

**TRENDS IN PUBLIC SECTOR CONTRACTING
- SOME ISSUES AND BETTER PRACTICES**

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1. INTRODUCTION

I am pleased to be invited again to speak at this conference of Corporate Lawyers to provide a Commonwealth public sector perspective on current trends in public sector contracting. This forum has provided an important opportunity to explore and discuss important issues in relation to the challenges currently facing contract managers in the public service. There is no doubt that this particular aspect of public administration is high on the priority list of most Chief Executive Officers (CEOs).

I would also like to take the opportunity to introduce the recently released Australian National Audit Office (ANAO) Better Practice Guide on Contract Management. The Guide has been developed to provide better practice examples for the ongoing, day-to-day management of contracted services and evaluation of the overall performance of the contract to enable effective succession planning. This will be the subject of the second part of the presentation. I would like to start with some contextual observations focused largely on dealing with the treatment of risk which I will follow with some observations on managing risk in contracting.

The use of contracted arrangements for the delivery of goods and services is not new to the Commonwealth. However, while the move towards contracting of government services has been gathering momentum, the trend now encompasses not just the support service contracts, with which most organisations are familiar, but also elements of agencies' 'traditional' core business. This trend creates significant risks and challenges for public sector managers now and in the future.

Experience in recent years is demonstrating to CEOs and contract managers alike that contracting of goods or services does not automatically lead to savings and other benefits. This does not reflect a view one way or another about any outsourcing policy and/or strategy. However, this experience does indicate quite clearly that contracting, like any other element of the business function, must be well managed. The experience of my Office has been that a poorly managed contract can result in higher costs, wasted resources, impaired performance and considerable public concern about associated outcomes. Conversely, a well managed contract can deliver the results required for all parties concerned with a minimum of costs, both direct and indirect.

In order to ensure contracts and contract management effectively address the needs of Commonwealth organisations, they must be managed within a risk framework as part of good corporate governance. The challenge for organisations is not just to identify the risks involved in contracting of goods or services but also to actively manage them, including taking advantage of any opportunities they provide, as well as minimising or eliminating them, as circumstances dictate. There are no short cuts and the amount of management time that is required to be devoted to contract management should not be underestimated.

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

*... clear identification and articulation of contract requirements at the outset can save considerable time, cost and effort later in contract management.*¹

The recently issued Better Practice Guide on Contract Management emphasises the importance of not only dealing effectively with risk in contracts but also in developing and maintaining a relationship with the contractor that supports the objectives of both parties and focuses on the agreed results to be achieved. In the latter connection, we should take note of an insightful comment made by the United Kingdom (UK) National Audit Office in a recent report as follows:

*Understanding the differences between the private and public sector approaches to the same output specification lies at the heart of assessing value for money.*²

Effective contract administration in the public sector goes beyond simply trying to hold contractors to account for each minute detail of the contract. Among other things, it includes:

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

Recent comments in the Senate's Finance and Public Administration Committee's second report on *Contracting Out of Government Services* emphasise the complexity of the task, the unpreparedness of public sector managers and the need for different skills as follows:

*Despite the volumes of advice on best practice which emphasise the need to approach contracting out cautiously, to invest heavily in all aspects of the process and to prepare carefully for the actual implementation, and the substantial body of comment in reports from the Auditor-General indicating that Commonwealth agencies have a very mixed record as project and contract managers, the prevailing ethos still seems to promote contracting out as a management option that will yield inevitable benefits. Resources must be made available to ensure that contract managers have the skills to carry out the task.*³

Parliament and the public are interested not only in the outputs and outcomes of Commonwealth organisations but also in the *processes* of decision-making and the *reasons* for action taken or not taken, as the case may be. This transparency places

pressure on Commonwealth agencies and public and private sector providers that again creates different risks that need to be managed in the contracting process.

Of particular concern to contract managers is how to establish a sound contract and contracting environment. One area of expertise they seek in this process, as noted above, is legal advice. Legal risks is one area of expertise where contract managers freely admit they require assistance. This raises the question of the need for at least some in-house legal expertise in agencies where contracting is extensive and intensive.

Legal advice should be framed with reference not only to the contract but should also give consideration to the relationship between the contractor and Commonwealth organisation and the risks the Commonwealth is exposed to by contracting-out that particular service. Inevitably, so-called transactions costs associated with outsourcing arrangements seem to be overlooked and/or under-stated. Equally, unfortunately, is that experience to date has generally shown a risk averse approach to contracting and contract management which has led, in some cases, to an ineffective and inefficient provision of the services under contract. The issue is not simply about a process or rules-based culture of public service as opposed to being more responsive and results oriented. The concern is about achieving the 'right' balance of complementary behaviour and approach to meet both accountability and performance imperatives in sometimes widely varying situations.

As well, the effective implementation of risk management in relation to contracting has been hindered by a risk averse culture reflecting an emphasis on accountability for process (inputs) rather than for outputs and outcomes. Given the current move towards increased integration of the public and private sectors, there is a need to at least consider whether the environment being created is leading to a different type of accountability. The tendency in some cases is to over-manage risks and to impose on providers a contract management relationship that leads to inefficiencies rather than benefits. As well, it is not an option to attempt to transfer all risk to a contractor. Experience in Australia and overseas clearly shows that the parties should bear the risks that each are best able to manage.

2. MANAGING RISK IN CONTRACTING

The ANAO's experience with contracting in recent years through, for example, audits of the Management of Contracted Business Support Processes (Audit Report No. 12 1999-2000), New Submarine Project (Audit Report No. 34, 1997-98), and the Construction of the National Museum of Australia and the Australian Institute of Aboriginal Studies (Audit Report No. 34, 1999-2000) indicates that there is a range of challenges to organisations in seeking innovative solutions to the achievement of business outputs and outcomes through contracting. It is, again, not a case of one size fits all.

In particular, the audits have drawn attention to agency deficiencies, particularly in commercial and management skills, to effectively implement risk management in a contractual environment.

Management of key business risks tailored to a contractual environment will ensure the achievement of benefits of contracting such as increased flexibility in service delivery; greater focus on outputs and outcomes; freeing of public sector management to focus on higher priorities; encouraging suppliers to provide innovative solutions; and cost savings in providing services.⁴ The following is a checklist of risks and benefits of contracting versus in-house provision which was provided in a report⁵ of a study conducted into government contracts in the State of Victoria last year.

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

Managing the risks associated with the increased involvement of the private sector in the delivery of government services, in particular the delivery of services through contract arrangements, will require the development and/or enhancement of a range of commercial, negotiating, project and contract management skills across the public sector and will be a key accountability requirement of public sector managers. Agencies have quickly learnt that contracting places considerable focus and emphasis on project and contract management, including management of the underlying risks involved both within and outside the public sector. The problem has been to achieve both management understanding of, and action on, these imperatives in a reasonable time period. The transition periods have usually left little scope for planned and managed adjustment.

Although the public sector may contract out service delivery, this does not equate to contracting out the total responsibility for the delivery of the service or program. The current Government and Parliamentary expectation of each agency, and agency management, is to ensure that the government’s objectives are delivered in a cost-effective manner, and to be accountable for that outcome. The bottom line, as is often reiterated in the Parliament, is that accountability cannot be outsourced.

The process of risk assessment and its treatment needs to be dealt with by agencies in an increasingly devolved environment, where they are also facing the challenges of managing outsourced service delivery and support. The following comment by Professor Richard Mulgan of the Australian National University on the accountability dilemma associated with the greater involvement of the private sector, particularly in the delivery of public services, is very challenging in these respects:

Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out because the main increases in efficiency come from the greater freedom allowed to contracting providers. Accountability is also likely to be reduced through the reduced availability of citizen redress... At the same time, accountability may on occasion be increased through improved departmental and Ministerial control following from greater clarification of objectives and specification of standards. Providers may also become more responsive to public needs through the forces of market competition. Potential losses (and gains) in accountability need to be balanced against potential efficiency gains in each case⁶.

Access to information and premises

One of the problems for both auditors and agency managers is having sufficient access to information that allows them to assess, and decide how to treat, risks and to ensure that they are in a position to be accountable for their functional (and statutory) responsibilities. A particular issue facing my Office and, I am sure, many others⁷, is that of access to contractor records and other information relevant to public accountability. This matter is of concern not only to Auditors-General, but also to public agencies in their role as contract managers, to Ministers as decision-makers, and to the Parliament when scrutinising public sector activities.

My Office has experienced problems in accessing contractor information both through audited agencies and in direct approaches to private sector providers. Several audits and parliamentary inquiries⁸ have focussed closely on what public accountability means in the context of contract management, third party service providers and commercially-based public activities.

As part of his/her statutory duty to the Parliament, the Auditor-General may require access to records and information relating to contractor performance. The Auditor-General's legislative information-gathering powers are set out in Part 5 of the *Auditor-General Act 1997*. These powers are broad but they do not include access to contractors' premises to obtain information.

In September 1997, my Office drafted model access clauses (reflecting the provisions of the *Auditor-General Act 1997*) which were circulated to agencies for the recommended insertion in appropriate contracts. These clauses give the agency and my Office access to contractors' premises and the right to inspect and copy documentation and records associated with the contract.

The primary responsibility for ensuring there is sufficient access to relevant records and information pertaining to a contract lies with agency heads. This responsibility is mandated in section 44 of the *Financial Management and Accountability Act 1997* which states clearly that a Chief Executive must manage the affairs of the Agency in a way that promotes proper use (meaning efficient, effective and ethical use) of the Commonwealth resources for which the Chief Executive is responsible.

For accountability measures to be effective, it is critical that agencies closely examine the nature and level of information to be supplied under the contract and the authority to access contractors' records and premises as necessary to monitor adequately the performance of the contract. I stress 'as necessary' because we are not advocating carte blanche access. Audit access to premises would not usually be necessary for 'products' or 'commodity type services' provided in the normal course of business.

The ANAO considers its own access to contract related records and information would generally be equivalent to that which should reasonably be specified by the contracting agency in order to fulfil its responsibility for competent performance management and administration of the contract. The inclusion of access provisions within the contract for performance and financial auditing is particularly important in maintaining the thread of accountability with Commonwealth agencies' growing reliance on partnering with the private sector and on contractors' quality assurance systems. In some cases, such accountability is necessary in relation to Commonwealth assets, including records, located on private sector premises.

The Joint Committee of Public Accounts and Audit (JCPAA) subsequently recommended that the Minister for Finance make legislative provision for such access.⁹ The Government response to that report stated that:

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

and that

the Government supports Commonwealth bodies including appropriate clauses in contracts as the best and most cost effective mechanism to facilitate access by the ANAO to a contractor's premises in appropriate circumstances.¹⁰

The response also stated that:

the Commonwealth Procurement Guidelines would be amended to emphasise the importance of agencies ensuring they are able to satisfy all relevant accountability obligations, including ANAO access to records and premises.¹¹

While noting the Government's response, the ANAO continues to encourage the use of contractual provisions as the key mechanism for ensuring agency and ANAO access to contractor's records for accountability purposes. The ANAO is currently in discussions with the Department of Finance and Administration to review the content of the standard access clauses and intend to write again to agencies recommending the use of the clauses once this consultation process is complete. This issue has implications for agencies' security responsibilities particularly where direct control over Commonwealth assets and/or information reside with a private sector provider. Specific responsibility is set out in the Commonwealth Protective Security Manual 2000 (PSM 2000) as follows:

*The agency must be able to carry out an examination of the contractor's security procedures when undertaking its regular audit or review of the contractor's methods and procedures. Access must be permitted for a security risk review to evaluate the contractor's security procedures.*¹²

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

Finally, in this context, I noted with some interest in a recent United Kingdom (UK) National Audit Office Report¹³ that the public authority concerned had faced great difficulty in getting timely information on the true extent of the private sector provider's financial difficulties as, under the contract, no access to the latter's underlying financial records.¹⁴ However, the Report also noted that greater rights of access to the private sector party's financial records is now standard in that country.¹⁵

Commercial-in-confidence information

Situations have arisen where performance data relevant to managing a contract is held exclusively by the private sector. Also, private sector providers have made, on many occasions, claims of commercial confidentiality that seek to limit or exclude data in agency hands from wider parliamentary scrutiny. Thus accountability can be impaired where outsourcing reduces openness and transparency in public administration.

The Australasian Council of Auditors-General has released a statement of Principles for Commercial Confidentiality and the Public Interest¹⁶. Of particular concern to Auditors-General has been the insertion of confidentiality clauses in agreements/contracts which can impact adversely on Parliament's 'right to know' even if they do not limit a legislatively protected capacity of an Auditor-General to report to Parliament. For example, the then Auditor-General of Victoria commented that:

*... the issue of commercial confidentiality and sensitivity should not override the fundamental obligation of government to be fully accountable at all times for all financial arrangements involving public moneys.*¹⁷

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

*Maintaining secrecy by confidentiality clauses in contracts is adverse to the Parliament's right to know. Confidentiality clauses should not, therefore, be used in contracts unless there are specific approvals for them by the Parliament itself.*¹⁸

I am sensitive to the need to respect the confidentiality of genuine 'commercial-in-confidence' information. This requires an understanding of the commercial imperatives in a competitive market environment. In my own experience, I have found that, almost without exception, the relevant issues of principle can be explored in an audit report without the need to disclose the precise information that could be regarded as commercial-in-confidence. In this way, the Parliament can be confident it is

informed of the substance of the issues that impact on public administration. It is then up to the Parliament to decide the extent to which it requires additional information for its own purposes. This view is supported by the Victorian Public Accounts and Estimates Committee in a landmark report last year, as follows:

*'5.6 Commercial-in-Confidence should not prevent Auditor-General and Ombudsman from disclosing information where they assess its disclosure to be in the public interest'*¹⁹

The Chairman of that Committee recently reiterated that a variety of options exist for dealing with commercially sensitive material and that, where genuine reasons exist, it is possible to take a middle ground between unrestricted access or total confidentiality.²⁰ The Chairman went on to note that the only Committee recommendations rejected outright related to the disclosure of information contained in tenders (as opposed to contracts) and the conferral of the Ombudsman of an extended oversight role in relation to commercial in confidence claims²¹.

Commercial confidentiality concerns have also been addressed by a number of Commonwealth Parliamentary inquiries.²² Recently, the Senate Finance and Public Administration References Committee, in its *Inquiry into the Mechanism for Providing Accountability to the Senate in Relation to Government Contracts*, addressed a motion that had been put before the Senate by Australian Democrat Senator Andrew Murray. Senator Murray's motion sought to achieve greater transparency of government contracting through passage of a Senate Order that would require:

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

The Committee's report noted that, at almost every estimates hearing, information is denied Senators on the grounds that it is commercially confidential. The Committee considered that this creates a situation where:

*Without recourse to an independent arbiter acceptable to both sides, this results in an impasse unsatisfactory to all. In many cases the confidentiality claim may be correct but, without seeing the information, senators are unable to judge the veracity of the assertion of confidentiality. Nor are they able to assess the level of financial risk to which the Commonwealth may be exposed by the use of confidential clauses, if they are denied access to contracts.*²³

Senator Murray's motion can be taken as a further indication of Parliament's frustration with insufficient accountability reporting associated with government contracting and a belief that commercial-in-confidence provisions are used excessively and unnecessarily in contracts.

During the ANAO's appearance at the Committee's public hearings on this Inquiry on 12 May 2000, the Deputy Auditor-General offered to conduct a performance audit on the use of confidential contract provisions. This offer was accepted by the Committee and, once the audit is completed, the Committee will report again on the Senate motion. I have commenced the audit and expect to table the report in Parliament in mid 2001. The audit is seeking to:

- assess the extent of guidance on the use of confidentiality clauses in the context of commercial contracts at a government wide level or within selected agencies;
- develop criteria that could be used to determine whether information in a commercial contract is confidential, and what limits on disclosure should apply; and
- assess the appropriateness of agencies' use of confidentiality clauses and the effectiveness of the existing accountability and disclosure arrangements for the transparency of contracts entered into by the Commonwealth.

Other potential impediments to Parliamentary access

As a result of one of my audit reports (Report No.9 2000-01, *Implementation of Whole of Government Information Technology [IT] Infrastructure Consolidation and Outsourcing Initiative*), the federal Finance and Public Administration References Committee initiated an inquiry into the Government's IT outsourcing initiative. An independent reviewer, Mr Richard Humphry AO, was employed to undertake a review of this issue. The report from the 'Humphry review' was provided to the Minister for Finance and Administration, Mr John Fahey, on 30 December 2000.

During the Committee's hearings, on 7 February 2001, Mr Humphry was asked to provide to the Committee copies of the submissions he received. Mr Humphry stated that the Australian Government Solicitor had advised him that the submissions did not form part of Commonwealth records and, therefore, were not covered by the Archives Act and remained the property of those who had written them. Based on that advice, Mr Humphry had returned all submissions to their respective authors.²⁴

The Department of Finance and Administration also stated that it had received similar legal advice from another firm. The Committee expressed disappointment that the Commonwealth had commissioned and paid for the review but was not able to access the submissions.

3. ANAO CONTRACT MANAGEMENT BETTER PRACTICE GUIDE

As a consequence of the greater use of contracted services as components of program delivery, contract management has become a more critical element in public administration. It is therefore incumbent on Australian Public Service managers to refine their skills and knowledge to embrace their role as managers of contractual arrangements, as well as the developers of policy.

The Parliament, through the Joint Committee of Public Accounts and Audit (JCPAA) reinforced this view in their report on Contract Management noting

'the search for excellence in contract management as one of the pressing challenges for the Australian Public Service'²⁵.

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

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

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

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

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

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

The contract management lifecycle has been broken down into seven steps as follows:²⁶

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

The Guide does not attempt to address issues associated with tender and contract negotiations, but rather focuses on providing guidance on the transition or implementation of the contract, ongoing management and succession planning. The early stages of the contract management lifecycle dealing with contract negotiation and tendering have been well documented in publications such as *Before you sign the dotted line*, MAB/MIAC Report No. 23, May 1997 and the ANAO Better Practice Guide on *Selecting Suppliers*, published in October 1998. However, as the Guide indicates, there is an important relationship in the lifecycle that needs to be kept in mind:

One factor which experience shows can benefit all parties is to ensure at least some continuity between those involved in the tender stage and the contract negotiation stage and with (sic) the actual contract management.²⁷

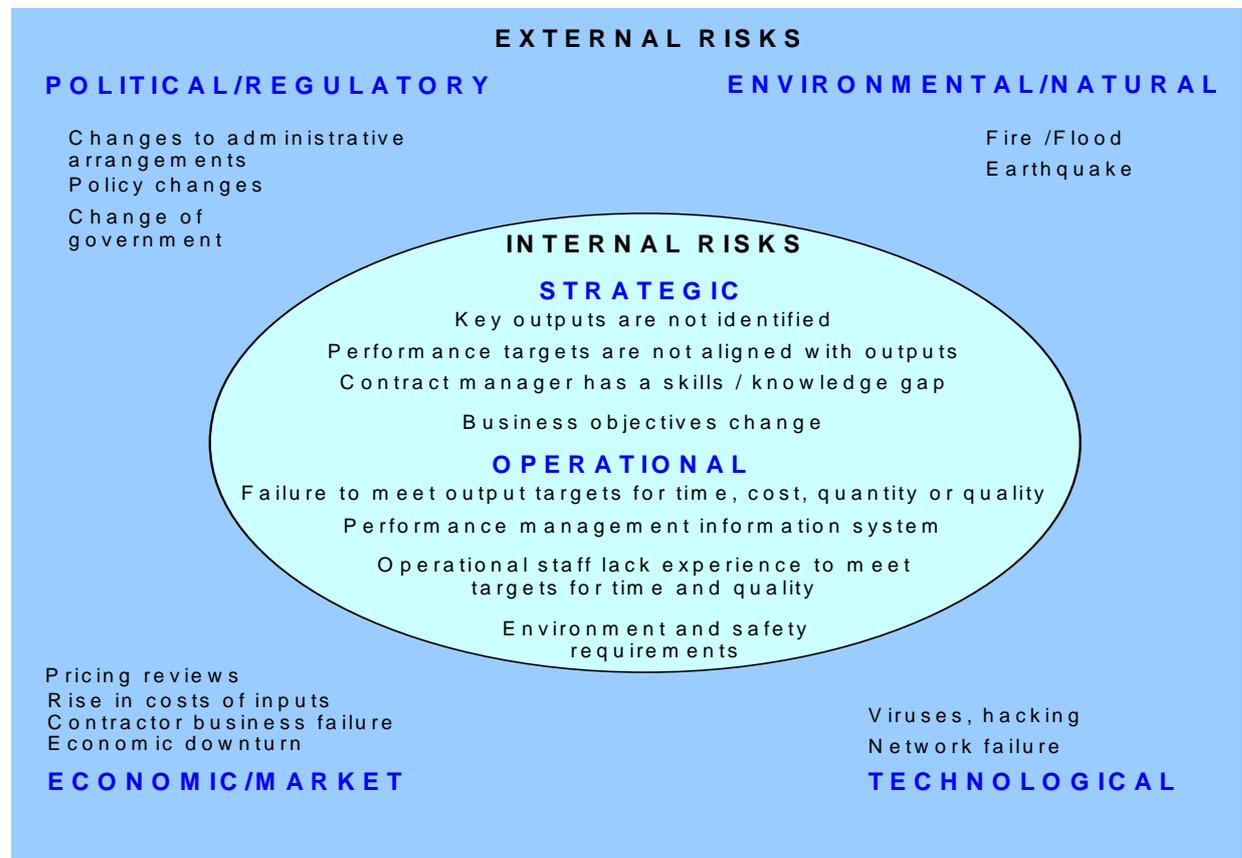
The following areas in the Guide are key to contracting success.

Dealing with risk in a control framework

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

The difference between a contract delivering benefits, and one that does not, can be often attributed to the way that the risks associated with the delivery of those services are managed.²⁸

Figure 1: External and Internal Risks



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

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

- short term flexibility may be compromised by unforeseen ‘downstream’ costs or liabilities which erode or offset early gains;
- there may be a tendency for government to bear a disproportionate share of the risks, such as through the offer of guarantees or indemnities;
- the failure of private sector service providers may jeopardise the delivery of the project, with the result that the government may need to assume the costs of completion plus the costs of any legal action for any contractual breaches;

- drafting inadequacies in contracts or heads-of-agreement with partners could expose governments to unexpected risks or limit the discretion of future governments by imposing onerous penalty or default clauses;
- inadequacies in the modelling and projection of costs, risks and returns may, under some conditions, result in an obligation by governments to compensate private sector providers for actual losses or failure to achieve expected earnings;
- there may be some loss of transparency and accountability for disclosure as a result of a private sector provider claiming commercial confidentiality with respect to the terms of their investment; and
- the level of private sector investment and the amount of risk private sector providers are willing to bear may be inversely proportionate to the conditions placed on them by governments to determine pricing, to manage delivery of community service obligations, or to transfer or sell an interest in the project.

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

The Guide emphasises the importance of considering levels of poor performance and mechanisms to address such an issue in the early stages of negotiation. These mechanisms should then be built into the contract and agreed operating procedures. It is simply no longer sufficient to threaten cessation of the contract when poor performance is detected. Agencies need a more robust framework for working through the issue to ensure successful resolution and continuance of the service, including a better basis for future discussion and settlement of performance requirements. Such resolution might include the public sector agency having to take back particular risks which were previously allocated to the private sector provider. For example, in the UK National Audit Office Report quoted earlier, the Royal Armouries Museum in Leeds had to assume the demand risk that visitor numbers would be insufficient to ensure the Museum’s future survival.²⁹

Transition to the contractor

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

It is during the transition, as accountability arrangements and changed organisational structures are bedded down, that the greatest risk to effective decision-making arises. This was particularly apparent in the audit of the implementation of the IT outsourcing initiative, where it was found that both agencies and tenderers had underestimated the complexity involved in managing the delivery of services to a group of agencies, particularly in simultaneously transitioning those services to an outsourced provider.³⁰ This lack of appreciation by the parties concerned contributed to service delivery

failures and significant delays in the provision by the service providers of reliable invoicing and performance reporting.³¹

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

Contract management

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

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

Service standards and performance measurement

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

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

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

service most important to agencies' business. Again turning to a UK example, the NAO audit found that:

*Bidders are incentivised by a payment mechanism to meet ... targets and they incur penalties of performance declines.*³²

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

For example, the outsourcing contracts reviewed in the IT outsourcing audit placed certain obligations on the private sector service providers in regard to ensuring that agency data held on the outsourced IT infrastructure was protected to identified security and privacy standards. That audit³³, and a subsequent audit of fraud control in the Australian Taxation Office³⁴, found that agencies had not developed adequate strategies for monitoring the providers' compliance with those obligations, and recommended improvements in this regard.

Sound contract management, and accountability for performance, are dependent on adequate and timely performance information. As noted above, it is important that agencies consider the level and nature of information to be supplied under the contract and the access they require to contractor records to monitor adequately the performance of the contractor. The more detailed the performance standards, the specific requirements for rigorous reporting and monitoring and the need for frequent renegotiation and renewal, the closer the contractual arrangements come to the degree of control and accountability exercised in the public sector.³⁵ Once again, it is a matter of balancing any trade-offs in efficiency and/or accountability if optimal outcomes are to be secured. I should add that any such trade-off should be subject to Parliamentary and/or Executive Government guidance.

The main message from the public sector's contracting experiences is that savings and other benefits do not flow automatically from their adoption. There is always the upfront cost of contracting out that needs to be taken into account, such as the initial legal costs involved in negotiating and drafting contracts. Other costs which also need to be taken into account in making a decision to contract out functions, include the cost of monitoring the contractor's performance and the need for legal advice as to how to interpret particular clauses in the contract.³⁶ Indeed, the contracting out process, like any other element of the business function, must be well managed and analysed within an overall business case which includes an assessment of its effect, either positive or negative, on other elements of the business.

Contract relationships

As I have already noted, contract management is more about effective delivery of goods and services than about ticking off the details of the contract. One of the most important aspects of this will be development of the most appropriate contract

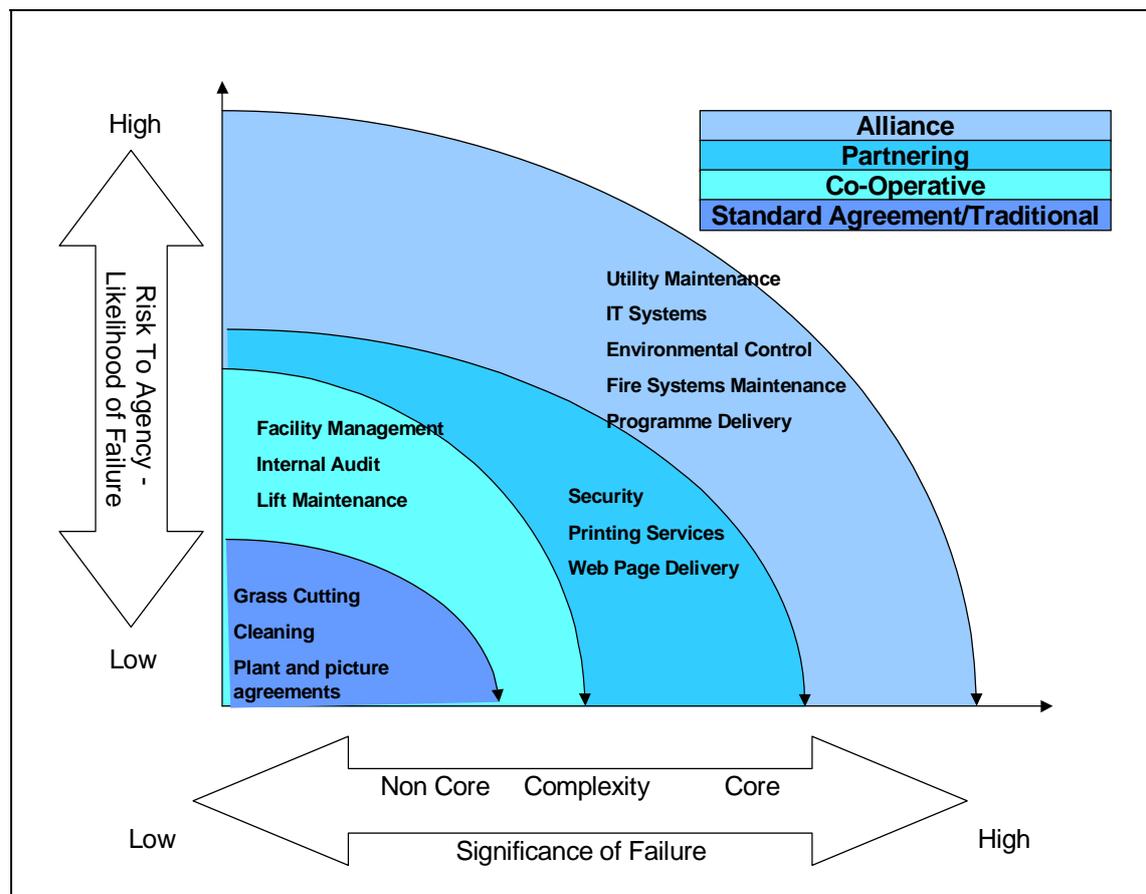
relationship style. The four common relationship types are on a continuum from traditional to cooperative, partnering and finally alliancing.

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

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

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

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



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

The notion of partnerships and alliances within and between the public and private sectors and concepts such as 'relational contracts'³⁷ are challenging the current public management view of accountability.

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

The ANAO found that the processes for the appointment of the Architects, Building and Services Contractors and Museum Exhibition Designers ('the commercial alliance partners') substantially complied with the Commonwealth Procurement Guidelines. The ANAO also found that the Department and the commercial alliance partners had sound processes and procedures in place to monitor appropriately the progress of construction and manage the cost, time, quality requirements and other project risks in a timely manner. Successful project alliancing depends importantly on skilful management of the particular risks involved. With respect to this project, the ANAO considered that appropriate financial incentives were in place to encourage 'best for project' behaviour from the Department and the commercial alliance partners.

Developing more networked arrangements

In my view, audit offices should be able to work positively with public sector managers to explore different partnership/cooperative arrangements that can accommodate both public and private interests. In that latter respect, I found the ideas underlying the seven principles of the "New Public Service" suggested by two academics in a recent volume of the Public Administration Review³⁸ to be worthwhile considering for discussion. Of course, whatever is attempted needs the support and endorsement of the Government and Parliament if it is to succeed. The ongoing challenge for all of us will continue to be meeting our various stakeholder performance and accountability expectations, whatever the approach taken to our changing public sector environment.

Such arrangements are likely also to be encouraged through the increased adoption and impact of e-commerce with its focus on coordination and collaboration in the business environment in particular and with shared databases as well as greater electronic integration in a virtual 'one-stop' service delivery environment. Between agencies, these arrangements are quasi-contractual and tend to be based on 'relational' rather than 'legal' agreements. Nevertheless, as discussed later, there are compelling reasons in a number of areas for considering the extension of the relational/partnering approach involving the private sector in a more networked environment. As one prominent researcher in public administration puts it:

*... co-operation vies with competition as the organizing principle of service delivery.*³⁹

He goes on to observe that networks are a distinctive way of coordinating and, therefore, are a separate governing structure from markets and hierarchies. In such situations, contracts acquire the characteristics of networks.⁴⁰

Key features of 'relational' contracts are:

*... the need for trust, flexibility and generality in contract specifications due to uncertainties in the environment (political or financial), and the difficulty of specifying targets and measuring results.*⁴¹

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

*Managers in public services who have had experience of marketization, competitive tendering arrangements and a contract culture may even express some dismay at the thought of having to operate within the context of a loosely coordinated and informal network of providers.*⁴²

As usual, a balance has to be struck in particular cases between the various demands on managers which can change depending on circumstances and the environment.

The networking concept is gaining favour as a means of delivering more responsive public services to citizens. For example, a recent ANAO report⁴³ discussed how three welfare agencies were defining their particular outcomes and outputs and how the outputs of one of these agencies were directly related to the outcomes of the purchasing departments. These arrangements have subsequently expanded such that the particular Commonwealth agency, Centrelink, now delivers services on behalf of a total of four agencies under formal purchaser-provider arrangements.⁴⁴ Centrelink's partnership agreement with the now Department of Family and Community Services reflects their emphasis on building trust; maintaining productive relationships and legal limitations.⁴⁵

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

The Committee will continue to monitor the results of implementation of charters to ascertain the extent to which identified customer needs and

*quality of services are being met and that any problem areas are addressed.*⁴⁶

Again, the notion is to make the public sector more accountable to the general Australian community and more outcomes-focused. The New Zealand Auditor-General has published recently a comprehensive report on service delivery including best practice criteria and a discussion of what distinguishes public from private services.⁴⁷ As well, the report included an analysis of service delivery over the Internet.⁴⁸

Where service delivery has been outsourced, Service Charters will clearly have a direct impact on the private sector contractor. In particular, it is to be expected that outsourcing contracts will need to reflect the Service Charter commitments if the Charters are to have any meaning. It will also be important to require, as part of the contractual arrangement, the provider to supply outcome, output and input information against which the provider's performance can be assessed, including whether processes are efficient and the service quality is satisfactory. In this way, even if the client is one or more steps removed from the responsible department, it should still be possible to ensure clients are receiving the appropriate level and quality of service, consistent with the Service Charter. Such an approach may also be expected to reinforce the notion of both the private sector provider and the contracting agency being dependent on one-another for delivering a satisfactory level of performance and accounting for their performance – in effect trading-off control for agreement.

It has been recognised that more networked approaches to service delivery that envisage more sophisticated and cooperative approaches to cross-cutting issues will stress the importance of partnerships, coordination and joint working. This is increasingly occurring at the inter-agency level and networking can be expected to evolve to include strategic arrangements and structures between public organisations, private operators and voluntary associations as well as individual clients and the community generally. Such interaction should in turn generate new forms of service delivery and redefine the relationship between government and the community.

The aim should be to deliver services that appear seamless to the recipient.⁴⁹ In such arrangements, where there is joint responsibility for overseeing and implementing programs across a number of bodies, involving public and/or private sector organisations, a clear governance framework and accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants, may be required. Increasingly, relevant governance arrangements will need to cross organisational boundaries to better align activities and reduce barriers to effective cooperation and coordination. Of note, in this respect, is the fact that globalisation has resulted in an increasing number of business networks operating across national borders. Networks do not necessarily require formal organisational structures.

More networked or partnered arrangements can also overcome the inflexibility of a contract. Partnering and strategic alliancing are increasingly being adopted in the private sector as a means of coordinating economic activity. Such networked arrangements are seen to enable a greater exchange of ideas and information and allow partners to gain access to knowledge and resources of the other parties. The Victorian

Public Accounts and Estimates Committee, quoted earlier, observed that a partnering approach could be warranted where:

- *service providers are encouraged to be innovative in the delivery of services;*
- *the nature of the services is highly variable or evolving, leading to poor predictability of demand and service content; and*
- *the services will be using leading edge practices/technology in which a high degree of flexibility on the part of both parties will be required to make it work.*⁵⁰

Realising the benefits of networking in a cross-cutting mode requires further cultural transformation in government agencies. For example, hierarchical management approaches may need to yield to more 'partnering-type' approaches. Process oriented ways of doing business will need to be supplanted by results-oriented ones. This is consistent with the Federal Government's outputs/outcomes approach to public administration and budgeting. Individual agencies, operating as virtual silos or islands of accountability but with overlapping functions and operations, will not only have to become more integrated organisations but will also have to become more externally focussed if they are to meet the needs of their 'shared' clients. What is needed is a positive and encouraging framework for building relationships, dialogue and negotiation that can lead to:

- *clearer and more realistic performance measurements;*
- *more buy-in on both sides to the results;*
- *a basis for ongoing dialogue throughout the year to improve the likelihood of achieving results; and*
- *capacity for learning and improvement.*⁵¹

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

Another important aspect of developing networked solutions is the availability of information to clients. Information technology is providing significant opportunities for government to ensure that existing and potential clients have access to the information they require. Information technology can also be an effective tool for improving the cost-effectiveness and quality of services provided to citizens. It is also central to improving accountability. It is not unrealistic to suggest that the effective networking of information technology systems will be crucial to implementing integrated public services. On this issue, I have noted that the Central IT Unit in the UK is establishing common standards and infrastructure to enable interoperability across government departments and the wider public sector.⁵²

Private financing of government activities

A related topic is that of the use of private finance in areas of the public sector such as infrastructure, property, defence and information technology (IT) and the way in which this can lead to risk transfer.

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

Extensive use has been made of private financing in the United Kingdom (UK). The Private Finance Initiative (PFI) was introduced in 1992 to harness private sector management and expertise in the delivery of public services.⁵³ By December 1999, agreements for more than 250 PFI projects had been signed by central and local government for procurement of services across a wide range of sectors, including roads, rail, hospitals, prisons, office accommodation and IT systems. The aggregate capital value of these projects was estimated to be some £Stg 16 billion.⁵⁴

The UK National Audit Office (NAO) has noted that the private finance approach is both new and more complicated than traditional methods of funding public infrastructure.⁵⁵ It brings new risks to value for money and requires new skills on the part of the public sector. Since 1997, the NAO has published eight reports on such projects. These reports collectively suggest that for privately financed projects to represent value for money, the price must be in line with the market, the contract must provide a suitable framework for delivering the service or goods specified, and the cost of the privately financed option (taking into account risk) should be no more than that of a publicly funded alternative.⁵⁶

It is undeniable that the PFI in the UK is being driven heavily by the objective to transfer risk.⁵⁷ For example, in contracting the funding, design and management of IT and infrastructure projects to the private sector, the associated transfer of risk to private sector managers is being justified on the basis that they are better able to manage the risks involved.

A report commissioned by the UK Treasury indicated that some invitations by public sector bodies to negotiate contract provisions included risks that could not realistically be best managed by the contractor.⁵⁸ The report went on to advocate an approach involving the 'optimum' transfer of risk, which simply means allocating individual risks to those best placed to manage them. As usual, the devil is in the detail but experience is indicating some useful means of deciding on an appropriate allocation of such risks.

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

In practice, on IT projects in particular, we have seen considerable naivety on the part of government departments as to the extent to which they can actually transfer risk.⁵⁹

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

Under heavy public and political pressure to get systems working properly, departments are then reluctant to take a hard line on their contractual rights and so sour relationships with the very contractors whose cooperation is essential.⁶⁰

It is difficult to evaluate the overall benefits that accrue from PFIs. In financial terms, it has been recognised that it is difficult for the private sector to borrow as cheaply as governments can. This is because government borrowings are considered by markets to be risk-free because of governments' capacity to raise taxes and because of the absence of default by most sovereign borrowers. Accordingly, delivering financial benefits from private financing requires cost savings in other aspects of the project and/or the effective transfer of risk. Clearly, any savings that are assessed from these aspects are sensitive to the benchmarks and assumptions used as follows:

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

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

Appropriate risk allocation between the public and private sectors is the key to achieving value for money on PFI projects. If the private sector are asked to accept responsibility for a risk that is within their control, they will be able to charge a price for this part of the deal which is economically appropriate. However, if the Department seeks to transfer a risk which the private sector cannot manage, then the private sector will

*seek to charge a premium for accepting such a risk, thereby reducing value for money. The Department should therefore have sought to achieve not the maximum but rather the optimum transfer of risk, which allocated individual risks to those best placed to manage them.*⁶¹

In Australia, most of the activity in private financing initiatives has occurred at the State government level, particularly in relation to infrastructure projects such as roads. Prominent examples include the Sydney Harbour Tunnel and the M2 Motorway in Sydney⁶² and the City Link project in Melbourne. Of note is that these high profile projects have been the subject of external scrutiny that has raised concerns about the exact distribution of risk and financial benefits between the public and private sectors, for example as indicated by the following audit observations:

- The New South Wales Auditor-General has consistently commented that, although private sector owners have been given long-term rights over important road networks, there has not been a proper comparison of the cost-effectiveness of private sector involvement and the traditional public sector approach. Accordingly, the Auditor-General was unable to conclude that the projects that have been undertaken were in the State's best interests from a financial viewpoint.⁶³ In particular, the opportunistic and ad hoc use of private finance was criticised as it was considered unlikely to improve the overall efficient use of the road network and reduce the total costs of road maintenance and management.⁶⁴
- The Melbourne City Link project is one of the largest infrastructure projects ever undertaken in Australia with an estimated total cost of around \$2 billion. It involves around 22 kilometres of road, tunnel and bridge works linking three of the Melbourne's most important freeways. A report by the State Auditor-General found that, while the users of the City Link via toll payments will, in substance, be the financiers of the project, the private sector has accepted substantial obligations associated with the delivery and operation of the City Link, including traffic and revenue risks. However, the auditors also found that the decision to establish the City Link as a toll road was not supported by a financial model which compared project costings on the basis of private sector financing versus government borrowings.⁶⁵

Significantly, there have also been concerns raised about public accountability for privately financed projects. These have stemmed from difficulties Parliaments have experienced in gaining access to contract documents. For example, in relation to the aforementioned M2 Motorway in New South Wales, the Parliament was denied access to the contract deed between the public sector roads authority and the private sector counterpart.⁶⁶

At the national level, the 1996 National Commission of Audit observed that the private sector has a significant capacity for a greater role in infrastructure services. The Commission also concluded that the role for government could be reduced and suggested that the identification of good opportunities for private sector investment in infrastructure could assist the goal of increased national saving.⁶⁷ Accordingly, there has been increasing interest in private financing initiatives at the federal level, although to date there has been limited actual adoption.

One example is the Cooperative Research Centres Program which involves collaborative research between industry, federal and State governments and universities and other research organisations. Funding of activities is shared between the participants and the distribution of any revenue from the commercialisation of commercial property is also negotiated.⁶⁸

In another example, the agency responsible for funding and managing the development of Australian government office and diplomatic properties has adopted private financing for a number of projects but has since discontinued private financing arrangements. My Office has examined one of these projects, within the context of risk management of foreign exchange dealings.⁶⁹ The key message in this context is the need for public sector managers to fully appreciate the nature of the commercial arrangements and attendant risks involved in private financing initiatives.

The Department of Defence has committed itself to examining the merits of using private financing in the delivery of Defence services, with an aim towards realising financial savings or improving effectiveness. Defence services included in this examination are to cover capital equipment as well as Defence facilities, logistical support and IT programs. The clear intention on the part of Defence in widening the use of private financing, reportedly for as many as 25 to 35 per cent of all future acquisition projects,⁷⁰ is to achieve the best affordable operational capability.

As an aside, I note that, in rebutting some criticism that PFI in the Defence context has been seen as ‘simply putting Defence capital expenditure on the plastic’, Mick Roche, Under Secretary of the Defence Materiel Organisation, has made the point that PFI will link the provision of the capital item or capacity with its life-cycle cost, and hence provide Defence with one *payment for availability*.⁷¹

An associated move that Defence is making in the area of private financing is to encourage increased participation in such financing methods by small to medium enterprises (SMEs), that may otherwise feel that the opportunities presented by such initiatives are only within the scope of larger, national and international defence industry players.⁷²

Of course, any such move towards private financing of Defence activities would need to consider what core business the Department needs to maintain in order to manage effectively the longer-term risks that are involved in any outsourcing. With this in mind, the Department has indicated in a Discussion Paper that private financing is to be considered for all capability proposals and tested as an acquisition method unless the capability:

- involves the direct delivery of lethal force (core Defence business); or
- is demonstrably inappropriate and uneconomic (that is, does not reflect best value for money).⁷³

The Defence Discussion Paper identified a number of lessons drawn from case studies arising from the UK Ministry of Defence’s experience as well as lessons from two State Governments⁷⁴—these may be of interest to other audiences, who are required to deal with similar private financing issues, albeit involving different subject matter.

In view of the growing interest in and use of private financing initiatives and the important financial, risk transfer and accountability issues raised, it can be expected that Auditors-General will increasingly focus their attention on examining such activities. It is hoped that such scrutiny can assist in optimising outcomes and providing assurance to the public and Parliaments about the processes adopted and outcomes achieved. In this context, I commend the work done by the UK NAO in examining privately financed projects and in providing sound guidance to auditors on how to examine value for money of privately financed deals.⁷⁵

4. CONCLUDING REMARKS

It is recognised that contractual performance is maximised by a cooperative, trusting relationship between the parties. However, it should never be forgotten that such relationships are founded on a business relationship in which the parties do not necessarily have common objectives. There should not be any equivocation about required performance nor about the obligations of both parties. Contract management is as much about achieving the desired outcome as it is about meeting particular accountability requirements. Both require sound, systematic and informed risk management. The United Kingdom National Audit Office has observed that:

*The success of a Public-Private Partnership requires a genuine alignment of interests between contracting parties to ensure that partnership is more than just a statement of intent. Achieving this alignment means that all parties to, and stakeholders in, a deal need to be engaged throughout [my underlining] the process.*⁷⁶

It is essential that agencies ensure staff have the capability and capacities to manage contracts effectively if they are to achieve the results required of us. But I stress that it is not just skills in relation to contracting that are important, there is still a high premium on knowledge and understanding of the functions/business being managed. Put simply, agencies have to be in a position to know what they are actually getting under a contract and whether it is meeting the objectives. If not, the success of those agencies and their very reason for being are at risk.

While the primary focus of an agency is on achieving required results, the contract manager has to consider a combination of preventative and detective controls to minimise the risk of failures in contract service delivery. The Guide suggests that:

*The level and complexity of these controls will be directly proportional to the assessment of the importance of the contracted services (and the risk assessment undertaken) in achieving the business objectives and outputs of the organisation.*⁷⁷

As I remarked earlier, one size does not fit all cases. The same comment applies to the relationship established between the parties for any particular contract as the following indicates:

Each relationship will develop according to the context of the contract, the risk assessment undertaken, the size and complexity of the contract,

*the nature and personalities of management of the purchaser and provider, and the commitment to maintaining the relationship.*⁷⁸

Standards should be developed against which performance can be compared. Generally those standards will be written in terms of cost (or efficiency), scheduling and service quality. They may be in absolute terms or expressed in terms of a specified acceptable range or by participants' rating service quality and expectations. Finally, it is important not to underestimate the planning and management effort required to ensure that there is a smooth transition from one contract to another. This should start with, and be part of, the initial contract preparation. It should also be an ongoing element in the contract manager's consideration of contract issues that need to be dealt with. The uninterrupted delivery of goods and services is key to continued delivery of organisational outputs or business continuity, one of the risks the organisation must manage at this stage (particularly if there is a change of provider).⁷⁹

The ANAO is shortly to embark on a series of workshops and seminars on the Contract Management Better Practice Guide which will not only help to raise awareness of contract management issues but will also provide an opportunity for exchanging and sharing experiences. We are all in a learning phase and I would like to thank sincerely the organisers of today's seminar as well as the Australian Corporate Lawyers Association for their initiative in both the selection of the topic and providing the opportunity to contribute.

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- ¹ ANAO 2001, *Contract Management Better Practice Guide*, Canberra, February, p. 3.
- ² United Kingdom (UK) National Audit Office (NAO) 2000, *The financial analysis for the London Underground Public -Private Partnerships*. Report, London, 15 December, p. 2.
- ³ Senate Finance and Public Administration References Committee 1998, *Contracting Out of Government Services*, Second Report, SFPARC, Canberra, May.
- ⁴ Industry Commission 1996, *Competitive Tendering and Contracting by Public Sector Agencies*, Melbourne,
- ⁵ Audit Review of Government Contracts 2000, '*Contracting, Privatisation, Probity and Disclosure in Victoria 1992-1999 : An Independent Report to Government*', Report, State Government of Victoria, Melbourne, May, p. 31.
- ⁶ Mulgan R 1997, *Contracting Out and Accountability*, Discussion paper 51, Graduate Public Policy Program Australian National University abstract.
- ⁷ The South Australian Auditor-General noted in his report for the year ended 30 June 2000 to the House of Assembly, fourth session, forty-ninth Parliament (Part A Audit Overview p. 205) tabled on 4 October 2000 that:

It is essential that the private sector provides considering projects involving the storage, processing and security of government information and systems, be advised at an early stage of both government agency and Auditor-General rights in regard to access and audit. This matter requires due contractual and legal consideration by the Government and its agencies to ensure the adequacy of safeguards over the security, integrity and control of government information and processes, and to accommodate the Auditor-General's statutory audit responsibilities.
- ⁸ The issue was given particular prominence in ANAO Report No.22 1992-93 *New Submarine Project*, ANAO Report No.31 1994-95 *Defence Contracting*, Joint Committee of Public Accounts, Report 337 *A Focus On Accountability: Review of Auditor-General's Reports*, ANAO Report No.34 1997-98, *New Submarine Project* and Joint Committee of Public Accounts and Audit Report 368, *Review of Audit Report No. 34, 1997-98, New Submarine Project Department of Defence*.
- ⁹ Joint Committee of Public Accounts and Audit 1999, *Review of Audit Report No. 34, 1997-98, New Submarine Project Department of Defence*. Report 368, June, p. xiv:

'Recommendation 5: *The Committee recommends that the Minister for Finance make legislative provision, either through amendment of the Auditor-General Act or the Finance Minister's Orders, to enable the Auditor-General to access the premises of a contractor for the purpose of inspecting and copying documentation and records directly related to a Commonwealth contract, and to inspect any Commonwealth assets held on the premises of the contractor, where such access is, in the opinion of the Auditor-General, required to assist in the performance of an Auditor-General function. (paragraph 6.20).'*
- ¹⁰ Government response to Recommendation 5 of the 368th Report of the Joint Committee of Public Accounts and Audit : Review of Audit Report No. 34 1997-98, New Submarine Project - Department of Defence. Letter from the Prime Minister to the Minister for Finance and Administration dated 12 August 2000.
- ¹¹ Ibid.
- ¹² Commonwealth Protective Security Manual 2000, Op.cit., p. F45 (para 6.19).
- ¹³ UK NAO 2001. *The Re-negotiation of the PFI-type deal for the Royal Armouries Museum in Leeds*. Report, London, 18 January.
- ¹⁴ Ibid., p. 5.
- ¹⁵ Ibid., p. 7.

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- 18 Schulze, Peter, MLC, Chairman, Tasmanian Public Accounts Committee, 1999. *Commercial Confidentiality – Striking the Balance – A Contributing Paper*, 1999 Australasian Council of Public Accounts Committees, 5th Biennial Conference, Perth, WA, 21-23 February.
- 19 Victorian Public Accounts and Estimates Committee 2000, *Inquiry into Commercial in Confidence Material and the Public Interest*, Report No. 35, Melbourne, March.
- 20 Loney Peter MP, 2001. *Commercial-in-Confidence - Striking the Right Balance*. 6th Biennial ACPAC Conference, 4-6 February, Canberra, p. 5.
- 21 *Ibid.*, p. 7.
- 22 See Joint Committee of Public Accounts and Audit (JCPAA) 2000, *Contract Management in the Australian Public Service*, Canberra: Parliament of the Commonwealth of Australia, [October 2000]; Senate Finance and Public Administration References Committee (SFPARC) 2000, *Inquiry into the mechanism for providing accountability to the Senate in relation to Government contracts*, Canberra [Online] Available: http://www.aph.gov.au/senate/committee/fapa_ctte/acnt_contract/contract.pdf, [7 December 2000]; JCPAA 1999, *Corporate Governance and Accountability Arrangements for Commonwealth Government Business Enterprises* (R.E. Charles, Chairman), Report 372, JCPAA, Canberra, December; SFPARC, 1998, *Inquiry into Contracting Out of Government Services-Second report*; and SFPARC 1997, *Contracting Out of Government Services—First Report: Information Technology*, Canberra, November.
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- 24 Senate Hansard 2001, *The Government's information technology outsourcing initiative*. Finance and Public Administration References Committee, Canberra, 7 February, pp. 45-51.
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- 29 UK NAO 2001. *The Re-negotiation of the PFI-type deal for the Royal Armouries Museum in Leeds*. Op.cit., p. 6.
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- The seven principles of the New Public Service suggested are:
- 1) Serve, rather than steer. An increasingly important role of the public servant is to help citizens articulate and meet their shared interests, rather than attempt to control or steer society in new directions.
 - 2) The public interest is the aim, not the by-product. Public administrators must contribute to building a collective shared notion of the public interest. The goal is not to find quick solutions driven by individual choices. Rather, it is the creation of shared interests and shared responsibility.
 - 3) Think strategically, act democratically. Policies and programs meeting public needs can be most effectively and responsibly achieved through collective efforts and collaborative processes.
 - 4) Serve citizens, not customers. The public interest results from a dialogue about shared values, rather than the aggregation of individual self-interest. Therefore, public servants do not merely respond to the demands of "customers" but focus on building relationships of trust and collaboration with, and among, citizens.
 - 5) Accountability is not simple. Public servants should be attentive to more than the market; they should also attend to statutory and constitutional law, community values, political norms, professional standards, and citizen interests.
 - 6) Value people, not just productivity. Public organisations and the networks in which they participate are more likely to succeed in the long run if they are operated through processes of collaboration and shared leadership based on respect for all people.
 - 7) Value citizenship and public service above entrepreneurship. The public interest is better advanced by public servants and citizens committed to making meaningful contributions to society rather than by entrepreneurial managers acting as if public money were their own.
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- *Know what you want, but avoid over prescription. Specify outcomes and standards rather than process.*

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- *Long term contracts, defined as at least 7 years, but usually in the 15 to 35 year range, are needed for the private sector to recoup investment.*
 - *Assessment of projects should be based on the private sector's cost of capital rate, which in turn is based on the project risk.*
 - *Projects need to be aggregated to an economic size, rather than a number of small 'packets', taking into account the benefits of proposals over the life of the asset and the benefits to the organisation as a whole.*
 - *Private financing involves higher initial transaction costs, and higher cost of finance, than traditional procurement, which need to be offset by whole of life savings and benefits. For this reason, private finance and traditional tendering processes should not normally be carried out in parallel.*
 - *Contracts have generally led to improvements, either through savings or through an improved level of service.*
 - *Risk assessment and management is critical to success.*
 - *A centre of expertise is necessary in private financial policy and practice, as is ready access to external financial expertise, to effectively manage and assess privately financed projects.*
 - *Competition needs to be retained in the marketplace as much as is practicable.*

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⁷⁹ Ibid., p. 79.