of service provision.

Developing proposed services and monitoring delivery

Proposed services

5.4 DIS operates within the services export industry, but also within the APS framework. Its main commercial business activity involves the preparation and lodgement of tenders of the provision of services in its area of expertise. The preparation of tenders (based on appropriate costs) which are successful in obtaining work would clearly provide a good indication of DIS' level of success in achieving its business purpose.

5.5 DIS has been previously invited to undertake work (without tender) or to bid for work in a field restricted to a limited number of bidders. This has represented about half of the work undertaken to date. However, DIS' clients are increasingly seeking bids on the basis of competitive tender. An analysis of tenders made by DIS for 1994-95 and 1995-96 showed a success rate of 60 per cent.

5.6 DIS has satisfactory processes in place to manage the development of tenders for possible projects. On receipt of a request for tender a bid team is formed. This team assesses the scope of the project and whether and how DIS can meet the tender requirements. The team includes a DIS staff member who is nominated as the project manager. The project manager's involvement from an early stage allows a strong knowledge of the project requirements to be developed within DIS. The responsibilities of the project manager are spelt out in a 'Functional Statement on Contract and Project Management' and include:

- developing and establishing the contract;
- mobilising the implementation team;
- monitoring field delivery;
- contract/budget management; and
- quality review and evaluation.

5.7 DIS has a number of mechanisms in place to obtain the relevant expertise required for a particular project. These include:

- approaching other relevant divisions of DEETYA to seek the services of available individuals who have the skills appropriate to the project and have expressed an interest in international work;
- maintaining a register of curriculum vitae for external consultants and DEETYA staff; and
- if necessary, contacting consulting firms which DIS knows have relevant expertise to be part of a team suitable for the scope of the project.

5.8 Using these approaches assists DIS to build teams with relevant skills but also provides a degree of flexibility in employment practices. That is, DIS does not need to have a large contingent of staff permanently within its business to provide the required skills for a range of projects but can instead draw quickly on identified personnel within other areas of the department and from external sources.

5.9 Where contractors are used, DIS establishes agreements with them as sub-contractors to the project. These agreements cover the obligations of the sub-contractor and DIS as well as the relevant financial conditions.

5.10 Once a bid has been successful DIS has arrangements in place to ensure that the conduct of the actual project is well managed. All projects undertaken by DIS are based on standard IFI contracts which set out clearly the responsibilities of all parties as well as the financial terms and conditions relating to the project.

5.11 Briefings are provided to team members prior to their departure to the country in which the project is being undertaken. These briefings cover the scope of the project, expected outcomes, travel and accommodation arrangements and risks associated with the particular project and/or country.

5.12 Team members are provided with a 'Project-Team Briefing Package' which covers such issues as dealing with travel, allowances, health and taxation matters relevant to the destination country. A 'Team Leader's Handbook' covers additional issues, particularly relating to financial management. To assist with the management of projects separate files are established for the contract, finance, travel and project delivery. The project delivery file contains correspondence between the project manager, the client and the team leader and includes progress reports against milestones and targets. The files reviewed during the audit contained evidence that project management is undertaken in a comprehensive manner.

Monitoring delivery of services

5.13 Monitoring of overseas projects is undertaken on the basis of a set of 'deliverables' that are set out in the tender and the contract. These 'deliverables' may take the form of stages in the project, or, in the case of short term projects, may simply be the completion of the project. DIS provide reports to the client on achievements against those 'deliverables' identified in the tender/contract, and on the basis of those reports payment is made. In progressing to the completion of these 'deliverables', monitoring of the projects is done on an informal basis to the project manager via international E-mail.

Conclusion

5.14 DIS has comprehensive processes in place for developing proposed services and monitoring their delivery. These processes focus on establishing a consulting solution based on the needs of the client and building on the available skills with DEETYA, supplemented as necessary with external resources. Each contract clearly identifies the respective responsibilities of the client and sub-contractor. As well, DIS has thorough briefing arrangements for the project team and by the use of comprehensive project management. All these factors have contributed to the level of success DIS has achieved in winning tenders and the overall client satisfaction with the services delivered.

Assuring quality

Preparation of tenders

5.15 As discussed above, DIS draws together a team with appropriate experience to develop the bid for specific projects. In late 1996 DIS reviewed the processes for preparation of tenders to identify areas for improvement. A number of areas were identified where the tender documentation required additional information. The findings of this informal review were circulated to staff with responsibilities in tender preparation and the matter was discussed at regular section heads meetings.

Client feedback

5.16 DIS understands that identifying the reasons behind the loss of tenders is important to the success of future bids, and follow-ups on all tender losses. However, documented procedures for collection, monitoring and reporting on all these outcomes have not yet been established.

5.17 DIS seeks feedback on its performance from clients and project partners on an ongoing basis (including a questionnaire for study tour participants which seeks an assessment of the program of appointments and presentations; and accommodation and transport arrangements). There are, however, no formal procedures for the ongoing assessment of the quality of its consulting services to ensure that comprehensive feedback is received for all projects and that it is linked to future business planning and project management processes.

5.18 In addressing this issue, DIS is developing a customer satisfaction form for introduction during 1997-98 to elicit direct comment by clients on the services provided by DIS. The ANAO also notes that this form could be adapted for completion by DIS' partners, to allow their feedback on the quality

of DIS' service delivery. This would provide an additional perspective that may be useful in ongoing monitoring and assessment of customer services.

Reporting on quality

5.19 DIS' procedures for reporting on quality focus on the communication of successes internally within the department and in promotional material. These procedures therefore could be enhanced to cover regular assessments of all projects and tenders against key performance indicators such as, in relation to projects, the suitability of client deliverables and compliance with deadlines and budget.

5.20 The absence of formal procedures for assessing and reporting on quality does not imply that DIS is achieving poor results in its work. The ANAO acknowledges that DIS has achieved a high level of success in terms of winning tenders to undertake consulting work. However, more comprehensive information may lead to a greater understanding of the factors leading to or influencing success and therefore increase the likelihood that this success will be repeated.

5.21 DIS has recently begun to investigate its level of success. The outcomes of a recent client survey show that DIS has established a good reputation with its clients; and that there is scope for further work with, at least, the seven clients who responded to the survey. A number of very positive comments about the professionalism and competency of the personnel involved in the projects and study tours were given.

5.22 All responding clients rated the overall performance of DIS as good or excellent and all clients except one felt that DIS had fulfilled its contractual obligations to their satisfaction. The one exception felt that DIS had fulfilled most of its contractual obligations. All clients would employ DIS in the future, except one who answered 'maybe' but without explanation.

5.23 Other information collected by the survey indicated that:

- government contact was the main form of awareness of the services offered by DIS; and
- the aspect of international consultancy service that was on average considered most important was its cost. Involvement with local partners ranked second in terms of average importance: all other criteria - external funding for the project, reputation of the consultants, reputation of the consultant's country, credibility of the government and experience in the region - rated equally as somewhat important for all respondents.

Conclusion

5.24 DIS has a good reputation with its clients which forms an important foundation for DIS to obtain future work. The development of a process for measuring customer satisfaction for introduction in 1997-98 provides a basis for the ongoing formal assessment of consulting service quality. However, DIS' processes for measuring quality would be further enhanced by:

- documenting processes for collecting, monitoring and reporting on all tender outcomes, and the reasons behind them;
- obtaining feedback from DIS' project partners as well as in relation to clients' satisfaction; and
- regular reporting of all projects and tenders against key performance indicators such as whether the deliverables have met clients' needs, requirements of the contract have been complied with and timeframes and budgets have been met.

5.25 The ANAO notes that, as part of the review being undertaken by DIS at the time of the audit, DIS was identifying ways of improving the quality of its tenders and service delivery.

1.

6. Accounting and financial management

This chapter discusses three key areas of DIS' accounting and financial management: costing; managing budgets and resource allocations; and financial risk. The ANAO found that there was scope for improvement in relation to the costing methodology and the management of financial risk and has made three recommendations to address these concerns.

Introduction

6.1 This chapter examines accounting and financial management issues as well as the development of DIS' costing methodology which underpins its pricing decisions. In turn, these decisions have an impact on both profitability and client satisfaction.

6.2 In relation to accounting and financial management many of the differences between the public and private sectors are currently being reduced under reforms to the APS. There have been limitations on financial management arising from an almost total reliance on annual cash accounting of inputs. The APS is now moving away from this to accrual-based output/outcome budgeting and financial management. However, it is recognised that limits on annual appropriations to departments and the need for transparent stewardship of public monies will continue to influence accountability in the APS.

Key criteria

6.3 Given the nature of DIS' business and its activities, the three areas discussed in this chapter were considered to be those which posed the major risks to its success among those included in the support processes in the model. These three issues were the DIS costing methodology, accounting, and financial management systems. The ANAO examined whether these were appropriate given its commercial objectives. The audit assessed:

- whether DIS' proposed services were costed to reflect the full costs of production;

- the management of budgets and resource allocations including the establishment of systems for tracking actual costs and revenues, and analysis of budgeted and actual performance; and
- the management of financial risk in terms of procedures for identifying, measuring and monitoring any significant financial risks or exposures, including debt management.

Costing proposed services

6.4 An important element in the development of services is to be able to understand and appropriately cost the proposed services and in turn establish sound pricing decisions.

6.5 While DIS is able to estimate the potential costs associated with salaries, consultants, travel and allowances for specific projects, it operates within the constraints of a departmental cash accounting system and has no system or information bases to determine the full cost of its operations (which include, for example, rent, salary on-costs and departmental support services). As a starting point in estimating these costs it has therefore relied on the formula provided by the Department of Finance and Administration (DoFA).¹⁴ The DoFA formula estimates full costs by applying a multiplier to direct salary costs. This multiplier covers such things as superannuation, compensation and legal expenses and accommodation expenses which are additional to the cost of direct salaries.

6.6 However, DIS did not apply this multiplier to all its direct salary costs. In particular, DIS did not include specific allowance in its tenders to cover either the direct salaries or on-costs of its management and administration staff. DIS advised that it took this course of action because it had assumed that the DoFA formula adequately covered these costs as it produced a higher full cost estimate than another formula which had been accepted by DEETYA and DoFA for costing new policy proposals. That is, the difference between the two estimates was taken to cover the costs of management and administration staff. Therefore, DIS only applied this multiplier to those staff directly undertaking consulting work. The DoFA multiplier should have been applied to all direct salaries costs to give an estimate of full costs.

6.7 DIS advised that some specific allowance for these costs is now made in tender pricing calculations but the general assumption that the DoFA formula would provide coverage for these costs still pertains in DIS' pricing approach.

¹⁴ 'Guidelines for Costing of Government Activities', DoFA 1991, Canberra.

6.8 As well as not applying the multiplier to all the relevant direct salary costs, there was no indication that DIS had sought to determine whether the general DoFA multiplier or the multiplier for costing new policy proposals was the appropriate multiplier given DIS' particular circumstances.

6.9 Deficiencies in the costing approach may have led to inappropriate pricing decisions and/or the inability to adjust the cost structure in accordance with commercial requirements. In DIS' case a cash deficit has accumulated since the commencement of commercial operations. Information in relation to DIS' financial position was set out in Table 1 but is repeated here for ease of discussion.

Table 1

DIS' financial performance 1993-94 to 1996-97

	1993-94	1994-95	1995-96	1996-97
Receipts	921 000	2 158 000	3 973 000	2 597 813
Payments	1 224 000	2 877 000	4 425 000	2 508 119
(Deficit)/Surplus	(303 000)	(719 000)	(452 000)	89 694
Cumulative (Deficit)	(303 000)	(1 022 000)	(1 474 000)	(1 384 306)

Note: The above table includes only direct cash receipts and payments. DEETYA was not operating on an accrual based accounting system during this period.

6.10 As can be seen from the above table, from 1993-94 to 1995-96 the business recorded a cumulative cash deficit of \$1.5m. In 1996-97 the business recorded a cash surplus of approximately \$90 000. After taking this surplus into account the accumulated cash deficit recorded for the business is \$1.4m.

6.11 Given that DIS does not know whether the costing methodology it is currently using takes account of the full costs of production, it could be that the accumulated cash losses are higher than \$1.4m. For example, DIS advised that the deficit recorded for 1995-96 could be understated by \$967 000.

6.12 DIS indicated that the accumulation of a cash deficit would reflect other factors such as DIS' non-commercial activities. However, the ANAO considers that if DIS wishes to define these activities as contributing to its cash surplus/deficit then the activities should be fully costed and then taken into account in determining the surplus/deficit.

6.13 The ANAO also notes that it is currently not possible to calculate the true financial position based on accrued costs because DIS has not been

operating under an accrual system. However, the ANAO understands that in 1997-98 DIS is to take part in the department's pilot scheme to establish accrual accounting and full cost attribution.

Conclusion

6.14 Due to shortcomings in the costing methodology used, DIS has not been able to identify the full costs of production reliably.

6.15 The DoFA formula, which is based on whole of government averages, together with adjustments made by DIS may, or may not, bear a relationship to DIS' actual cost structure. However, DIS advised that 'the use of the DoFA formula was always seen as a temporary measure'. DIS further advised that it 'has been waiting for revised guidelines to be released by DoFA and the moves within the department to develop full cost attribution'. The ANAO considers that DIS should have sought to determine whether the costing methodology was appropriate to its purpose and provided an adequate reflection of actual full costs.

6.16 Based on the current methodology, DIS has recorded an accumulated cash deficit. This means that the business is being subsidised by other departmental operations.

6.17 A sound understanding of costs is fundamental to business success whatever the level of commerciality. As well, a more precise method of quantifying costs and incorporating these in fee-setting considerations is considered to be essential.

Recommendation No.8

6.18 The ANAO recommends that DIS reviews and improves its costing methodology in a way which ensures that the full costs of production are properly determined and taken into account and therefore provide a sound basis for decisions on appropriate pricing strategies.

DEETYA response

6.19 The costing methodologies utilised by DIS were based on the then existing DoF 'Guidelines for Costing of Government Activities.'

6.20 Accurate costing attribution is needed for further refinement and improvement to costing methodologies. As DEETYA moves to accrual-based accounting it will become possible to accurately attribute salaries and oncosts in a way not possible under the previous cash-based system. This should provide a sound basis for pricing strategies which relate to full cost recovery.

Managing budgets and resource allocations

6.21 A sound understanding of the full costs of production is particularly important in the management of budgets, financial reporting and resource allocations. DIS develops an annual recurrent expenditure budget as a component of the Department's budget. Its current expenditure includes:

- DIS management and administration salaries;
- project related salaries (which include the salaries of DEETYA staff);
- DIS administration expenses; and
- project administration expenses (which include the costs of external consultants).

6.22 The budget is reviewed after six months and DIS monitors the main expenditure categories against actual cash expenditure recorded on the department's financial and payroll systems, producing monthly financial summaries. DIS has recently developed financial systems to enable it to monitor actual project expenditure against budgeted project expenditure. The effectiveness of the monitoring of financial performance is affected by a number of limitations in the departmental and DIS financial systems. These include the following:

- the departmental systems can currently only provide financial information on a cash basis;
- DIS has not developed internal accrual accounting financial systems;
- the Departmental financial systems do not incorporate, and cannot interface with, financial project management systems maintained by DIS and cannot handle foreign currency transactions; and
- neither the department nor DIS has developed a cost attribution system that would enable the assessment of the full cost of DIS' operations or of individual projects.

6.23 DIS has advised that it will be piloting accrual accounting and enhanced processes for cost allocation in 1997-98 including an examination of cost attribution principles and how they would be applied. In developing its accounting arrangements, DEETYA has established that DIS' financial reporting systems must provide sufficient information to ensure that the department could be satisfied that DIS costs were being recovered and that branch performance indicators were established appropriately and were being achieved.

Conclusion

6.24 The ANAO considers that ongoing effective commercial operation, or effective management of a full cost recovery regime, is not feasible without systems for accrual accounting and full costing to reveal properly the impact of all financial transactions on a particular accounting period. DIS has recognised the need to further develop its capacity in these areas.

6.25 The ANAO notes that DIS explored alternative systems but they were not taken up because DIS was aware that DEETYA was moving towards an accrual system. However, given DIS' commercial objectives and its relatively small size it would have been appropriate to consider methods of obtaining accrual information on a periodic basis, for example:

- modifying cash information to take account of the full costs and revenues; or
- using one of the readily available packages for establishing an accrual system on a personal computer. While the ANAO recognises that this would probably have necessitated maintaining a separate system from the departmental financial system this would have assisted DIS in better estimating its costs and operating in a more effective commercial manner.

Managing financial risk

6.26 The ANAO examined two areas of financial risk which are particularly important to DIS' commercial operation. These are foreign currency exposure and debt management, which are discussed under separate headings below.

Foreign currency exposure

6.27 The major part of DIS' activities is the conduct of international projects. Because of IFIs and foreign ministry requirements, the financial transactions contained in the contracts entered into by DIS are denominated in United States dollars (\$US). The ANAO acknowledges that the Commonwealth has self-insurance arrangements¹⁵, DIS is not therefore required to insure (or 'hedge') against the foreign currency losses that may arise due to currency fluctuations. However, because of the nature of DIS' business where all transactions are denominated in \$US, the risk exposure in terms of foreign currency losses could be high. This issue was drawn to DIS' attention by the department's internal audit branch which undertook a review in 1994-95. The report noted that

¹⁵ The Commonwealth has a scale of operations which enables it to carry its own insurance risk.

'DIS was unaware of the need to have in place hedging tools or risk management strategies to remove forex (foreign exchange) risks from transactions...'

6.28 During the 1995-96 financial year DIS incurred foreign currency losses of \$96 000 on currency fluctuations between the time invoices were issued and the subsequent receipt of funds. This loss represents approximately three per cent (\$96 000) of the invoiced value of the services provided in that year. While initially three per cent may not appear significant it could represent a substantial proportion of the business' profit margin. For example, if the profit margin is fifteen per cent then a three per cent loss on foreign currency exchange would represent 20 per cent of the profit margin. Whether or not hedging was necessary under the above-mentioned Commonwealth self-insurance arrangements, the ANAO considers that DIS should have reviewed the risks it was facing in this area and the management of those risks including the costs/benefits of implementing hedging arrangements.

6.29 The ANAO understands that DIS was investigating the use of hedging arrangements during the course of the audit fieldwork. However, this was some two years after the problem was first drawn to its attention by internal audit and four years since DIS began operations.

Debt management

6.30 Apart from the implications that bad debts have for profit, debts also generally become more difficult and costly to collect as they age. The timely payment for work undertaken will reduce to the need to devote resources for follow-up action and recovery.

6.31 DIS has a system in place to monitor the identification and collection of debts on a monthly basis. DIS has also established a performance indicator which states that aged debtors should not exceed ten per cent of total debt at any point in time. However, DIS has not defined what was meant by 'aged debtors'. The following table shows debts by number of days outstanding and the total value at each level as at 30 June 1997.

Table 2
Debts by age

Age of debt	\$
Current	104 801
0 - 30 days	97 745
31 - 60 days	25 100
61 - 90 days	—
91 - 120 days	81 345
Over 120 days	156 368
Total	465 359

6.32 The ANAO has defined ‘aged debtors’ in this case to be those debts outstanding for more than 60 days and notes that debtors over 60 days amount to some 51 per cent of the total debt which is considerably in excess of the DIS performance indicator of ten per cent. The status of its debts (which include one client which owes 52 per cent of the total debt) would indicate the desirability of DIS establishing policies on debt collection specific to its operations and additional to departmental policies, including whether work should continue to be performed for slow payers. DIS advised that its policies in relation to debt management were in line with those for the department as whole. However, DIS needs to consider whether such policies are appropriate for its operation.

Conclusion

6.33 DIS has not had procedures in place to manage financial risk in terms foreign currency exposure. The ANAO notes that DIS is currently exploring the use of hedging arrangements to reduce its foreign currency exposures. The ANAO considers that this should have been undertaken earlier in the life of the business.

6.34 DIS has a limited business specific statement of policy in relation to debt recovery. This involves setting a performance indicator that ‘aged’ debt would not exceed ten per cent of total debt at any point in time but DIS has not met this target. The ANAO considers that DIS should define what they mean by an ‘aged debtor’ and review this target to determine if it is appropriate. DIS should also review the factors contributing to the non-achievement of the

target. DIS has relied on general departmental policy (which had been developed for domestic operations) in relation to debt management.

6.35 This is another area which has been affected by the lack of a clearly defined and agreed business purpose. A clear business purpose is essential in order to tailor the debt management policy to suit the approved business objective.

Recommendation No.9

6.36 The ANAO recommends that DIS establishes a debt management policy appropriate to its operations in order to maximise the recovery of costs in a way which meet its business objective.

DEETYA response

6.37 As noted by the ANAO report, the Commonwealth has self-insurance arrangements against foreign currency losses, and DIS is therefore not technically required to hedge against such losses. It is often possible to minimise currency fluctuation losses through contractual arrangements. The clearer business choice and cost recovery parameters in the new DIS Operational Framework will assist in further minimisation of such risks.

6.38 DIS has also reduced its 'aged debtors' through systematic follow-up procedures utilised by all project managers.

Canberra ACT
2 March 1998

P. J. Barrett
Auditor-General

Part Three

Appendices

Appendix 1

The Normative model

In preparing to undertake the assessment of DIS, a normative model of the key processes of commercial operations was developed. This model reflects the management and operational requirements which would be expected to exist in a publicly listed company. The model has been structured to include such things as the scale of operations and the level of scrutiny, accountability, and reporting in a way that would make a comparison with similar activities in the APS meaningful. The second step in preparing for an assessment of DIS was to consider the differences, if any, which exist between the operations of a purely commercial business and one which is operating within the APS.

Developing the model

The model was developed by the PSI Consulting Group which was contracted by the ANAO to undertake this work on the basis that their company had relevant background knowledge, skills and expertise in the field. The PSI Consulting Group also undertook extensive secondary research and consulted widely with senior public servants and academics to establish the components of the model. These components were then refined by taking a view of business from a number of dimensions to ensure completeness in documenting the model. These dimensions included applicable legislation (corporations law, trade practices/consumer affairs, environment, taxation, industrial relations, patents and so on); the roles of individuals or groups of individuals in the business (the Board, Directors, Chief Executive Officer, Company Secretary, Chief Finance Officer, Chief Information Officer and so on); and stakeholder/interfacing organisations (customers, suppliers, industry associations, Australian Stock Exchange, lenders, ratings agencies, equities analysts and so on).

Structure of the model

The model addresses three levels of organisation and process, with each view providing a greater level of detail. These views are set out in Figures 1 to 5 below.

The Level 1 view of the Model starts by dividing the processes of the organisation between the three basic components:

- corporate management processes (which equally could be referred to as corporate governance processes)
- core processes, and
- support processes.

The Model then defines the sub-processes for each of the three basic components (the Level 2 view). Then, the Level 3 view of the Model goes on to define the sub-processes in terms of what they would be expected to encompass together with an assessment of the differences that might be expected in the delivery of the process in the public versus the private sectors.

In order to provide a model which is manageable in terms of size, large amounts of discussion have not been included in this report. The Model does not therefore depict all the nuances that reflect reality in a company's operations. In particular, it should be noted that the component parts of the Model are not linear, they do not simply follow one after the other as might be implied by the following diagrams. The development of financial plans and the acquisition and redeployment of assets, for example, are closely linked in reality. However, these two sub-processes are depicted at some distance from each other in the model (refer to Figures 2 and 4 below).

Normative Model Overview – Level 1

The following diagram shows the Level 1 view of the *Normative Model of Commercial Business Operations*. It divides the total processes of the organisation between corporate management processes, core service processes and support processes.

Figure 1
Corporate Management Processes

Develop Corporate Strategy and Plans	Maintain Corporate and Financial Structure	Manage Performance	Manage External Relationships
--------------------------------------	--	--------------------	-------------------------------

Core Service Processes

Develop and Market Products or Services	Produce Products or Services	Sell Products of Services and Provide Customer Service	Manage Logistics
---	------------------------------	--	------------------

Support Processes

Accounting and Financial Management	Human Resources Management	Information Resources Management	Assets Management	General Services Management
-------------------------------------	----------------------------	----------------------------------	-------------------	-----------------------------

Normative Model Overview – Level 2: Corporate Management Processes

The following diagram shows the Level 2 view of the *Normative Model of Commercial Business Operations* for the Corporate Management Processes. It outlines the sub-processes that constitute each of the main processes. These sub-processes are further defined in the Level 3 view.

Figure 2
Corporate Management Processes

Develop Corporate Strategy and Plans	Maintain Corporate and Financial Structure	Manage Performance	Manage External Relationships
Understand customers and environment	Design the organisation structure	Set financial and operational standards	Communicate with shareholders
Define the business concept and strategy	Develop financial plans and structure	Manage business performance	Manage government relationships
Set organisation goals		Manage improvement and change	Build lender relationships
			Develop public relations/image program

Normative Model Overview – Level 2: Core Service Processes

The following diagram shows the Level 2 view of the *Normative Model of Commercial Business Operations* for the Core Service Processes. It outlines the sub-processes that constitute each of the main processes. These sub-processes are further defined in the Level 3 view.

Figure 3
Core Service Processes

Develop and Market Products or Services	Produce Products or Services	Sell Products or Services and Provide Customer Service	Manage Logistics
Develop concepts and plans	Plan and manage production	Develop and maintain customer relationships	Maintain the supplier relationship
Develop products or services	Design and engineer solution	Sell through various distribution channels	Procure materials and services
Develop market and customer strategy	Produce products or services	Enter and process orders	Warehouse/store materials and product
Develop advertising and promotion strategy	Assure quality	Manage credit, bill and collect	Manage product distribution
		Provide customer interface	
		Provide after sales service	

Normative Model Overview – Level 2: Support Processes

The following diagram shows the Level 2 view of the *Normative Model of Commercial Business Operations* for the Support Processes. It outlines the sub-processes that constitute each of the main processes. These sub-processes are further defined in the Level 3 view.

Figure 4
Support Processes

Accounting and Financial Management	Human Resources Management	Information Resources Management	Assets Management	General Services Management
Manage budgets and resource allocation	Create and manage HR strategy	Plan for information resource management	Acquire and redeploy assets	Perform the legal function
Manage financial resources and risk	Manage deployment of personnel	Develop and rollout systems	Maintain equipment and assets	Manage administrative services
Process financial transactions	Educate, train and develop employees	Manage information storage and retrieval	Plan and manage environment programs	
Report financial performance	Establish reward and recognition systems	Manage facilities and network operations		
	Manage employee relations	Manage information services		
		Facilitate information communication		
		Provide user support		

The level 3 view provides a detailed description of what each sub-process would be expected to encompass and is not included in its entirety in this report. An example of the matters which are covered in the level three view is set out below. This example shows a segment from the Level 2 view: Develop Corporate and Strategy Plans. A level 3 view has been developed for each segment defined in the level 2 view.

These detailed descriptions are available separately from the ANAO or the PSI Consulting Group.

Figure 5
Level 3 - Develop corporate strategy and plans

Understand Customers and Environment
<ul style="list-style-type: none">• assessing customer needs and satisfaction• analysing and understanding the competition: performance, trends, strategy, products and pricing• analysing and understanding the marketplace: size, shares, trends, ease to entry/exit• identifying economic, demographic, social and political trends understanding regulatory issues• assessing technology and other innovations, and• identifying acquisition/merger/joint venture possibilities.

Adjusting the model

The second element of the audit methodology was to adjust the model taking into account the requirements of operating within the APS. In the detailed model each element of each level is classified as to whether the APS is considered to be substantially the same or somewhat different from a commercial operation. These differences are not discussed in detail here but are described in the normative model which is available separately.

Drawing on the detailed examination of the areas of difference in the normative model it is possible to summarise a number of fundamental differences in the principles which underpin the APS compared with commercial operations. Any Australian Government agency operates under the Australian Constitution and is directed by the philosophy of the government of the day. In addition, a key function of government, and therefore of agencies which conduct business on the government's behalf, is responsibility for the appropriate management, including expenditure, of public monies. As well, APS agencies are not working towards the single purpose of the bottom line profit or increasing shareholder value required of the commercial sector.

Areas where greatest differences in principles between the two sectors are likely to occur include:

- the public service ethic;
- accountability and transparency of operations;
- risk management which will be influenced by the stewardship of public monies and the need for accountability to government; and
- responsiveness to government and its whole of government interests.

The differences in principles explain the consequential differences in processes between private and public sector organisations.

Using the normative model

As noted in Chapter 2, public sector agencies should first define their business purpose and seek approval from the Executive and Minister for this purpose. Once agreement has been reached the normative model provides the framework for appropriately establishing the business, whatever its purpose. Each of the components at the more detailed level of the model need to be tested for relevance to the type of business chosen.

Figure 6 and the discussion below give examples of how the relevant aspects of the model might be identified in order to tailor the model to suit a particular business.

Figure 6
Level 2 Corporate Management Processes

Develop Corporate Strategy and Plans	Maintain Corporate and Financial Structure	Manage Performance	Manage External Relationships
Understand customers and environment	Design the organisation structure	Set financial and operational standards	Communicate with shareholders
Define the business concept and strategy	Develop financial plans and structure	Manage business performance	Manage government relationships
Set organisation goals		Manage improvement and change	Build lender relationships
			Develop public relations/image

Develop Corporate Strategy and Plans

For the majority of businesses, whether they are private or operating within the APS, each of the elements in this part of the model would be highly relevant and would therefore need to be addressed to provide the basis for a successful business.

Maintain corporate and financial structure

The elements listed under the above heading would need to be considered by all businesses. In the APS it may be that parts of the organisational and financial structure have been pre-determined in broad terms. However, this needs to be translated into detailed structures and plans to support the business purpose and particular type of operation. For example, the organisational structure may need to be sufficiently flexible so that skilled personnel relevant to the business needs can be readily accessed. As well, in deciding the organisational structure, its impact on business costs must also be considered.

Manage performance

Again, for the majority of businesses these would be essential elements to be addressed. A business operating in the APS will need to have measures to indicate whether the government's objectives and accountability requirements are being met. However, if the decision has also been made, for example, that the business is to realise a profit then the performance information regime also needs to incorporate more traditional private sector measures such as return on investment, production capacity and so on.

Manage external relationships

In managing external relationships there are relevant elements in the model but these elements may need to be reinterpreted to take account of operating within the APS, for example:

'communicate with shareholders' is more likely to refer to communicating with stakeholders;

'manage government relationships' has a different meaning for a private sector business because, by definition, they are external to government. For an APS business, the nature of the relationship is more likely to be internal. That is, managing relationships with Ministers, the Executive and other government agencies in the

course of establishing the policy and program, and its subsequent operation.

'build lender relationships' may not be relevant to an APS business if funds are provided by government appropriation.

'develop public relations/image program' - the emphasis may be more on informing clients about a program, their eligibility and access in the case of an APS business. However, if for example, the decision has been made to be profit-making it will be important to create a client base and build a marketable image for the business.

Conclusion

The above discussion is an example of the analysis of one area of the normative model. It should be noted that all sections of the model needed to be analysed and tested for relevance to ensure that a sound framework has been developed for your particular business. The resulting framework will be, and should be, configured differently for different businesses and it should be reviewed regularly throughout the life of your business.

Appendix 2

Bibliography

Andrew and Nada Korac-Kakabadse, '*The Leadership Challenge for the Australian Public Service (APS): An Internationally Comparative Benchmarking Analysis*', Cranfield University School of Management, 1996

Australian Stock Exchange Limited July 1996. *ASX Listing Rules*.

Commonwealth Procurement Guidelines, issued under Finance Regulation No.42.

Department of Finance May 1997. *Competitive Tendering and Contracting: Guidance for managers*, Exposure Draft, Canberra

Department of Finance May 1997. *The Performance Improvement Cycle: Guidance for managers*, Exposure Draft, Canberra

Department of Industrial Relations 1997. *Workplace Relations Advices (various)*, Canberra

Grindley, K 1991. *Managing IT at Board Level*, Pitman.

Hilmer, F G 1993. *Strictly Boardroom: improving governance to enhance company performance*, The Business Library, Melbourne.

Independent Committee of Inquiry August 1993. *National Competition Policy*, AGPS, Canberra

MAB/MIAC 1995. *Achieving Cost Effective Personnel Services*, Report No.18, AGPS, Canberra.

MAB/MIAC May 1996. *Ethical Standards and Values in the Australian Public Service*, Report No.19, AGPS, Canberra.

MAB/MIAC October 1996. *Guidelines for Managing Risk in the Australian Public Service*, Report No.22, AGPS, Canberra.

National Commission of Audit, *Report to the Commonwealth Government*, AGPS, Canberra.

Procurement Australia 1996. *Managing Risk in Procurement: A Handbook*, AGPS, Canberra 1996.

Task Force on Management Improvement December 1992. *The Australian Public Service Reformed: An evaluation of a decade of Management Reform*, AGPS, Canberra.

Yates, R B 1997. Correspondence from the Department of Industrial Relations to the ACTU.

