



**PUBLIC ACCOUNTS
AND ESTIMATES COMMITTEE**

THIRTY-FOURTH REPORT TO PARLIAMENT

**REPORT OF THE INQUIRY INTO
OUTSOURCING OF GOVERNMENT
SERVICES IN THE VICTORIAN PUBLIC
SECTOR**

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PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

MEMBERSHIP - 54TH PARLIAMENT

Mr P J Loney, MP (Chairman)

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Hon. L Asher, MP*

Ms A P Barker, MP*

Ms S M Davies, MP*

Hon. R M Hallam, MLC*

Mr T J Holding, MP*

Mrs J M Maddigan, MP*

Hon. G K Rich-Phillips, MLC*

Hon. T C Theophanous, MLC

- * These Members were appointed to the Public Accounts and Estimates Committee prior to the tabling of this report and took no active part in the Inquiry, which was undertaken during the 53rd Parliament.

Report on Outsourcing in the Victorian Public Sector

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

MEMBERSHIP – 53RD PARLIAMENT

The Members of the Public Accounts and Estimates Committee during the term of this Inquiry were:

Hon. W Forwood, MLC (Chairman)
Hon. R Best, MLC
Mr S P Bracks, MP ¹ (Deputy Chairman)
Mr R J Hulls, MP
Mr P J Loney, MP ²
Hon. N B Lucas, PSM, MLC
Mr S J McArthur, MP
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Hon. A. Sheehan, MP ⁴
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¹ Discharged from attendance as a Member of the Committee on 21 April 1999

² Appointed 3 September 1998 in place of Hon. A Sheehan

³ Appointed 21 April 1999 in place of Mr S Bracks

⁴ Resigned from Parliament 8 July 1998

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MEMBERSHIP OF THE SUB-COMMITTEE⁵

Members

This Inquiry was undertaken by:

Hon. W Forwood, MLC (Chairman of this
Inquiry)

Mr S P Bracks, MP⁶

Hon. T C Theophanous, MLC

Mr K A Wells, MP

For this Inquiry, the Sub-Committee was supported by a secretariat comprising:

Ms M Cornwell	Executive Officer
Mr R Szpak	Research Officer on secondment from the Auditor-General's Office
Ms F Essaber	Assistant Executive Officer
Ms S Kestle	Secretarial Assistant

Specialist Advisers:

Ms Sarah Cullen	Consultant with Deloitte Touche Consulting Group
Dr Graeme Hodge	Program Director, School of Management, Mt Eliza Business School

⁵ The Parliament was prorogued on 24 August 1999.

⁶ Discharged from attendance as a Member of the Committee on 21 April 1999

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DUTIES OF THE COMMITTEE

The Public Accounts and Estimates Committee is a joint parliamentary committee constituted under the *Parliamentary Committees Act 1968*, as amended.

The Committee comprises ten Members of Parliament drawn from both Houses of Parliament and all parties and includes an independent Member.

The Committee carries out investigations and reports to Parliament on matters associated with State financial management. Its functions under the Act are to inquire into, consider and report to the Parliament on:

- (a) any proposal, matter or thing connected with public administration or public sector finances;
- (b) the annual estimates or receipts and payments and other budget papers and supplementary estimates of receipts and payments presented to the Assembly and the Council.

The Committee, in consultation with the Auditor-General, also determines the objectives of performance audits and identifies any particular issues that need to be addressed during these audits.

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GLOSSARY

Accredited Purchasing Unit	A unit established within a department following the devolution of responsibilities under the government's management reforms, to co-ordinate and manage departmental purchasing activity and provide in-house expertise to deal with more complex purchasing issues.
Benchmarking	A system of systematically measuring and comparing the products, services and processes of an organisation - internally and externally - and adopting best practice.
Bundling of services	Grouping a number of complementary services into one tender.
Business case	The broad cost/benefit justification for the approval of a decision to outsource a service.
Competitive tendering	The process of selecting a preferred supplier from a range of potential contractors by seeking offers (tenders) and evaluating these on the basis of one or more selection criteria.
Competitive neutrality	A policy which aims to keep competition between the public sector and private sector fair. Under this policy, government business must compete with private businesses on the same basis, by pricing their products according to full commercial costs.
Compulsory Competitive Tendering (CCT)	Where agencies were required under the <i>Local Government Act 1989</i> to introduce competitive tendering to specified services or to a specified level of expenditure.

Contestability	Potential or actual competition for services through market testing.
Contracting out	An arrangement whereby an agency enters into a contract with an external supplier for the delivery of services which have previously been provided internally. Contracting out does not necessarily involve seeking competitive bids.
Effectiveness	The extent to which outcomes or stated objectives are achieved.
Efficiency	The maximisation of outputs for a given level of inputs. Efficiency is concerned with the processes by which a service is provided.
In-house bid	A tender prepared and submitted by internal agency staff and where, if successful, internal staff provide the specified service on a contractual basis.
Inputs	Resources, both human and other, used to produce outputs.
Market testing	The practice of comparing the internal costs of service delivery (or the in-house bid price) against the costs of externally sourced service delivery.
Objectives	Concise, realistic, outcomes-oriented statements as to how a service is to be achieved and measured.
Outcomes	All the impacts of a service beyond its direct outputs. A causal link between a service and an outcome must be demonstrated to assess effectiveness. Outcomes are often delayed or long-term and they may be either intended or unanticipated.

Outputs	The services or products that are delivered by an agency. Output measures are more readily identifiable than outcomes and may provide useful background information for decision-making.
Outsourcing	See Contracting out.
Partnering	An approach to contracting designed to create cooperative working relationships between the parties to a specific contract. This may be expressed in a separate agreement or integrated into the structure of the principal contract. The individual legal rights and obligations of the parties remain unaffected.
Partnership	Partnership (as distinct from partnering) does have a specific legal connotation, namely, an intention of the parties, which are separate legal entities, to accept joint liability for each other in the course of a business.
Performance information	Evidence about performance that is collected and used systematically to enable judgements to be made on the extent to which desired outcomes are being achieved. Such information can be quantitative or qualitative in nature and include a balance of efficiency and effectiveness measures.
Performance indicators	Quantitative and qualitative information used to assess the extent to which objectives are being achieved.
Performance measures	Measures of quantity, quality and timeliness used to describe how many, how well, when, or how frequently, the outputs that the government intends to fund will be delivered.
Purchaser provider split	A distinction between the purchaser of a service (agency) and the service provider (supplier). The purchaser, in the context of this report, is generally a public sector agency, while the provider may come from the public, private or not-for-profit sectors. In some cases the purchaser/provider split may be established within an agency, where the head office or

policy areas of the department purchases services from divisions or regions. Such an arrangement applies within the Department of Human Services.

Quality	Relates to the characteristics by which an agency's services are judged by consumers and government. In its broadest sense, quality incorporates assessment of outputs and outcomes from the perspective of those key interest groups.
Quality assurance	An activity that provides independent review of a product or process to ensure appropriate quality standards are met. Standards are usually determined by peak and professional organisations or may be in the form of directions, guidelines or manuals developed by departments or agencies. Quality assurance proves useful in the selection and evaluation of tenders and also provides a means of ensuring standard outputs.
Relationship agreements	Agreements designed to facilitate a cooperative working relationship between parties rather than the adversarial approach fostered by the traditional contractual arrangements. As with partnering, their purpose should be clearly stated to avoid conflict with existing legal contracts between parties.
Risk management	The systematic application of management policies, procedures and practices to the tasks of identifying, analysing, assessing and monitoring risk. This process includes quantifying and making order of actual and potential risks and their associated losses, and developing management strategies to minimise the impact of these risks.
Service Agreements	A contractual arrangement between a government instrumentality and an external service provider for the delivery of services at an agreed price.
Standards	Pre-defined levels of excellence against which performance can be measured. Standards can relate to the quality and objectives of a service

	or to aspects of service delivery, and can be set at different levels.
Strategic alliances	These are less specific, longer term arrangements for establishing a general framework for cooperation between parties and networking between their staff.
Targets	Quantifiable performance levels or changes in the level of performance to be attained at a future date. Targets enable a direct judgement to be made of performance and can be used to clarify and simplify the process of monitoring.
Teaming	Generally used to refer to arrangements, sometimes established through written agreements, where parties agree to join together in tendering for specific projects and in the performance of any resulting contracts.
Transaction costs	The costs associated with the process of buying and selling to external organisations. For instance, costs incurred in conducting a tendering process and specifying contracts.
Transition costs	One-off costs incurred in the change from internal provision to contracting. They may include redundancy payments and the costs of selling surplus equipment.

ACRONYMS AND ABBREVIATIONS

ACOSS	Australian Council of Social Service
ARC	Administrative Review Council
CCT	Compulsory Competitive Tendering
CFA	Country Fire Authority
COAG	Council of Australian Governments
CPSU	Community and Public Sector Union
CTC	Competitive Tendering and Contracting
GBE	Government Business Enterprise
IT	Information Technology
KPIs	Key performance indicators
MII	Management Improvement Initiative
MRP	Management Reform Program
OCM	Outsourcing and Contract Management
PACCER	Procurement and Contracting Centre for Education and Research
PTC	Public Transport Corporation
SECV	State Electricity Commission of Victoria
SOE	State Owned Enterprises
VCOSS	Victorian Council of Social Service
VGPB	Victorian Government Purchasing Board

CHAIRMAN'S INTRODUCTION

In the past two decades, the Victorian public sector has arguably undergone some of the most significant and far-reaching changes in its entire history. This has resulted in change in structure, process and underlying ideology. This report reviews one key element of these significant reforms - the outsourcing of government services.

A key problem that the Committee encountered during this Inquiry was the incomplete nature of the performance and financial information that was available. There was little reliable or accurate data and there were problems in distinguishing between transitional and continuing effects, both in terms of costs and benefits. The inquiry was also hampered by the lack of data on matters of a more intangible nature, such as trends in staff morale, capability and probity issues.

It is also noted that there has been very limited critical assessment of the impact of outsourcing from a whole of government perspective. For example, what has been the transitional costs and what will be the potential future costs of not having the capacity to deliver services from within the public sector. As a consequence, the Committee has not canvassed all of the issues associated with outsourcing or analysed the issues from a user perspective. Instead the Committee has focused on how outsourcing was being undertaken by agencies prior to the change of government in late 1999.

The recommendations contained in this report are premised on the assumption that outsourcing of government services will continue to be used as a management option for delivering services. However, the Committee is aware that three independent Members of Parliament, Ms Susan Davies (a Member of this Committee), Ms Russell Savage and Mr Craig Ingram, have signed an Independents' Charter with the Bracks Government. Under the terms of this agreement, the government has committed itself to a review of contracted out services which will report on whether the system should continue or be wound down and abolished as contracts expire. The outcome of that review may have significant implications for the level of outsourcing undertaken in the future.

While it is acknowledged that the effects of major reforms such as outsourcing are likely to be felt over a long period of time, we believe that this Committee has an important role in assessing the on-going political, economic and social consequences of major changes in public policy. Accordingly, during this year the Committee will be reviewing further elements of the reform program. Future inquiries will cover service agreements for the health, community and welfare sectors and appropriate corporate governance arrangements for the Victorian public sector.

The Committee also intends, at a later stage, to review other matters relating to outsourcing. This review will include issues relating to privacy, employment, equity and service quality.

Two key issues that emerged from this Inquiry concerned transparency of information relating to the tendering and contracting process and public accountability. These are issues that were addressed as part of the Committee's inquiry into commercial in confidence and the public interest. That report will be tabled at the same time as this report.

Over the course of the Inquiry we have been assisted by many people. I would like to thank all those individuals and organisations that provided evidence and support throughout the inquiry. I would also like to thank the members of the previous Public Accounts and Estimates Committees, and the staff of the Public Accounts and Estimates Committee secretariat, who have worked on this inquiry.

Report on Outsourcing in the Victorian Public Sector

The Committee hopes that the recommendations in this report will provide useful guidance to the many government agencies that are contracting out government services.

A handwritten signature in black ink, appearing to read 'Peter Loney', with a large, stylized flourish at the end.

**Peter Loney, MP
Chairman**

EXECUTIVE SUMMARY

Chapter 1: The inquiry in context

Over the past five years the Kennett Government introduced a number of reforms which have radically altered the structure, operations, management and financial accountability of the public sector at both state and local government levels. These reforms were intended to increase the efficiency of public services.

This report reviews one instrument of the reform process, outsourcing of government services, which is defined as;

*a contractual arrangement for an external organisation to take responsibility for performing specific activities, on a commercial basis, which are required for a government department/agency to fulfil its functions*⁷

The impact of this reform is fundamentally changing the way publicly funded services are delivered. Instead of relying on “in-house” resources, the government is now widely utilising the private sector to provide a range of services to the community.

The Committee’s inquiry identified a five-fold increase in the extent of outsourcing in Victoria since the early 1990s. Prior to July 1992, service contracts let to the private sector were estimated at \$171 million, however a recent survey identified the figure for 1996-97⁸ to be in excess of \$841 million⁹ for the delivery of a wide range of services.

The inquiry revealed that the interests of the various groups affected by outsourcing, such as taxpayers, potential contractors, public sector employees, unions and those in rural and remote areas, can and often do conflict.

This report does not attempt to analyse the claims of different interest groups but rather focuses on how outsourcing was being undertaken by agencies in the context of reform in the Victorian public sector. The Committee intends, at a later stage, to undertake a further inquiry into other issues relating to

⁷ MAB/MIAC Report No. 23, *Before You Sign the Dotted Line... Ensuring Contracts can be Managed*, May 1997, Joint publication of the Management Advisory Board (MAB) and its Management Improvement Advisory Committee (MIAC), refer to Glossary

⁸ Details of the survey results for 1997-98 were not provided to the Committee

⁹ Victorian Government Services Conferencing Survey 1996-97, dated November 1998, Foreword by Minister of Finance

outsourcing including privacy, quality of service, equity, and employment.

Afterword: The report on this Inquiry was completed and considered by the former Public Accounts and Estimates Committee prior to the dissolution of the Parliament on 24 August 1999. As the former Committee considered there were several issues raised in this report which had implications for the Committee's other inquiry into commercial in confidence and the public interest, it was agreed to hold this report over until the commercial in confidence report had been finalised. As both reports complement each other, it is the intention of this Committee to present the reports together.

Since the change of government¹⁰ there have been a number of policy changes which impact on the evidence contained in this report. These changes include:

- on 5 November 1999, the Outsourcing and Contract Management Unit within the Department of Treasury and Finance was disbanded¹¹; and
- legislative changes¹² have been made to the Local Government Act to implement the Bracks' Government election commitment to abolish compulsory competitive tendering for local government. In place of compulsory competitive requirements, councils will now have an obligation to ensure that councils seek the best value in providing services.

In addition, the three independent Members of Parliament, Ms Susan Davies (a Member of this Committee), Mr Russell Savage and Mr Craig Ingram, have signed an Independents' Charter with the Bracks Government. Under the terms of this agreement the government has committed itself to a review of contracted out services which will report on whether the system should continue. The outcome of that review may have significant implications for the level of outsourcing undertaken by the public sector in the future.

Chapter 2 The trend towards outsourcing

The ever-growing pressure on governments throughout the 1980s and 1990s to control public expenditure has focussed attention on outsourcing and privatisation. Outsourcing is not new in the

¹⁰ The Bracks Government was commissioned on 20 October 1999

¹¹ Memorandum from Mr J.Rickard, Director of Procurement, Department of Treasury and Finance

¹² *Local Government (Best Value Principles) Act 1999*

public sector. Many services have traditionally been the subject of competitive tendering, particularly those services which are considered 'non-core' activities, such as cleaning and gardening.

The introduction of competition is seen by proponents of outsourcing to provide significant benefits in terms of incentives for productivity gains; through innovation in service delivery; access to expertise and resources and new technology. In addition, both in the private and public sectors, there is a belief that a more business oriented approach can drive the changes necessary to reduce costs while at the same time improve the quality of services delivered.

The use of competitive tendering and contracting was an integral part of the Kennett Government's approach to public sector reform. This approach significantly altered the government's role from one of a direct provider of services to that of a purchaser of services. This separation of functions focused the government's attention on specifying service requirements, as opposed to concentrating on service delivery issues.

Chapter 3 The potential risks and benefits of outsourcing

The Committee identified a number of potential benefits and risks which may arise from outsourcing. These are detailed in pages 17-19 of this report.

The Committee concluded that the key to successful outsourcing will lie in the sound application, management and supervision of outsourcing concepts and processes and in taking a competitive approach to the provision of public sector services.

Outsourcing places a great deal of reliance on contractual specifications which are seen as the key to ensuring that services are delivered in the required manner.

The major difficulties with outsourcing encountered by government agencies have centred on the need to establish clear and measurable targets for more complex and sensitive areas, such as Information Technology (IT) and Human Resources.

The impression gained by the Committee has been that contractors have generally been satisfied with the outsourcing process, however, attention needs to be given to advising unsuccessful service providers of the outcome of the tendering process.

Chapter 4 Key issues

The inquiry highlighted the following key issues:

Core activities

Representations made to the Committee highlighted differing opinions as to what constitutes 'core' and 'non-core' activities and the appropriate methodology for deciding what should be contracted to outside suppliers. However, some witnesses were of the view that all services, regardless of whether they were classified as 'core' or 'non-core', should be considered for outsourcing. On this point, the Committee has concluded that the differentiation of 'core' and 'non-core' raises more questions than answers.

Concern was expressed to the Committee that there has been insufficient debate about the benefits of outsourcing, particularly in relation to services such as the privatisation of prisons.

Use of outsourcing to meet government objectives

The Committee maintains that outsourcing is not an end in itself. If policy objectives are to be incorporated into contracts then measures should be employed to ensure transparency of costs of implementing those objectives.

Promoting and ensuring a competitive market

It is evident from the public hearings that doubt exists that a 'level playing field' can be established to enable a meaningful comparison of costs attributable to in-house service providers and the price proposed by an external contractor.

The Committee believes that potential advantages and disadvantages of public provision of services should be assessed against a range of factors before determining to outsource services and activities.

Perceptions of unfair competition may result from in-house teams having or perceived to have advantages such as access to internal information and a close relationship with staff responsible for evaluating competing tenders.

The Committee noted diverse views on whether or not in-house bids are desirable and also that, there are many difficult issues which need to be dealt with such as staffing concerns, including loss of knowledge and expertise and industrial relations issues.

Previously, in-house bids were discouraged in Victoria at the State government level (unlike the local government sphere where the level of in-house bids remains significant), on the basis of concerns about the probity of such bids.

It is the view of the Committee that successful in-house teams should be separated from all aspects of contract management and be subject to monitoring and reporting.

The Committee believes that the issues of supplier capture and contract renewal will need specific attention as initial contract periods come to an end.

Alternatives to outsourcing

Outsourcing is only one of many management tools to improve the efficiency of an agency and the services it delivers. The Committee agrees with the view of some witnesses that the level of savings and benefits sought from improvements, other than the competitive tendering and contracting initiatives, would generally not be of the order that would be obtained through outsourcing. Nevertheless, the question remains as to what happens when there is no private sector equivalent to provide competition.

An alternative to outsourcing is benchmarking. The Committee is of the view that benchmarking is of little merit unless applied to services where significant change can be effected rapidly. For benchmarking to be of value, a suitable model has to be found against which performance can be measured. This may not be attainable.

Employee welfare

Management needs to be aware of the effects that outsourcing of services will have on staff.

Many witnesses were concerned with the impact on the morale of the remaining staff following the transfer of staff to service providers. The Committee acknowledges the potential impact on those 'left behind' as a result of the decision to outsource and retrench staff.

Chapter 5 Quality of guidance provided

In December 1995 the Department of Treasury and Finance issued the *Outsourcing and Contract Management Guidelines*, for use by departments and agencies, which expand upon previously released guidelines. These guidelines have been developed around a six-phase life cycle approach for outsourcing projects with

medium to large projects in mind. (An overview of the framework is discussed at pages 55 to 59 of this report).

The Department of Treasury and Finance has not been able to clearly discern whether or not, and the extent to which, the Guidelines have been referred to in practice. Consequently, it was difficult for the Committee to properly evaluate the effectiveness of the Guidelines. However, based on evidence given by various agencies, the Committee believes that the Guidelines represent an important aspect of the overall purchasing framework within Victoria.

The Committee would expect that the Guidelines be updated regularly and their future use by departments and agencies should be monitored to ensure that these are a useful tool.

The Committee noted that the Outsourcing and Contract Management Unit within the Department of Treasury and Finance had previously played a significant role in promoting the move to outsourcing. As part of its activities, the Unit had developed various training programs, conducted workshops and seminars as well as keeping in close contact with many public service staff involved in the outsourcing process. In addition, the Unit had been represented on steering committees and provided assistance in selecting management and legal consulting support. While the Committee has not examined in depth the work of the Outsourcing and Contract Management Unit, the Committee is satisfied that the activities of the Unit assisted the contracting out process.

All Australian governments have general purchasing policies and procedures. Some have developed guidelines specifically related to competitive tendering and contracting and it is understood that a number of individual departments and agencies have developed their own guidance materials. The Committee noted that the Commonwealth approach to the implementation of competitive tendering and contracting is much the same as for Victoria.

Under the National Competition Policy, the Kennett Government undertook action in a number of key areas to improve the overall efficiency of the State's economy. One of those key areas was the application of competitive neutrality pricing principles to all business activities in government ownership. In applying these principles, the intention was to allow public and private businesses to compete fairly on the basis of their relative skills and expertise.

Chapter 6 Cost savings derived from outsourcing

The Committee noted the extensive research undertaken by the Productivity Commission on the impact of contracting on the costs of service provision to governments. In its report, the Commission concluded that in general, contracting reduces the ongoing costs of service provision and that the amount of savings identified through its research was in the range of 10 per cent to 30 per cent. However, the Committee remains uncertain, along with many other commentators, that these levels of savings are achievable for all services and over time.

The Committee noted from submissions received that estimates for cost savings could not be provided for a number of reasons, including the impact of restructuring and inadequate costing systems.

While acknowledging that outsourcing may achieve cost savings, the Committee firmly believes that the source of these savings needs to be closely analysed to determine whether there is a net gain to the community.

While submissions made to the inquiry provide many examples of cost savings having been achieved, no indication was given in those submissions as to the manner in which those savings were derived.

The Committee believes that more comprehensive data should be accumulated on the nature and extent of these cost savings to enable meaningful conclusions to be reached.

The Committee considers that there should be substantial analysis of at least the more significant contracts entered into by departments and agencies, to determine the level of real savings achieved and how those savings arose.

The Committee noted that much of the success of outsourcing will revolve around the capacity of the private sector to continue to provide the contracted-for services, in an efficient and effective manner.

The recently introduced Management Reform Program represents a fundamental change in the focus of departments to deliver the specified quantity and quality of outputs at a specified price, while managing their costs. The capacity of a department to meet these requirements is linked to the implementation of competitive tendering and contracting.

Chapter 7 Outsourcing within departments and agencies

Responses to the Committee's questionnaire about outsourcing were received from all departments, and a number of statutory authorities and companies and local government bodies. Each agency commented on specific questions relating to their experiences with outsourcing, including savings achieved, difficulties encountered and suggestions for improvement. In addition, the Committee met with representatives of the Department of Infrastructure and the Department of Human Services to gain an insight into their experience with implementing outsourcing.

The Committee noted the following:

Department of Infrastructure

- the Department spends \$300 million¹³ on outsourcing, covering in excess of 1 500 contracts for such activities as bus services and information technology;
- cost savings claimed from the public transport outsourcing were in excess of \$10 million per annum, but the Department did not elaborate on the nature and source of these savings; and
- the Department was unable to provide the level of savings achieved through outsourcing its Information Technology function and had experienced major difficulties with its outsourcer on issues relating to the level of service and the design and implementation of measurable targets.

Department of Human Services

- external provision of services was around 86 per cent¹⁴ of the Department's operating budget; and
- for the majority of its activities, the Department was unable to provide the Committee with an assessment of the total savings derived through its outsourcing program.

Local Government

- the mandating of outsourcing within Victorian local government appears to have provided the necessary impetus to drive the competitive tendering and contracting initiative; however, some adjustments were

¹³ This information relates to the Budget Estimates for 1997-98

¹⁴ Ibid.

warranted in relation to matters such as the adequacy of self-regulation;

- the Municipal Association of Victoria indicated that it had no difficulty with the concept of outsourcing, however, it expressed some concern with the provisions of the Local Government Act;
- a number of practical difficulties were encountered in the implementation of compulsory competitive tendering for example the definition of 'core' and 'non-core'; and
- concerns by contractors as to the manner in which outsourcing is proceeding, such as perceptions of bias in favour of in-house bids.

Overall, the Committee believes that the experience gained in the application of compulsory competitive tendering, to local government councils, was invaluable in evaluating the implementation of outsourcing services in departments and agencies.

The Committee noted the new government policy decision to abolish compulsory competitive tendering for local government, and instead provide a new best value approach that enables councils to determine the most effective means of providing a service to the community. It is hoped that the new system will address the concerns raised during this Inquiry.

Chapter 8 Impact of outsourcing on human services

Victoria was the first state to introduce reform of its funding of health and community services. Reform continued with the introduction of output-based funding.

The Committee noted that the Victorian Council of Social Service (VCOSS) views the introduction of output based servicing as being contentious and is of the opinion that the major risks for community organisations in the new contracting culture are loss of autonomy and flexibility, and distortion of purpose.

Some community organisations concede that when managed well the use of contracts offers potential advantages including:

- greater clarity in service definition and performance expectations;
- more certainty through longer term contracts; and
- a framework for better management.

From evidence given at the inquiry, the Committee is aware that the impact of competition on the structure of the community

services sector has varied – it has given some larger agencies a chance to expand and threatened the viability of smaller ones. However, combined organisations could offer potential strengths.

The Committee received a submission in respect of a Victorian research project which was being undertaken on the impact of compulsory competitive tendering (CCT) on consumers of aged care and disability services provided by councils. The study focused on people with care and support needs and family carers, rather than being purchaser or provider focused. The Committee was advised that the project team found that a significant problem with the CCT process had been a lack of appropriate feedback mechanisms available to consumers. In addition, the project team's final report concluded that *'there is little evidence to support the assumptions that competitive tendering has actually improved service quality or provided better value for money'*.

After evaluating all evidence the Committee believes there would be merit in the Department of Human Services funding independent studies into the impacts of outsourcing and competitive tendering on the quality of service delivery in the welfare services area.

The Committee believes that consideration should be given by departments and agencies to the conduct of customer impact surveys to complement the annual outsourcing activity survey.

The Committee noted that a major concern of the community services sector is that there is an enormous amount of work required from program and management staff in preparing for, writing, submitting and attending interviews relating to the tendering process, all of which are unfunded, and require a diversion of staff from the organisation's core function.

The Committee was advised that smaller organisations do not have the human and financial resources to spend the time necessary to prepare tenders. On this matter, the Department of Human Services advised that it did not fund the preparation of tender bids, as such an approach would diminish the benefits to be derived from the competitive tendering process. The Committee believes that this puts small community organisations at a disadvantage.

The likelihood of amalgamations/mergers within the community services sector was made apparent to the Committee by VCOSS which indicated that the majority of service provider agencies have less than five employees, with most of these people being involved in the direct provision of services. The introduction of competitive tendering and contracting impacts directly on the capacity of these smaller organisations to operate since they do not have the necessary funds for research, evaluation, monitoring, and other matters such as change management.

While recognising that competitive tendering and contracting may effectively lead to a rationalisation of the community services sector because of the influence of competition, the Committee is concerned that, despite the significant benefits that may accrue to amalgamated/merged organisations, there is potential for reductions in service quality where the competition results in a lessened collaboration within that sector.

Whichever way consumer needs are determined, the Committee has found general acceptance that not only should all matters of importance to the consumers be documented in the contract specifications but also that the consumers should be made aware of what those contractual arrangements mean.

One way of providing this awareness is through customer service charters. The Committee considers that the key to whether customer service charters will be effective, revolves around the review and accountability mechanisms, which ensure that there is an appropriate level of commitment by the service provider and purchasing agency.

The Committee is of the view that customer service charters are essential to provide assurance to consumers that service quality under competitive tendering and contracting is maintained, if not improved.

Chapter 9 Implications for the Parliament

The Committee noted fundamental disagreement about whether contracting out does lessen the accountability of government for the provision of public services.

From the Committee's perspective, it is important that accountability in the delivery of government services be evidenced in fact by the capacity of the public to gain an awareness of the key features of contractual arrangements entered into and contribute to the decision making process.

External reporting obligations of departments and agencies are embodied in the *Financial Management Act 1994* and for local councils, the *Local Government Act 1989*. However, the Committee considers that the present external reporting requirements on outsourcing are deficient to the extent that there is no provision for the disclosure of relevant information regarding the level and nature of outsourcing undertaken by government agencies.

The Victorian Ombudsman receives a large number of inquiries from people seeking advice about services that have been outsourced. The Committee considers that, in general terms, the service provider should be first approached when a problem arises, then the purchasing agency by way of a well defined contact point and finally, the Ombudsman.

The Ombudsman and the Auditor-General have an important accountability role in providing assurances to the Parliament and the public as to whether outsourcing decisions have been soundly based and do not disadvantage individuals or the community.

Chapter 10 Conclusions reached by the Committee

Based on submissions and evidence given by departments, the Committee formed the view that all departments were actively pursuing strategies for the increased outsourcing of their activities.

The Committee believes that the results of outsourcing activities are mixed. It further believes that the issuing of central agency guidelines was a significant step and encourages all departments and agencies to use them extensively. The Committee considers that compliance audits on the effectiveness of the guidelines are important.

The inability of departments and agencies to provide details of the make-up of cost savings is a significant shortcoming in the implementation of competitive tendering and contracting.

The Committee believes that evaluation of the benefits of outsourcing should be ongoing during the contract period.

Various witnesses indicated to the Committee that the present system for monitoring and evaluating performance of services is inadequate. The Committee appreciates that outcomes and quality are difficult to define particularly in human services and even more difficult to measure.

The Committee believes it is therefore essential that departments have effective monitoring systems in place to ensure that the performance of the contractor is monitored in accordance with the standards, benchmarks and performance indicators specified in the service agreement.

Without effective mechanisms for monitoring, it is not possible to know whether stakeholders are satisfied with the service being delivered.

It is clear to the Committee that individual departments are seeking to address many of the key issues relating to competitive tendering and contracting. In this context, the Committee noted that departments and agencies are making efforts to enhance their capacities to cope with further outsourcing of services.

RECOMMENDATIONS

Chapter 3

The Committee recommends that:

Recommendation 3.1:
page 29

The Department of Treasury and Finance’s Outsourcing and Contract Management guidelines should contain information on handling customer complaints and require that the service provider should be the initial contact for lodging complaints by service users.

Recommendation 3.2:
page 29

Agencies should be responsible for ensuring that service recipients are advised of all their avenues of complaint, either by providing this information directly or by requiring contractors to do so.

Recommendation 3.3:
page 34

In order to ensure a robust competitive system in tendering for government contracts, the Procurement Branch in the Department of Treasury and Finance consider what actions are necessary to better inform potential contractors about the opportunities to participate in outsourcing.

Chapter 4

The Committee recommends that:

Recommendation 4.1:

page 40

As a general principle, competitive tendering and contracting should not be employed by departments and agencies purely to satisfy other government policy objectives. In cases where there are other policy objectives (such as regional employment) to be incorporated into contractual requirements, a two envelope system should be used to ensure the transparency of costs of implementing those objectives.

Recommendation 4.2:

page 45

It is imperative that successful in-house teams should be separated from all aspects of contract management and subject to the same monitoring and reporting arrangements which would apply to an external provider, to ensure that the agreed price and performance standards are achieved.

Recommendation 4.3:

page 46

Every effort should be made to develop completely objective specifications of services and performance measures.

Recommendation 4.4:

page 46

Real or perceived conflicts of interest, whether in respect of in-house or external bids, should be evaluated and acted upon at an early stage.

Recommendation 4.5:
page 48

Prior to undertaking a tender process, departments and agencies should assess the potential market and consider strategies to expand the market and maximise competition.

Recommendation 4.6:
page 48

Departments and agencies frame tender specifications in a way that will encourage greater participation by potential tenderers.

Recommendation 4.7:
page 48

Departments and agencies report in their annual report on the extent to which a satisfactory level of competition has been achieved in the outsourcing process for the more significant contracts entered into, whether with external contractors or in-house teams. Where a decision to outsource has been made involving less than a reasonable number of competitors, then an explanation should be provided as to the reasons for non-participation by the remaining competitors and whether their non-participation has impacted upon the expected outcomes of the tendering process.

Chapter 5

The Committee recommends that:

Recommendation 5.1:
page 64

The Department of Treasury and Finance undertake a review of the Outsourcing and Contract Management guidelines and the guidelines of the Victorian Government Purchasing Board to ensure both sets of guidelines are consistent.

Recommendation 5.2:

page 64

The Department of Treasury and Finance:

- **adopt a clear definition of outsourcing ; and**
- **develop a methodology so that consistent and meaningful information on the level of financial savings achieved may be collected for analysis and reporting.**

Recommendation 5.3:

page 66

Departments and agencies ensure that adequate training on probity and ethics issues is undertaken by staff involved in the tender process to ensure they are fully aware of their duties and responsibilities.

Recommendation 5.4:

page 67

Departments and agencies ensure their staff and potential contractors are aware of the principles of ethics and probity applicable to public sector tendering and that they understand the importance of compliance with those principles.

Recommendation 5.5:

page 67

The appointment of a probity auditor to oversee the tendering process should be encouraged by departments and agencies. The probity auditor should be appointed by the Accredited Purchasing Unit and report directly to the Chief Executive Officer of the agency.

Chapter 6

The Committee recommends that:

Recommendation 6.1:
page 73

The Department of Treasury and Finance examine the coverage of the current outsourcing survey and seek further enhancement of the questions posed to departments and agencies regarding:

- (a) the significant contracts entered into by departments and agencies and the nature and extent of financial savings achieved;**
- (b) an analysis of the major contributing factors for such savings;**
- (c) whether those savings continue to be achieved over time and reported on;**
- (d) an assessment of the adequacy of the initial cost and service level estimates prepared as the basis of the tender evaluation;**
- (e) contracted service levels in relation to service quality and value for money;**
- (f) the cost of contract management to gain the complete cost picture; and**
- (g) compare the results to previous years and other jurisdictions.**

Recommendation 6.2:
page 77

Departments and agencies undertake analysis of their significant contracts and determine the level of real savings achieved and how those savings arose.

Recommendation 6.3:

page 79

The Department of Treasury and Finance develop guidelines for the treatment of staff costs in developing and assessing a business case for outsourcing.

Chapter 7

The Committee recommends that:

Recommendation 7.1:

page 90

Annual reports of councils should include an overall assessment of the level of real financial savings and other benefits achieved by councils through outsourcing services, and how these savings arose.

Recommendation 7.2:

page 92

Annual reports of councils should disclose such matters as:

- **the comparative level of in-house and external service provision;**
- **the extent of corporatisation of in-house business units;**
- **the manner in which decisions on contracting out are made, i.e. are all contracting out decisions considered by the Council or are some delegated; and**
- **the nature of the commercial arrangements entered into e.g. partnering, strategic alliances.**

These disclosures should be designed to demonstrate transparency and the existence of a level playing field.

Chapter 8

The Committee recommends that:

- Recommendation 8.1:**
page 103 Further research should be undertaken by the Department of Human Services on the potential impact of the competitive tendering model on the delivery of services for which the department has responsibility.
- Recommendation 8.2:**
page 103 Consideration be given to the quality of the performance indicators or measures on which contractor performance in the human services areas is evaluated.
- Recommendation 8.3:**
page 106 Consideration be given by departments and agencies to the conduct of customer impact surveys to complement the annual outsourcing activity survey.
- Recommendation 8.4:**
page 106 Departments and agencies with responsibility for community and welfare service delivery should fund independent empirical studies into the impacts of outsourcing on service users and providers and other relevant stakeholders including rural communities.
- Recommendation 8.5:**
page 110 The Department of Human Services provide training and research for the community services sector to assist those service providers to achieve required standards of service delivery.

Recommendation 8.6:

page 110

For significant tenders, the Department of Human Services should make allowances for non-recurring costs incurred in the preparation of tenders by non-government organisations, to ensure that as wide a range of service providers is involved in the tender process as is possible.

Recommendation 8.7:

page 114

The Committee's previous recommendations on the introduction of customer service charters into Victoria be reconsidered and, at a minimum, departments and agencies be required to include details of service standards, rights and obligations and other matters, in their annual reports with a statement as to whether such commitments have been met.

Chapter 9

The Committee recommends that:

Recommendation 9.1:

page 118

The annual reporting requirements under the *Financial Management Act 1994* be amended to mandate departments and agencies to disclose the nature and extent of outsourcing undertaken during the current financial year and the impact of outsourcing on the manner in which those departments and agencies have sought to achieve their operational objectives.

Chapter 10

The Committee recommends that:

Recommendation 10.1:

page 123

Departments and agencies should ensure that service agreements contain explicit statements covering:

- **the purpose of the agreement;**
- **the specific parties to the agreement;**
- **the specific duration of the agreement;**
- **the price to be paid for the specific outputs and outcomes and the circumstances in which prices may be varied. Where the price to be paid does not cover the full cost of service provision, the contracting department or agency should clearly specify this, stating that the service provider is expected to make a contribution to the cost of providing the service. The full amount of this contribution should be specified in the service agreement;**
- **the times, amounts and methods by which performance will be assessed. Where outcomes are difficult to measure, these should be in terms of policy objectives;**
- **the penalties and rewards for performing below or above agreed standards. Consideration should be given to the increased use of rewards/incentives where service providers exceed the agreed performance standards; and**
- **a requirement for compliance with relevant State laws.**

Recommendation 10.2:

page 124

A clear statement of the contractor's responsibilities and those of the contracting agency be set out in the service agreement. This statement should cover:

- **accountability of the service provider to the contracting agency for the services that they are providing. The government must be able to ensure that the contract is being fulfilled in a timely and appropriate manner;**
- **accountability of the service provider to the consumer of the service. Where community welfare services are contracted out to non-government organisations, the consumer is the third party. As consumers of the service are not a party to the agreement, they may not necessarily have directly enforceable rights against the service provider, such as the provision of information access rights, privacy protection and complaints mechanisms;**
- **accountability of the contracting agency to the service provider. Questions of accountability in contracting out often focus solely on the responsibilities of the service provider. However, it is also important that contracting agencies acknowledge their responsibilities to service providers by ensuring that the tender process is transparent and encompasses adequate mechanisms for unsuccessful tenderers to seek review, as well as adequate mechanisms for successful tenderers to seek redress for problems faced in performance of the contract.**

Recommendation 10.3:
page 125

The Department of Treasury and Finance extend the outsourcing activity survey process to include details of methodology for contracting out adopted by departments and agencies and how the integrity of these procedures was confirmed as being satisfactory, whether by internal quality

assurance or external independent examination.

Recommendation 10.4:

page 126

Departments and agencies develop a comprehensive quality assurance program that incorporates:

- **a quality accreditation program to ensure that prospective contractors are capable of achieving the standards expected under the contract;**
- **a performance monitoring regime to ensure that the contractor is providing the service specified in the contract. Monitoring should be on-going which will facilitate identifying any difficulties or problems in a timely manner so that corrective action can be taken before it is too late;**
- **appropriate performance measures to enhance accountability and enable the performance of government services to be opened to greater public scrutiny; and**
- **an evaluation process to determine outcomes achieved under the contract.**

CHAPTER 1 THE INQUIRY IN CONTEXT

1.1 The broad context

Over the past six years the Kennett Government introduced a number of public sector reforms which radically altered the structure, operations, management and financial accountability of the public sector at both state and local government levels.

Although some of the reforms have close parallels in other Australian jurisdictions, there are various aspects of these reforms which Victoria has taken further than most other governments. These broadly relate to:

- improving financial and management information systems with the aim of fundamentally reforming the way government services are planned, delivered, monitored and reported on; and
- achieving greater efficiency in service delivery by introducing market-based initiatives (e.g. commercialisation, corporatisation and exposing public services to competition).

This inquiry is about one instrument which incorporates elements of these reforms: outsourcing of government services.

The impact of this reform is fundamentally changing the way publicly funded services are delivered. Instead of relying on agencies and public servants, the government is now utilising the private and not-for-profit sectors to provide a very wide range of services.

Prior to July 1992, it is estimated that agencies had let service contracts to the value of \$171 million to the private sector. These were mainly cleaning, security services, building maintenance and works related services. A recent survey of the extent of outsourcing in Victoria estimated the figure for 1996-97 to be over \$841 million¹⁵, a five-fold increase, with the range of services now outsourced expanded to include human resource management functions, corporate services, information technology, internal audit, legal services and some policy development.

¹⁵ Department of Treasury and Finance, *Victorian Outsourcing Activity Survey 1996-97*, November 1998, p.8. Details of the latest survey for 1997-98 were not provided to the Committee.

As an integral part of the Kennett Government's policy platform, outsourcing was the preferred tool for achieving the following public sector reform objectives:

- reducing public debt and improving the State's credit rating;
- reducing public expenditure and the size of the public sector;
- improving the effectiveness and efficiency of the public sector;
- improving services to the community;
- creating a business environment to attract foreign investment and encouraging Victoria's businesses to be more competitive and expand their export programs.

The principles which have underpinned the introduction of outsourcing have been:

- the government should only be involved in those activities that cannot be carried out more efficiently and effectively by private businesses or voluntary agencies;
- any commercial enterprises retained within the public sector should be structured along the lines of private sector companies; and
- wherever possible, publicly funded services, including the purchasing of policy advice, should be made contestable and subject to competitive tendering.

1.2 Definition of outsourcing

For the purposes of this report, outsourcing refers to an arrangement where a government agency ceases to provide a specific activity or service through directly employing its own staff, and instead purchases that service or activity from a private operator or non-government agency for a pre-determined price and according to pre-defined performance criteria. The service delivery is on the basis of a contract between the agency (purchaser) and the private or non-government agency (provider).

The Committee believes that the following simple definition of outsourcing may provide the basis for an understanding of its nature and scope:

contractual arrangement for an external organisation to take responsibility for performing specified activities, on a

*commercial basis, which are required for a government department/agency to fulfil its functions*¹⁶

However, the Committee recognises that there are certain essential aspects of outsourcing¹⁷ which need to be appreciated in any examination of developments in this area, including the following:

- provision of services - the focus is on the outputs/outcomes of the services with minimal prescription regarding the basis of delivery or assets to be employed;
- size and duration of contract - outsourcing contracts are ongoing, typically covering an initial period of three to five years with options for further extensions and early termination;
- transfers of assets and resources - the transfer of staff, equipment or facilities used to provide services from the customer to the supplier is common and raises many issues regarding valuation, intellectual property and personnel;
- breadth of responsibilities - the supplier accepts responsibilities and risk for all activities associated with the provision of services - however, the purchaser should always ultimately be accountable;
- style of relationship - outsourcing agreements typically assume a partnering style of relationship between the parties with the expectation of a service level agreement;
- new skills required - under outsourcing, an agency's focus shifts from managing inputs to managing outputs - the agency becomes a contract manager rather than a resource manager - skills in the areas of negotiation, contract law and administration, performance measurement, and audit all become critical to successful management;
- performance monitoring - effective monitoring by the agency is essential to safeguard against contracting problems and to ensure the service is delivered effectively once the contract is in place;¹⁸ and

¹⁶ MAB/MIAC Report No. 23, *Before You Sign the Dotted Line ... Ensuring Contracts can be Managed*, May 1997, Joint publication of the Management Advisory Board (MAB) and its Management Improvement Advisory Committee (MIAC), refer to glossary

¹⁷ Deloitte Touche Consulting Group, *Achieving Results Through Outsourcing - The Full Life Cycle*, May 1997

¹⁸ Industry Commission Report No. 48, *Competitive Tendering and Contracting by Public Sector Agencies*, January 1996, p.359

- performance driven - the success of the supplier's performance is based on key performance indicators (KPIs) specified in the service level agreement - the KPIs must be important and meaningful to the stakeholders; measurable; readily available; and within the control of the supplier.

1.3 The inquiry process

The Public Accounts and Estimates Committee in the 52nd Parliament commenced an inquiry into outsourcing in the Victorian Public Sector on 27 September 1995. Terms of reference for the inquiry were developed and a questionnaire was sent to all public sector agencies, including state departments, government business enterprises and municipal councils. The survey sought information on:

- the internal framework for outsourcing;
- the accountability framework of board/senior management to the Parliament;
- decisions relating to outsourcing;
- the role of central agencies;
- current and expected future levels of outsourcing; and
- the existence of market competition for government services.

The terms of reference for the inquiry were advertised on 28 October 1995 in the national press. Invitations to provide submissions were sent to community and consumer organisations, business associations, departments and agencies and other interested persons. Eighty submissions were received, but no evidence was taken before the dissolution of the Parliament on 5 March 1996 and the inquiry lapsed.

Following the establishment of the Committee in the 53rd Parliament, it was agreed to resume the inquiry. By then, the membership of the Committee had changed considerably and only one original Member remained.

The Committee reviewed the evidence that had been received in the previous Parliament, and revised the terms of reference to reflect developments that had since occurred in outsourcing of government services. The revised terms of reference adopted by the Committee were:

- the extent of outsourcing activities in the Victorian public sector;

- whether the guidelines/directions, if any, were appropriate including whether or not they defined core and non-core services;
- whether the agencies conducted a base line costing and established objectives before deciding to outsource a service;
- whether the agencies are monitoring the outcomes of the outsourcing and the performance of the contractors; and
- the public and parliamentary accountability implications of outsourcing.

The inquiry was again advertised and the Committee invited interested persons and organisations to make submissions. Those who had submitted evidence to the previous inquiry were invited to update their information. Sixty-six additional submissions were received. Evidence was taken from 53 individuals and organisations during briefings and public hearings in Melbourne, Sydney and Canberra in 1997 and 1998. Details are contained in Appendices 2 and 3.

The Committee would like to thank all those organisations and individuals who either gave evidence or provided a submission. All their views have been taken into account in the preparation of this report. The Committee also wishes to record its appreciation to the specialist advisers, Dr Graeme Hodge and Ms Sarah Cullen, and to the Public Accounts and Estimates Committee secretariat for their assistance.

The following Sub-Committee was appointed to conduct this Inquiry:

Hon. Bill Forwood (Chairman)
Mr Steve Bracks¹⁹
Mr Rob Hulls; and
Mr Stephen McArthur²⁰

The report on this inquiry was completed and considered by the former Public Accounts and Estimates Committee prior to the dissolution of the 53rd Parliament on 24 August 1999. As the Committee considered that there were several issues raised in this report which had implications for the Committee's other inquiry into commercial in confidence and the public interest, it was agreed to hold this report over until the commercial in confidence

¹⁹ Discharged from attendance as a Member of the Committee on 21 April 1999

²⁰ Membership lapsed with the prorogation of the Parliament on 24 August 1999

report had been finalised. As both reports complement each other it is the intention of this Committee to present the reports together.

Since the change of government²¹ there have been a number of policy changes which impact on the evidence contained in this report. These changes include:

- on 5 November 1999, the Outsourcing and Contract Management Unit within the Department of Treasury and Finance was disbanded; and²²
- changes²³ have been made to the Local Government Act to implement the Bracks' Government election commitment to abolish compulsory competitive tendering for local government. In place of compulsory competitive requirements, councils will now have an obligation to ensure that they seek the best value in providing services.

1.4 Key perspectives of interest groups

From the research undertaken by the Committee, it is apparent that there are many perspectives on the outsourcing of government services:

- taxpayers and ratepayers want to see public money spent efficiently and equitably, while ensuring that a range of cost effective and quality services are provided;
- potential contractors want fair opportunities to compete for what can be significant markets;
- public sector employees and their unions want to protect the public delivery of the services; and
- those in rural and remote areas are concerned about the effect of competition on the local economy.²⁴

The Committee's inquiry has revealed that the interests of these various groups can and often do, conflict. At the heart of the debate is whether - and under what circumstances - outsourcing leads to better policy outcomes than direct public provision.

Criticism from opponents of outsourcing falls into two main areas: objections to the underpinning assumptions and criticisms of the

²¹ The Bracks Government was commissioned on 20 October 1999

²² Memorandum from Mr J.Rickard, Director of Procurement, Department of Treasury and Finance.

²³ *Local Government (Best Value Principles) Act 1999*

²⁴ These issues are discussed in the Industry Commission, *Report on Competitive Tendering and Contracting by Public Sector Agencies*, Report No.48, 1997, p.52

empirical evidence. While the former relates to whether the market is prone to systemic failure, the latter focused on the actual size of savings; the quality of services; the social implications of changes to the overall levels and organisation of employment; and a potential loss of accountability.

During the course of the inquiry the following were identified as areas of interest:

From an agency/purchaser perspective:

- determining what services could be contracted out;
- the amount of baseline cost data relating to services previously undertaken in-house;
- managing the transition from in-house to external service provision or the retention of an in-house provider;
- recruitment and training of suitable contract management staff;
- implementing an effective performance monitoring and management system;
- ensuring that appropriate service standards are included in contracts; and
- the effectiveness of the purchaser/provider model.

From a contractor/provider perspective:

- concerns about the skills level of public officers involved in contract negotiation, preparation, management and monitoring, particularly in relation to more complex areas such as information technology;
- creation of monopolistic situations because of the need to consolidate services to achieve economies of scale;
- potential for unsatisfactory practices to occur, such as collusive tendering;
- in-house teams being given a competitive advantage; and

- advantages/disadvantages in taking a partnering or adversarial approach to outsourcing e.g. in respect of ownership of intellectual property and risk of supplier capture.

From a client/consumer perspective

- the amount clients/consumers are involved in the specification of service delivery outputs and the development of measures, targets, and standards of performance;
- the avenues and mechanisms for addressing complaints from clients/consumers may be limited and not made apparent;
- clients/consumers believe that, as a consequence of outsourcing, there have been cost and/or quality trade-offs and a reduced level of accountability and transparency;
- there is considerable doubt among peak welfare groups as to the appropriateness of competitive tendering in health, community and other services;
- insufficient attention has been given to wider economic impacts, viz rural communities, employment levels; and
- issues relating to privacy and commercial in confidence matters are not being given due consideration.

The Committee is holding a separate inquiry into commercial in confidence issues and will report on this matter shortly.

1.5 The Committee's approach

During the inquiry the Committee reviewed a number of reports, articles and surveys which advocated that outsourcing can bring significant benefits when certain conditions are met, in particular, the existence of a competitive market for the service provided. The Committee also reviewed a number of authoritative reports questioning the claims about the extent of the benefits of outsourcing.

This report does not attempt to analyse these competing claims.

Rather, the Committee reviewed the Victorian experience and came to a view on how outsourcing was being undertaken by agencies in the context of reform of the public sector.

- various Commissions of Audit which looked at financial and other management reforms in the Commonwealth and the States;
- the Council of Australian Governments' (COAG) adoption of the Hilmer Report on National Competition Policy (1994) and the comprehensive Report by the Productivity Commission (formerly Industry Commission) into Competitive Tendering and Contracting by Public Sector Agencies (1996) which argued that all government activities should be potentially subject to competitive tendering unless they can be shown to be 'core' operations; and
- national micro-economic reform.

Essentially the introduction of competition is seen by proponents of outsourcing to provide the incentive for greater productivity through innovation in service delivery, access to expertise and new technology.

There is a belief, in both the private and public sectors, that a more business-oriented approach can drive the changes necessary to reduce costs and implement benefits of a more strategic nature while, at the same time, improving the quality of services delivered through the specification of services.

As various witnesses pointed out to the Committee, real or potential competition is a powerful tool in implementing management reform. The threat of competition and the need to maintain market position are positive drivers in organisations seeking more efficient service delivery methods.

The magnitude of the trend towards outsourcing in the public sector is exemplified by the decision by the Commonwealth Government to outsource its Information Technology requirements, a move which was predicted to yield savings of \$1 billion²⁵ over seven years. However, the extent of the savings initially projected now seems to be in doubt following the reduction in the size of the first cluster of departments/agencies to participate in the tendering process and the Commonwealth Government's requirement that local small and medium IT companies be included in consortia with the major computer groups.²⁶

²⁵ Article in *The Australian* newspaper, 28 August 1999

²⁶ Ibid.

2.1.2 In Victoria

In Victoria the framework for outsourcing is part of a broader framework for reform of public sector management financial systems and business processes. This framework comprises numerous policies, legislation and guidelines that affect outsourcing decisions and define the roles of stakeholders.

Outsourcing is well advanced in Victoria, and this reform process has been undertaken in line with the Kennett Government's policy directions. In many instances, significant cost savings are being reported by agencies, although the Committee noted that often transition and redundancy costs and the cost of market testing services were not taken into account in calculating potential savings. The Committee is also concerned that the amounts agencies could be expected to save, were estimated on the basis of inadequate data. The Committee noted that comprehensive guidelines are now available to assist with the ongoing process of improving outsourcing decisions and refining contracting practices.

The use of competitive tendering and contracting (CTC) was an integral part of the Kennett Government's approach to public sector reform.

The Victorian approach mirrors actions taken in other Australian public sector jurisdictions, which have significantly altered the government's role from one of a direct provider of services to that of a purchaser of services. This separation of the purchaser/provider functions focuses government on specifying service requirements, as opposed to concentrating on service delivery issues.²⁷ The Committee has not reviewed the philosophical issues associated with contracting out services but rather views it as only one of a number of management options which agencies may wish to pursue in seeking to reduce costs or improve efficiency.

It is clear from submissions received by the Committee that there has been a significant level of outsourcing taking place in the Victorian public sector, confirming the position conveyed in the *Victorian Government Services Contracting Survey for 1996-97* published in November 1998.²⁸

²⁷ Ms E Proust, Department of Premier and Cabinet, Victoria, *Implementing the Contract State*, Address to the National Institute of Public Administration Australia Conference 20-22 November 1996, Melbourne

²⁸ This is the latest information provided to the Committee. The survey covering 1997-98 was requested but not provided by the Department of Treasury and Finance

2.2 Some recent private sector developments

Outsourcing is being introduced throughout Australian industry with the highest use being made in the banking, insurance and finance sector, particularly in such areas as information technology and facilities management, to allow organisations to concentrate on their core functions rather than dealing with non-strategic issues.

The decision to outsource is related to the belief that only a few key competencies need to be retained within an organisation and that some activities can be better undertaken by contractors. Because of their specialisation, global activities, economies of scale and scope, and research and development activities, contractors are able to provide services which incorporate the latest technology and methods, and, in some cases, at a lower cost compared with the in-house provision of such services.

While outsourcing in the private sector typically has been performed on a purchaser/provider basis, there have been instances where organisations have taken a level of equity in the contractor and vice versa. Furthermore, the shift to outsourcing has also led to the creation of new joint ventures that have been established to match the specific contracting needs of the customer organisation, particularly in relation to information technology.

Two significant examples of such joint ventures are:

- Telstra - where two new outsourcing companies, IBM Global Services Australia (IBM GSA) and Advantra, which have the same shareholders (IBM Australia, Telstra and Lend Lease) have been formed. A focal point of the relationship was Telstra's ten year contract to outsource its mainframe and midrange infrastructure and maintenance to IBM GSA. Advantra's primary role will be the management and operation of networks. Under the arrangement, a large number of Telstra personnel will join other staff at those companies;²⁹ and
- Commonwealth Bank of Australia - which has entered into a \$5 billion ten-year arrangement with EDS Australia under an equity relationship which will provide access to skills that the bank felt could not be matched if it had kept its information technology in-house. In this case, cost reductions

²⁹ *The Australian* newspaper, 29 July 1997, p.35

were of a secondary consideration and the more important issues were innovation and timely access.³⁰

The Committee was advised that such joint ventures remain quite rare although they are highly publicised. It is certainly not a path applicable to most organisations, either public or private sector, who do not wish to further invest in a service that is not contributing to sustainable competitive advantage, or does not return sufficient value back to shareholders.

The Committee understands that the most common approach to the outsourcing relationship remains a contractual, rather than an equity association.

³⁰ *The Australian* newspaper, 30 September 1997, p.40

CHAPTER 3 THE OUTSOURCING PROCESS

3.1 The potential risks and benefits of outsourcing

The *Outsourcing and Contract Management Guidelines* issued by the Department of Treasury and Finance in December 1995 were developed for use throughout the public sector.

A key element of these guidelines is the recognition that, while outsourcing is the preferred option for the public sector, such an approach implies an ongoing, long-term relationship with service providers which may be difficult to implement and maintain. Indeed, there are a number of potential benefits and risks which may arise from outsourcing. These potential advantages and disadvantages from outsourcing are summarised below.

Financial	
Potential Advantages	Potential Disadvantages
<ul style="list-style-type: none"> ◆ Cost savings through economies of scale. ◆ Cash flow relief by supplier buying your assets and hiring your staff. ◆ Predictable costs either through fixed or usage based price agreements. ◆ Costs are known as an invoice is paid for all costs, avoiding the traps of inappropriate or non-existent internal cost allocation. ◆ Rebates or liquidated damages for non-performance of agreed service levels. 	<ul style="list-style-type: none"> ◆ Unexpected costs - for those that are not explicitly in the scope of the agreement. ◆ Higher per unit service costs - if usage projections are above or below those agreed. ◆ Cost of outsourcing - planning, investigating, tendering, implementation and ongoing management and supervision. ◆ One off personnel-related costs - remuneration payouts, outplacement, and industrial relations difficulties. ◆ Cost of additional skills and resources required to manage the relationship. ◆ Potential litigation costs for contract breaches.

Flexibility	
Potential Advantages	Potential Disadvantages
<ul style="list-style-type: none"> ◆ Catalyst for organisational change - behaviour, restructuring, rationalisation, etc. ◆ Shifting of expenditure from capital to the operating budget, which is usually less rigid. ◆ Remove inflexible work practices mandated by the public sector and unions. ◆ Access to leading edge, specialised skills. ◆ Shorter lead times to take advantage of new technology and ideas. ◆ Economies of scope (i.e. the variety of services able to be produced). ◆ Access to technology without capital investment. 	<ul style="list-style-type: none"> ◆ Leakage of confidential information resulting in competitive disadvantage, adverse media, or legal liability. ◆ High exit barriers and irreversibility - reduced cost-effective options if arrangement fails. ◆ Loss of control over decision-making, resource management, and daily operations. ◆ Supplier inflexibility to economically meet changing requirements on a timely basis. ◆ Exposure to suppliers' financial strength and profit motive. ◆ Supply restrictions - locked into a single supply source. ◆ Possibility of being tied to obsolete technology for supplier to achieve economies of scale. ◆ Possibility of being forced to upgrade for supplier to comply with maintenance provisions or to gain operating efficiencies.
Efficiency and Effectiveness	
Potential Advantages	Potential Disadvantages
<ul style="list-style-type: none"> ◆ Predetermined service levels - parties are forced to define and/or agree to what is expected. ◆ With pay for performance, suppliers are more responsive to performance complaints if it will affect profitability. ◆ Centralised support - often there will be one point of call at the supplier. ◆ Enables technology catching up or leap frogging - if converted to the supplier's state-of-the-art infrastructure. ◆ Efficiency motivation by converting internal cost centre to 	<ul style="list-style-type: none"> ◆ Exposure to suppliers' lack of commitment - they may focus their attention on larger or more strategic customers. ◆ Suppliers are not motivated to improve customer efficiency, as it will lower their revenue - unless they receive a higher margin. ◆ Supplier will only meet service levels, not exceed them, without incentives. ◆ Loss of in-house expertise. ◆ Homogeneous orientated services - pay more if a tailored service is desired. ◆ Service changes must be negotiated

<p>a supplier profit centre - however the supplier tends to receive the cost savings.</p> <ul style="list-style-type: none">◆ More frugal use of IT resources - when paying 'real' money, users change their behaviour.	<p>- suppliers have responsibilities to other customers and must make a profit.</p> <ul style="list-style-type: none">◆ Price for competitive tendering may have an impact on equity and quality issues, particularly in human services areas, and lead to under-funding of services, either by design or default.
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The Committee believes it is important that the advantages and disadvantages of outsourcing be well understood and appreciated because such arrangements will have long term implications. A balance has to be reached on an individual basis to ensure that an agency's objectives can be met using outsourced services that meet quality standards and are cost effective.

One point of view put to the Committee is that the process of service specification would not only lead to greater accountability but also more clearly define the nature and extent of the service required.³¹ From the Committee's viewpoint, the claim that the greater specification of services through the outsourcing process will enhance accountability is of particular interest.

3.2 The key to successful outsourcing

The Committee was advised that the key to successful outsourcing lies in the sound application and management of outsourcing concepts and processes and the ability of managers to take a competitive approach to the provision of public sector services.

The outsourcing process has to be considered as a set of activities to be systematically worked through with each agency considering all the options and choosing the appropriate path for its particular circumstances.

While outsourcing has been in the public sector for many years, the practice of competitive tendering and contracting has not been pursued with the same vigour.

3.3 Scope for continuous improvement

Some witnesses hold the view that the implementation of outsourcing will improve as more expertise is gained. One witness, in referring to his local government experience, suggested that:

³¹ Deloitte Touche Consulting Group, *Achieving Results Through Outsourcing – The Full Life Cycle*, May 1997 and modified by the Committee

The initial period of the contract - say a 2 or 3-year contract - can be used to better inform management about what it has been providing over those years, and hence it will be better informed for the next contract. The first contract is often a learning experience on how to control risks.³²

While the Committee has not undertaken any detailed examination of the policies and procedures followed by individual departments, it understands that departments are seeking to enhance existing practices. The following are indicative of matters presently being addressed:

- review of contract compliance by internal audit;
- selection of appropriate industry benchmarks for inclusion in contracts;
- implementation of risk management practices in contract performance;
- improving the reporting processes by the service provider; and
- streamlining the interface with the service provider.³³

According to Ms Sara Cullen, a consultant who has been working closely with a number of agencies, the process is improving generally. Examples of improvements include:

- ending the practice of using the supplier's standard contracts;
- no longer signing long-term contracts when the service to be provided is for a shorter duration; and
- using rewards and penalties as a means of directing service provider behaviour.

The Committee was advised that transferring critical knowledge about the outsourcing process between the experts and the novice remains one of the difficult tasks for public sector agencies.

During the inquiry, the Committee was made increasingly aware that information databases and staff skills and knowledge were key considerations in the discussion on the relative merits of competitive tendering and contracting.

CTC Consultants submitted to the Committee that after their review of 7,500 outsourcing initiatives the lessons learned included:

³² Mr P Rohan, Principal, Ernst & Young, Transcript of Evidence, p. 11

³³ **CTC Consultants, Government** *Outsourcing – What has been learnt?*, March 1999, pp. 4-6

- outsourcing achieved savings ranging from 46 per cent for cleaning to 0.7 per cent for corporate support services. Although corporate advisory services and information technology services were reported to have cost slightly more when outsourced, there were identifiable reasons for this outcome. Furthermore, large contracts for information technology services went against this trend and achieved cost savings of approximately 5 per cent;
- open tender was associated with greater cost savings from outsourcing than the other methods of awarding contracts and, in general, as the degree of competition decreased, so did the level of savings;
- the relative cost of managing contracts increased disproportionately as the size of the contracts decreased i.e. as contract size fell progressively below \$250,000 management cost increased rapidly from 5.5 per cent to 11 per cent. Conversely, management cost decreased only gradually for contracts above \$250,000; at \$1 million, the contract management cost was 3 per cent;
- contrary to the criticism often levelled at outsourcing, cost savings were not achieved by trading off on contract performance. Indeed the results suggest that contract performance may have improved slightly as the level of cost savings increased; and
- the implementation of a performance monitoring and management system was positively related to service quality. When such a system was not in place the quality of service was rated as being average. However, the quality of service improved by 38 per cent when a performance monitoring system was implemented.³⁴

3.4 Partnering

It was pointed out to the Committee that some contractual arrangements where a level of partnering takes place may be more flexible than others.

The need for a partnering approach could be warranted where:

³⁴ Ibid., p. 10

- 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 predicability 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.

The then NSW Auditor-General, Mr Tony Harris, emphasised to the Committee that care needs to be taken to ensure the risks associated with partnering arrangements are provided for adequately in the contract, particularly with respect to such matters as intellectual property, flexible pricing models, and the transition arrangements.³⁵

Partnering is an approach to contracting designed to create cooperative working relationships but is not meant to affect the legal rights and obligations of the parties. According to Skilled Engineering Limited, partnering is:

*very hard to put in practice because you have to develop a strong business and commercial relationship with the people with whom you are partnering*³⁶

Skilled Engineering Limited indicated to the Committee that very few of the contracts the company had entered into had developed into genuine 'partnering' relationships.

An interesting variation on this approach was outlined by Mr Core Peeters, Yarra Valley Water, who indicated that his company seeks:

*to run the business so that the customers do not know that they are dealing with us or one of our contractors*³⁷

Mr Peeters provided the examples that:

Transfield does all our maintenance, yet its trucks have our logo and its people wear our uniforms. They use our computer system to report a complaint, and they take a job number. We

³⁵ Mr Tony Harris, then NSW Auditor-General, Private Briefing, 9 September 1997

³⁶ Mr R Cheffers, Corporate Services Manager, Skilled Engineering Limited, Transcript of Evidence, p. 135

³⁷ Mr Core Peeters, General Manager - Finance, Yarra Valley Water Limited, Transcript of Evidence, p. 137

*control their job numbers through our complaints mechanism and they go out and fix the problem.*³⁸

Other witnesses³⁹ had a cautious view on partnering, seeing the outsourcing process, at its simplest, as being a supply function where payments are exchanged for services rendered. It was emphasised that a lot of outsourcing is strategic from the purchaser's viewpoint, not from the supplier's perspective, particularly when the purchaser is not a major customer. In addition, partnering should be considered as very high risk if it is considered that commercial contracts and service level agreements are not required, or can be done in the future, or can be written at such a high level as to make them ineffective.

The benefits of a partnering relationship may be minimised in some circumstances because of the contractual arrangements. For example the Committee was advised that with the public sector tending to keep all intellectual property rights, some contractors show little or no incentive to be innovative since they do not have the rights to anything they come up with during the course of delivering the contracted service:

*the success stories overseas have been where the government has let go of intellectual property and encouraged a reward sort of structure where the supplier could identify improvements, help get those in place and get the reward*⁴⁰

3.5 Specifications

The process of service specification involves detailing what is wanted in terms of outputs or outcomes. Some witnesses⁴¹ advocated that specifying how services are to be provided should only occur in cases where the outputs/outcomes are difficult to articulate or there is a real need to specify the 'how' rather than the 'what'. The Committee was advised that it is generally best for all parties if the outputs/outcomes drive the service conduct.

Outsourcing places a great deal of reliance on contractual specifications which are seen as the key to ensuring that services are provided by the contractor to meet the desired outcomes and reflect the needs of the community.

³⁸ Ibid., p. 137

³⁹ For example, Ms S Cullen, Principal Consultant, Deloitte Touche Consulting, Transcript of Evidence, p. 57

⁴⁰ Ibid., p. 58

⁴¹ For example, Ms M. Sussex, then Head of Cabinet Office, Department of Premier and Cabinet, Transcript of Evidence, pp. 46-47

The specifications need to be clearly developed by the purchasing agency and where appropriate, the consumers. If competitive tendering and contracting is to be done well, the specification should be developed with an understanding of the market conditions, an appreciation of what services are to be provided and consideration as to how contractor performance will be assessed.

There are risks with some contract specifications. If done well, as many witnesses put to the Committee, the specifications should enhance accountability by providing, in some instances for the first time, reliable financial and other information regarding the service being provided. On the other hand, there is the danger that over-specification, such as specifying how a service is to be performed rather than the output/outcomes, may restrict the flexibility that can be attached to an outsourcing arrangement.

3.6 Use of commercial in confidence clauses

The Committee has examined the issue of commercial in confidence material in the public sector through another inquiry and will report on this issue separately. However, during this inquiry it was an issue raised by various witnesses.

Mr Kerr, Head of Office, Productivity Commission expressed the view that virtually everything in relation to outsourcing should be on the public record:

*I would stop short of the details of unsuccessful tenderers, but I do not see why, where public money is being spent, people should not know or should not have the available details...I would have thought that it would be essential information for a healthy process*⁴²

Mr Cheffers, Corporate Services Manager, Skilled Engineering Limited indicated that:

*key performance indicators and measures should be made public, whether they relate to people-delivery requirements such as health and safety, work force productivity or availability plant and equipment*⁴³

The only concern Mr Cheffers had was in relation to labour rates, since these have been set at competitive levels.

The Civil Contractors' Federation indicated that there should also be full accountability within the local government area. The

⁴² Mr R Kerr, Head of Office, Industry Commission, Transcript of Evidence, p. 43

⁴³ Mr R Cheffers, Corporate Services Manager, Skilled Engineering Limited, pp. 132-133

Federation's Chief Executive Officer, Mr Jacka, stated that, in addition to informing all tenderers of the winning bid, subsequent significant variations in the contractual arrangements should also be made public.⁴⁴ The Federation made reference to the inconsistent practices within local government with respect to the announcement of the winning tender –

*some municipalities ... have a public opening of tenders, so that every tender is read out ... you have others where 10 weeks after the event they still will not tell you*⁴⁵

Yarra Valley Water Limited concurred with these views and advised the Committee that only competitive charge-out rates should be excluded from disclosures on outsourcing.⁴⁶ Water companies such as Yarra Valley Water have three public documents – an operating licence, customer contract and customer charter - which convey the powers and functions of those companies and the manner in which they seek to meet their objectives efficiently and effectively.

A number of witnesses indicated to the Committee that the impetus for the trend towards inclusion of all-encompassing commercial in confidence clauses in contracts has not come from the private sector. For example, Professor Neave, former President of the Administrative Review Council (ARC), advised the Committee that:

*One thing that we (the Council) have been consistently told in the context of access information is that the demand for confidentiality is coming more from the government than from the contractors, and we (the Council) have been told that by people in both the Commonwealth and State spheres.*⁴⁷

Another witness expressed concern about the general lack of transparency with contractual arrangements:

Obviously, a line has to be drawn somewhere between the two (access to information vs notion of commercial confidentiality), but at the moment I suggest that it is drawn close to the interests of those providing the service and being paid to provide the service compared with the rights of taxpayers to

⁴⁴ Mr I Jacka, Chief Executive Officer, Civil Contractors' Federation, Transcript of Evidence, pp. 158-159

⁴⁵ Ibid., p. 159

⁴⁶ Mr Cor Peeters, General Manager- Finance, Yarra Valley Water, Transcript of Evidence, p. 141

⁴⁷ Professor M Neave, former President of the Administrative Review Council, Transcript of Evidence, p. 10

*know how the money is spent and an assessment of the outputs.*⁴⁸

In August 1998 the Administrative Review Council (ARC) presented its report on public access to information when government services are provided by contractors.

The Council considers that:

*rights of access to information should not be lost or diminished because of changing mechanisms of government service delivery or because a document relating to the provision of services under a government contract is in the possession of a contractor and not a government agency*⁴⁹

These issues have been addressed in more detail in the Committee's report on commercial in confidence and the public interest.

3.7 Customer complaints

In providing comment on the ARC's Issues Paper *Contracting Out of Government Services*, the then Premier of Victoria, Hon. J. Kennett, indicated that:

In our experience the use of contracting out has, in the majority of cases, increased the quality and responsiveness of services to consumers needs due to an increased emphasis on the precise specification of the service outputs required, the introduction of competition and a stronger focus on customer service.

*a case by case approach is more favourable than adopting a general legislative approach as it recognises the vastly different range of services which are outsourced and allows a more flexible approach which can provide for particular remedies for individual circumstances where required*⁵⁰

A research study undertaken by Ms Sharon Moore⁵¹ found that some service users expressed concern about the appropriate avenue for complaints after services were outsourced.

⁴⁸ Mr P Keogh, Assistant Secretary, Community and Public Service Union, Transcript of Evidence, p. 21

⁴⁹ Administrative Review Council, *The Contracting Out of Government Services*, Report No. 42, August 1998, p. 6

⁵⁰ Hon J Kennett, Premier of Victoria, June 1997, Submission (No. 29) to the Administrative Review Council on the Council's Issue Paper, *Contracting Out of Government Services*

⁵¹ RMIT University School of Management, *Contracting Care - The Impact of Competitive Tendering on Victorian Local Government Aged and Disability Service Users*, January 1999

Previously the provider of the service was the local council, but under the new arrangements, services were being provided by other parties on the council's behalf. In such circumstances, the witnesses considered the avenue for complaints was no longer clear.

While guidance is provided in the Department of Treasury and Finance's *Outsourcing and Contract Management Guidelines* regarding the handling of disputes in relation to contractual arrangements, they do not address the issue of complaints from service users.

With the recent contracting out of activities within the Corrections and Health sectors, which are regarded as sensitive or vulnerable areas, the *Freedom of Information Act 1982* and the *Ombudsman Act 1973* have been extended to cover organisations delivering services in those sectors.

The Kennett Government acknowledged its primary responsibility for service delivery, whether or not it was contracted out. However, the then Premier in a submission⁵² to the ARC stated that the decision as to whether existing remedies and safeguards should be enhanced through administrative law remedies is dependent on whether or not service providers have the potential to make decisions that may have an effect on aspects of the service recipient's life, as is the case in the Corrections and Health sectors. Alternatively, where the service recipient does not need access to administrative law remedies, an accessible complaints and redress mechanism should be incorporated into the contract and closely monitored by the purchasing agency.

The Committee sees merit in seeking to distinguish situations where legislative redress might apply. However, the Committee remains concerned that consumers may be confused or uncertain as to what avenues are available for the handling of complaints.

The Committee considers that the outsourcing guidelines for departments and agencies should require that details of complaint mechanisms should be provided to service users. Information should include contact details and customer rights and be included in customer service charters or their equivalent.

The Committee recommends that:

Recommendation 3.1:

⁵² Hon J Kennett, Premier of Victoria, June 1997, Submission (No. 29) to the Administrative Review Council on the Council's Issue Paper, *Contracting Out of Government Services*, pp. 2-3

The Department of Treasury and Finance's Outsourcing and Contract Management guidelines should contain information on handling customer complaints and require that the service provider be the initial contact for lodging complaints by service users.

Recommendation 3.2:

Agencies should be responsible for ensuring that service recipients are advised of all their avenues of complaint, either by providing this information directly or by requiring contractors to do so.

3.8 Contract management

The current approach to contracting out represents a substantial change for the public sector. As the Department of Treasury and Finance outlined to the Committee⁵³, traditional contract management focussed on compliance with terms and conditions, looking at price variations and rise-and-fall clauses and similar matters. The business case approach now adopted is about managing the relationship, in an environment of greater reliance on the contestability of services, with a contractor who is now undertaking an activity that was previously directly provided by the public sector.

The major difficulties with outsourcing encountered by departments and agencies have centred on the need to establish clear and measurable targets for more complex and sensitive areas such as information technology and human services and to ensure that there are appropriate contract management skills available within the public sector.

One witness stated that as government is increasingly moving towards contracting with the private sector for the provision of services, contract management is becoming one of the core activities of departments. In this environment the scope of a contract manager's role now involves:

1. **Applying** performance penalties (if specified in the contract);
2. **Assessing** performance and cost trends each reporting period and over the life of the contract;

⁵³ Mr L Bailey, Executive Director, Office of Purchasing, Department of Treasury and Finance, Transcript of Evidence, p. 78

3. **Auditing** compliance with the contractual provisions, internal controls of both parties, and performance and billing information;
4. **Benchmarking** costs and performance levels in accordance with industry standards and leading practice;
5. **Communicating** to all affected stakeholders any potential changes to both parties and the impact on their objectives and the services provided;
6. **Documenting** all formal and informal communications within the organisation and between the parties in a systematic manner that provides an audit trail;
7. **Forecasting** volume and capacity of services required and cost;
8. **Implementing** variations to contracts and documentation to reflect changes in best practice requirements, performance levels, etc.;
9. **Liaising** with internal management and users and between the parties regarding issues and feedback;
10. **Meeting** regularly with both parties regarding performance reviews and operational issues;
11. **Monitoring** performance levels, volume levels and the organisation's effective use of the contractor;
12. **Negotiating** desired changes to the arrangement by either party and resolution of issues;
13. **Preparing** for the end of the contract - both the conclusion of the natural term or early termination;
14. **Reporting** achievement of strategic and operational goals of the services contracted and the contract arrangement itself;
15. **Structuring** the management and operational accountabilities and processes required internally and between the parties; and
16. **Verifying** eligibility of invoices for payment and appropriateness of requests for service changes by either party.

3.9 Dispute resolution

The *Outsourcing and Contract Management Guidelines* include, in Phase 5 of its contracting framework, provision for the resolution of contractual disputes but only from the purchasing department/agency perspective. The guidelines outline the steps

to be taken in dealing with the dispute, output requirements resulting from this activity and the matters which need to be considered during the resolution process.

The objective expressed in the guidelines is that contractual disputes are dealt with 'quickly, fairly and without affecting day-to-day operations'⁵⁴. The focus is on applying the mechanisms in the guidelines before resorting to formal dispute resolution procedures specified in the contract. The Committee is aware that formal dispute resolution is expensive to both parties and time consuming.

The need to have a clear path for the resolution of disputes has been supported by a consultant specialising in outsourcing, who emphasised that mechanisms need to be in place to support the contractual arrangements and provide a basis for the resolution of issues that inevitably arise. Mr Rohan referred to the need to have a realistic contract management process that involved the service provider developing a good partnership with the purchasing department or agency to deal with any problems.⁵⁵

3.10 Outcomes

Some observers believe it is too early to fully assess the impact of outsourcing on the provision of public sector services. This view is supported by the Victorian Council of Social Service (VCOSS). The Executive Director indicated to the Committee that sufficient empirical data is not yet available on the outcomes from outsourcing, particularly in the human services area.⁵⁶

Nevertheless, the Committee believes that it is timely that the status of outsourcing be examined and that progress in future years be monitored by the Committee to ensure that competitive tendering and contracting are achieving the government's objectives.

3.11 The views of contractors

The Committee was advised of concerns about the lack of a uniform approach by government agencies to outsourcing. As various witnesses pointed out, the private sector is considered to be very experienced in the tendering process.

⁵⁴ Department of Treasury and Finance, *Outsourcing and Contract Management Guidelines*, December 1995, Phase 5, p. 59, task 5.4.3

⁵⁵ Mr P Rohan, Principal, Ernst & Young, Transcript of Evidence, p. 4

⁵⁶ Ms P Morrison, Executive Director, Victorian Council of Social Service, Transcript of Evidence, p. 75

Mr Cheffers, advised the Committee of his experiences with the State Electricity Commission of Victoria (SECV) ⁵⁷ in the late 1980s and early 1990s where existing extensive and well-written contracts had to be particularly tailored for outsourcing. While the SECV at that time had good inside administration and good legal people, the outsourcing team relied heavily on the Loy Yang contract administrators because they had dealt with the commercial world.

Skilled Engineering Limited was the successful tenderer for a Country Fire Authority (CFA) contract ⁵⁸ and the company had found the outsourcing process to be well conducted in this instance. The initial stages of the tender process involved the major bidders, according to Mr Edwards, from the conceptual stage of determining what service was needed. In this way, they were made aware of the CFA's objectives for the contract. Mr Edwards described the relationship as 'plain sailing':

From the start, they did their homework; then they talked to the industry, not just our company, and formulated an opinion and views of what the service providers could give them ⁵⁹

For the CFA contract, Skilled Engineering Limited initially engaged a team of people working for the CFA which gradually dropped away to a small project team, then to a project manager who looks after the CFA contract on a full time basis. ⁶⁰

Mr Edwards also commented on their involvement with the Municipal Associated Purchasing Scheme, or MAPS Group, which is responsible for the purchasing needs of all councils. Mr Edwards informed the Committee that the company was one of 20 or 30 suppliers to that Group, and:

the information coming from it is excellent...Some of the councils are good at those negotiations and some of them are terrible, having no idea of what the market is providing ⁶¹

The capacity of contractors to deal with competitive tendering and contracting was also raised by a consultant working in the area, who indicated that small suppliers were quite naive about outsourcing and relied upon the government to tell them what to

⁵⁷ Mr R Cheffers, Corporate Services Manager, Skilled Engineering Limited., Transcript of Evidence, pp. 129-130

⁵⁸ Mr L Edwards, Victorian Trades Services Manager, Skilled Engineering Limited., Transcript of Evidence, pp. 130-131

⁵⁹ Ibid., p. 131

⁶⁰ Ibid., p. 132

⁶¹ Ibid., p. 131

do - a case of 'hand holding'. Therefore the assumption that the market is competitive and knowledgeable is not always valid and a level of education may be required to ensure that contractors are interested and have the capacity to deliver the services being outsourced.⁶²

The Committee gained the impression that the contractors have generally been satisfied with the outsourcing process. However, this is dependent on the capacity of potential contractors to participate effectively in the tendering process and the willingness of purchasers of services to gain an awareness of the nature and extent of competitive forces in the market place.

The feedback from witnesses was not indicative of any major problems in this regard but suggested that attention needed to be given to advising unsuccessful tenderers of the outcome of the tendering process. The Committee understands that debriefing unsuccessful tenderers is a normal commercial practice, which is available if requested by the unsuccessful tenderers. It was pointed out to the Committee that the debriefing must be carefully managed to ensure only relevant and accurate information is disclosed.

The Committee recommends that:

Recommendation 3.3:

In order to ensure a robust competitive system in tendering for government contracts, the Procurement Branch in the Department of Treasury and Finance consider what actions are necessary to better inform potential contractors about the opportunities to participate in outsourcing.

⁶² Ms S Cullen, Principal, Deloitte Touche Consulting, Transcript of Evidence, pp. 53-54

CHAPTER 4 KEY ISSUES

4.1 Deciding what to outsource

In his background briefing to the Committee, the then Assistant Director, Outsourcing and Contract Management Unit of the Department of Treasury and Finance made reference to the following⁶³:

- the then Minister for Finance, Hon. R. Hallam, in his presentation to the inaugural monthly outsourcing seminar in July 1996, indicated that: *The message is clear ... nothing should be immune from being considered a candidate for outsourcing*; and
- the then Treasurer of Victoria, Hon. A Stockdale, repeated this message in his 1996-97 Budget Speech: *The private sector will increasingly be given the opportunity to deliver services where it is demonstrated that equal or better services can be delivered at lowest cost.*

The test for outsourcing was put to the Committee by a witness⁶⁴ who suggested that, if it was possible to answer the following questions in the affirmative, then outsourcing should be considered:

- can you specify the service requirements?
- can you measure performance?
- is there a real private sector capacity to respond?
- can you manage the contract?

It was argued by the Department that a negative response should not preclude moving to CTC in the future. The Committee believes that for this to occur, management should become more knowledgeable about the specification of service requirements, the conditions in the market place, performance measurement methodologies and the development and retention of contracting skills.

⁶³ Mr B Williamson, Assistant Director, Outsourcing and Contract Management Unit, Department of Treasury and Finance, Background Briefing, p. 3

⁶⁴ Mr P Rohan, Principal, Ernst & Young, Transcript of Evidence, p. 11

4.2 Services appropriate and inappropriate for outsourcing

Increasingly, external service providers are being called on to contract to all levels of the education sectors. In health and community services, the issue has become not whether the service should be outsourced but who should provide the service. For the Department of Human Services, external service provision has been common-place for many years and is now being made contestable.

Whether there should be a limit on the nature and extent of outsourcing of public services was commented on by the then Head of the Cabinet Office ⁶⁵:

Clearly, there are some areas of governance and judicial functions which will never be outsourced - and cannot and should not be - but beyond that, what that statement is giving you is a starting point. It is setting a question of what cannot be rather than what can be ... The presumption is one of outsourcing rather than one of services being delivered ... the long held view that there are things that governments do and must do and the statement marked a change in the presumption. It now says that the presumption is that generally the non-government private sector should perform functions unless there is a reason the government should do it.

It seems also that the nature and complexity of a service may not be a barrier to the application of outsourcing. Increasingly, many aspects of Information Technology have been contracted out primarily on the basis of enhanced quality of service as opposed to cost reductions. Deloitte Consulting's survey into Information Technology outsourcing has shown that skills and technology are now the driving reasons for outsourcing, their importance having at least doubled.⁶⁶

4.3 Application of the concept of core and non-core services

Originally the decision to outsource or not was made dependent upon whether the activity under consideration was a 'core' or 'non-core' activity. However, some witnesses supported the theory that all services should be considered. The philosophy that all services should be considered for outsourcing, thereby debunking a core and non-core split for the public sector, received support from a number of witnesses.

⁶⁵ Ms M Sussex, then Head of Cabinet Office, Department of Premier and Cabinet, Background Briefing, pp. 42-43

⁶⁶ Deloitte Consulting, 1997 *IT Outsourcing Survey*, November 1997

One witness suggested that with policy, while decision making should not be outsourced, it was possible to outsource the supporting research.⁶⁷ Ms Cullen advised the Committee that: *If it is done well, anything can be outsourced.*⁶⁸ Other witnesses made similar statements.

This view was also endorsed by the Productivity Commission:

*governments or agencies should not spend a lot of time trying to define once and forever a core group of services, by which it could therefore be assumed that everything else could be ... the contracting process was just a managerial tool which any good manager should have in his or her kitbag and should look at applying and make judgements about applying according to the circumstances of a particular case.*⁶⁹

In taking this approach to outsourcing, the Productivity Commission indicated its opposition to compulsory competitive tendering which was legislated for the Victorian local government sector by the Kennett Government.⁷⁰ As a general principle, the Commission believed that competitive tendering and contracting should be an available managerial option with the extent of its use varying according to the size and nature of an organisation's operating activities.

In the submission from Victorian Police, the Acting Chief Commissioner referred to the evolving nature of outsourcing which now encompasses such areas as infrastructure investment, commercial development, joint venturing, and strategic alliances, all of which add greater complexity to the outsourcing arrangement.⁷¹

A consultant working on outsourcing projects stated that most of her clients have debated the core/non-core issue repeatedly to no avail. She stated that the core/non-core argument is often fruitless. In her opinion the key issues that should be concentrated on are whether the service is important for sustainable competitive advantage, the current degree of competition in the market and the sustainability of that competition, and the relative competence of the organisation with regard to that service.⁷²

⁶⁷ Ms S Cullen, Principal Consultant, Deloitte and Touche Consulting, Transcript of Evidence, p. 58

⁶⁸ Ibid., p. 59

⁶⁹ Mr R Kerr, Head of Office, Productivity Commission (formerly Industry Commission), Transcript of Evidence, p. 34

⁷⁰ The Local Government Act was amended in December 1999 to abolish compulsory competitive tendering for local councils.

⁷¹ Victoria Police submission, p. 1

⁷² Ms M Cullen, Transcript of Evidence, pp. 51 to 54

A further development on the definition of core and non-core services is in the local government area where the Municipal Association of Victoria indicated to the Committee that councils, in responding to the needs of their communities, will determine what are core and non-core services. Ms Proctor, the Association's Acting Chief Executive Officer suggested that:

*over the past 12 to 18 months the approach of most councils seems to have been one of dividing core into governance-type functions and non-core into traditional service delivery*⁷³

The Committee noted in the case of the Victoria Police that:

*the core/non-core definition for establishing candidacy for outsourcing has been supplanted by a broader range of factors focused around concepts of strategic versus non-strategic services*⁷⁴

The Committee has concluded that the differentiation of core and non-core activities raises more questions than are answered. An example of the complexity of the issue is in the Corrections area of the Department of Justice where a number of private prisons have been established, replacing certain existing facilities. The difficulty in defining what is core was demonstrated to the Committee by the Department of Human Services which indicated that the maintenance of youth training centres, essentially correctional facilities, is considered a core activity for that Department as opposed to such areas as corporate services which are less critical.⁷⁵

4.3.1 Public benefit

With respect to emergency services, the Executive Director, Consumer Law Centre Victoria Inc., took the view that those services by their very nature are services that the community needs to be sure are available regardless of the economics. Mr Nelthorpe indicated to the Committee that his comments encompassed the fire brigade, ambulance or police services on the basis that:

the community is better off thinking it may not have the service because it is inefficient rather than thinking it does not

⁷³ Ms H Proctor, Acting Chief Executive Officer, Municipal Association of Victoria, Transcript of Evidence, p. 150

⁷⁴ Victoria Police submission

⁷⁵ Mr A Clayton, Acting Secretary, Department of Human Services, Transcript of Evidence, p. 62

*get the service because of the needs of competition or because it is based on cost factors*⁷⁶

The concern expressed by Mr Nelthorpe was that there has been insufficient debate about the public benefits of these and other services including such matters as the privatisation of prisons.

4.4 Use of outsourcing to meet government objectives

The Productivity Commission was of the view that policy effectiveness and value-for-money objectives should be dealt with separately.⁷⁷

The Committee has noted with interest that outsourcing has been used in some jurisdictions to implement government policy objectives. For example, in the South Australian approach to the outsourcing of Information Technology, provision was made for the inclusion of apprenticeships, training courses and related issues. Furthermore, the cluster tendering of information technology by the Commonwealth Government provides for the involvement of small and medium Australian Information Technology companies in the process.

In evidence Mr Kerr stated that the Commission was:

*not particularly attracted to the process of using government purchasing as an industry development tool ... there was some tension between industry development objectives and value-for-money objectives ... that is not to say that governments should not be interested in industry development objectives ... there should be other tools and processes they should turn to*⁷⁸

Mr Kerr further indicated that the extra cost involved in meeting the government policy objective should be identified and paid for separately.⁷⁹ If the objective was to be met through the contracting process, it would be preferable that a two envelope process be employed in the tendering process to ensure that the industry development component is transparent and its cost is separated from the normal contractual arrangement.

Under a two envelope system, the first envelope would detail how an organisation's tender meets the contract specifications and provides the offer price, and the second would deal with industry development proposals associated with the tender.

⁷⁶ Mr Nelthorpe, Executive Director, Consumer Law Centre Vic. Inc., Transcript of Evidence, p. 85

⁷⁷ Mr R Kerr, Head of Office, Productivity Commission (formerly Industry Commission), Transcript of Evidence, pp. 34-35

⁷⁸ Ibid., pp. 34-35

⁷⁹ Ibid., p. 36

The Committee recommends that:

Recommendation 4.1:

As a general principle, competitive tendering and contracting should not be employed by departments and agencies purely to satisfy other government policy objectives. In cases where there are other policy objectives (such as regional employment) to be incorporated into contractual requirements, a two envelope system should be used to ensure the transparency of costs of implementing those objectives.

4.5 Promoting and ensuring a competitive market

The Committee heard evidence that care needs to be taken in calling for tenders as this process will not always guarantee effective competition.⁸⁰ The characteristics of the market may be such that there are relatively low levels of competition. Indeed, there may only be one supplier or the market may be characterised by barriers to entry which restrict contestability. The risk is that skills and knowledge and assets disposed of may be difficult to regain or replace, should this become necessary. Where a monopoly exists, a range of problems might arise such as reduced incentives for efficient production, unnecessarily high costs and poor service responsiveness.

4.5.1 In-house bids

It was pointed out to the Committee that a key issue to be considered in competitive tendering and contracting is the process of selecting the most efficient and cost-effective provider of public sector services. Within this context, departments and agencies need first to consider whether in-house bids should be encouraged or discouraged.

The Committee is aware that different approaches have been taken by the Commonwealth and the states. In Western Australia, in-house bids are discouraged where a competitive external market exists. Such bids are relatively infrequent in Victoria, apart from within local government, and are not encouraged. In New South Wales the view is that in-house bids should be encouraged as indicated in an extract from that State's submission by the NSW

⁸⁰ Mr T Monagle, Industrial Officer, Community and Public Sector Union, Transcript of Evidence, p. 31

Government to the Productivity Commission Review on Competitive Tendering and Contracting:

*The benefits of market testing and contracting arise from competition and not necessarily from whether the private or public sector undertakes the function. In recognition of this and to ensure adequate protection for employees, the option of contracting to in-house service providers must be fully assessed and in-house service providers should be given every opportunity to compete on an equal footing with external contractors.*⁸¹

In-house bids are discouraged in Victoria at the State level, unlike within the local government sphere, due to concerns with the probity of such bids. In the view of the then Head of the Cabinet Office, Ms M Sussex, in-house bids might only be considered in the case of an immature market or because of other similar factors.⁸²

The Community and Public Sector Union indicated to the Committee that:

*There seems to be far less support for in-house bids and far less encouragement and facilitation of those bids in the Victorian public service as against any other State public service, Commonwealth and local government*⁸³

The Union is of the view that there should be provision for in-house bids to provide a market alternative and has sought to support bids through the production of manuals and the delivery of training courses.

Within local government, corporatisation of the in-house team is sought. In this situation the team providing the service becomes a separate distinct entity, legally separated from the parent agency. Such a structure requires amongst other things, clear commercial objectives, managerial autonomy in day-to-day operations, a requirement to earn a commercial rate of return on assets, clear and separate funding of any community service obligations, and subjection to taxes and regulatory requirements that would apply if the same activities were carried out in the private sector.⁸⁴

⁸¹ Productivity Commission (formerly Industry Commission), *Competitive Tendering and Contracting by Public Sector Agencies*, January 1996, pp. 285-286

⁸² Ms M Sussex, then Head of the Cabinet Office, Department of Premier and Cabinet, Transcript of Evidence, p. 43

⁸³ Mr T Monagle, Industrial Officer, Community and Public Sector Union, Transcript of Evidence, p. 31

⁸⁴ *Ibid.*, p. 296

The Committee is of the view that as a general principle, the active discouraging of in-house bids may not be in the public interest, and may actually undermine competition.

4.6 Competitive neutrality

The Committee was informed that there are many costs associated with either passively permitting or encouraging in-house bidding. A major concern is bringing the in-house team up to a standard comparable with that of external suppliers. For services which are specialist in nature and require a degree of market responsiveness, this upgrading process could prove time-consuming and costly.

It is clear from the evidence taken by the Committee that for many tenderers considerable doubt exists that a 'level playing field' can be established to enable a meaningful comparison between costs attributable to in-house service providers and the price proposed by an external contractor. While recognising that competitive strength can be gained through differences in operational size, asset base, staff and management skills and experience, the potential advantages and disadvantages from public ownership should be taken into account before a meaningful assessment of the case to outsource can be made.

Some witnesses pointed out that perceptions of unfair competition may result from in-house teams having, or being perceived to have:

- access to internal information;
- the ability to influence service specifications in such a way as to favour the in-house team;
- a close relationship with those agency staff responsible for evaluating competing offers; and
- an advantage due to inappropriate costing of in-house bids, leading to concerns that in-house bid prices do not permit accurate comparisons of the relative cost of in-house and external tenders.⁸⁵

In Victoria, the importance of competitive neutrality has been recognised and a *Policy Statement on Competitive Neutrality* was published in June 1996. Under the policy, most state and local government businesses were required to apply full costings from 1 July 1997.⁸⁶ A Competitive Neutrality Complaints Unit has been established within the Department of Treasury and Finance. A

⁸⁵ Productivity Commission, *Competitive Tendering and Contracting by Public Sector Agencies*, p. 288

⁸⁶ [<http://www.vic.gov.au/ncp/brochure.html>]

brochure on the subject and details of the complaints mechanism applicable are available on the Internet.⁸⁷

4.7 Difficulties faced by in-house teams

The Committee noted diverse views on whether or not in-house bids are desirable and the implications it has for staff equity and morale, and industrial relations.

In *Special Report No. 55: Child Care and Kindergartens*, the Auditor-General found that in the case of two councils where the services were subject to in-house agreements, the assignment of role and responsibilities was not always clearly defined. The report identified problems concerning the ability of in-house teams to operate autonomously from the council; the employment status of staff; the dispute mechanisms available and that there was no clear separation of management and governance costs from service delivery costs.⁸⁸

In-house bids, even prepared on a comparative basis to private sector bids, may suffer from the disadvantage of being required to provide full details of existing activities and attributable costs as part of the outsourcing process. On the other hand, the ability for in-house staff to access internal information should be recognised and the same information should be made available to other tenderers.

One witness indicated to the Committee that, in his experience, because external service providers have worked with a range of clients, those providers tend to have better quality management systems than in-house bidders.⁸⁹

Another witness⁹⁰ noted that in addition, many in-house service providers are not permitted the degree of flexibility they believe necessary to make changes to improve service and/or lower cost. This is why outsourcing to external parties can provide an impetus for organisational change.

A further concern with in-house bids is that public sector organisations have not easily adapted to the purchaser/provider split. There clearly needs to be a separation of the organisational structure, accounting systems and information technology.

The Committee recommends that:

⁸⁷ [<http://www.vic.gov.au/ncp/brochure.html>] and [<http://www.vic.gov.au/ncp/complain.html>]

⁸⁸ Victorian Auditor-General's Office, *Special Report No. 55: Child Care and Kindergartens*, pp. 129-130

⁸⁹ Mr P Rohan, Transcript of Evidence, p. 9

⁹⁰ Ms S Cullen, Principle, Deloitte Consulting

Recommendation 4.2:

It is imperative that successful in-house teams should be separated from all aspects of contract management and subject to the same monitoring and reporting arrangements which would apply to an external provider, to ensure that the agreed price and performance standards are achieved.

4.7.1 Bundling of services

Where competition is found to be limited, the benefits to be derived from competition can still be achieved through the appropriate bundling of services for example, in the case of large programs being disaggregated into smaller contracts to facilitate a wider interest among smaller firms. For similar contracts to be tendered and to maintain competition between contractors, contracts could be let for varying periods with staggered commencement and completion dates. Some organisations have split or disaggregated contracts to allow for competitive benchmarking as well. Western Australia has been particularly active in this approach.

An interesting development in this bundling approach is the direction taken by the Commonwealth Government with respect to the outsourcing of Information Technology. Purchasing departments and agencies have been brought together as clusters to achieve economies of scale, and the contracts are to provide for participation by small to medium Australian enterprises in the arrangements.

However, the improper use of the bundling of services to usurp the outcome of tenders is seen as a significant risk in contracting out. In such cases, services may be bundled together in such a way as to reduce the market capacity to provide all the services specified.

A fundamental concern conveyed to the Committee by the Civil Contractors Federation is the practice by which tenders are passed through an auction process before a final decision is made. While conceding that such a practice may be acceptable in a negotiated contract situation, the Federation was of the firm view that this should not be the case in respect of the smaller contracts where, as the Federation put it to the Committee, the margins are *so skinny*.⁹¹

⁹¹ Mr Jacka, Chief Executive Officer, Civil Contractors Federation, Transcript of Evidence, p. 154

The Committee recommends that:

Recommendation 4.3:

Every effort should be made to develop meaningful specifications of services and performance measures.

Recommendation 4.4:

Real or perceived conflicts of interest, whether in respect of in-house or external bids, should be evaluated and acted upon at an early stage.

4.7.2 Incumbent suppliers

In addition to the approach taken to the packaging of services to be contracted out, there are risks that the integrity of the process may be impaired by the manner in which contracts are renewed upon the expiration of the contract period.

Incumbency is a key issue to be considered as the second round of contracts are dealt with. Several witnesses, including the then NSW Auditor-General noted that organisations are most likely to stay with the same supplier.⁹²

The advantages from incumbency will be greater the closer the working relationship between the purchaser and the provider. The extent of these advantages would be reflected by a knowledge of the true costs of service provision, operational experience in the delivery of the service, and actual performance against contract measures over time. As indicated, encouragement of in-house bids may represent similar exposures to the purchasing agency.

Professor Neave expressed concern about supplier capture.⁹³ Professor Neave referred to the case of the Department of Social Security which had a complex critical computer system that had to be changed. An overseas company won the tender for this work but was subsequently bought out by another overseas company which decided not to continue with the contract. The Department then had to try to organise another contractor.

The Committee believes that the issues of supplier capture and contract renewal will need to be given specific attention as initial contract periods come to an end. Whether or not the optimum level of competition is arrived at will be dependent upon the industry acceptance of and participation in the tendering process.

⁹² Mr Tony Harris, then NSW Auditor-General, Transcript of Evidence

⁹³ Professor M Neave, former President of the Administrative Review Council, Transcript of Evidence, p. 113

In the light of comments made by witnesses as to the reluctance of service providers, in certain instances, to be involved, it would seem appropriate for the pre-tender process to include a formal assessment of the scope of competition within a particular market. It should also include information about the extent to which competitors have participated in and the reasons for such non-participation e.g. dissatisfaction with level playing field, treatment of unsuccessful tenderers and other significant matters of concern.

The Auditor-General in his recent *Report on Ministerial Portfolios*⁹⁴ commented on the non-application of competitive tendering processes and stated that:

To enable proper accountability and justification of decisions to engage consultancy and contractor services, it is imperative that agencies apply the spirit of competitive selection principles. Unless alternative service providers are sought to expand the available market, the expertise will always remain with the same contractors who will continue to be appointed without competitive tendering for projects.

The Committee recommends that:

Recommendation 4.5:

Prior to undertaking a tender process, departments and agencies should assess the potential market and consider strategies to expand the market and maximise competition.

Recommendation 4.6:

Departments and agencies frame tender specifications in a way that will encourage greater participation by potential tenderers.

Recommendation 4.7:

Departments and agencies report in their annual report on the extent to which a satisfactory level of competition has been achieved in the outsourcing process for the more significant contracts entered into, whether with external contractors or in-house teams. Where a decision to outsource has been made involving less than a reasonable number of competitors, then an explanation should be provided

⁹⁴ Victorian Auditor-General's Office, *Report on Ministerial Portfolios*, May 1999, p. 42

as to the reasons for non-participation by the remaining competitors and whether their non-participation has impacted upon the expected outcomes of the tendering process.

4.8 Alternatives to outsourcing

While a significant advantage of competitive tendering and contracting is the emphasis on the specification of service needs, simply because the area does not lend itself to CTC does not mean that a service could not be made more efficient and effective by using a different approach.

Outsourcing is only one of many management tools to improve the operations of an agency. However, the Committee agrees with the view of some witnesses that the level of savings and other benefits sought from improvements would generally not be of the order or within the timeframe that would be obtained through outsourcing. Nevertheless, the question remains as to what happens when there is no private sector equivalent to provide the competitive influences through market testing.

It was pointed out to the Committee that the danger with compulsory competitive tendering is that the level and range of services to be contracted out has to be initially addressed. The likelihood was that the more readily outsourced services e.g. engineering, catering, maintenance, etc. would be dealt with in the first instance rather than the business being examined as a whole. A major contributor to 'picking the low hanging fruit' is that these services also have a very competitive market with many substitute suppliers, and thus there is less risk of outsourcing failing.

An alternative to outsourcing is benchmarking of internally provided services. However, it is important to note that all outsourcing involves some re-engineering in order to be successful, thus these are not mutually exclusive options.

Opponents of the benchmarking approach suggested that financial savings are maximised where there is competition. However, one academic is of the view that the benchmarking of services against comparable private and public sector providers would provide an effective way to achieve savings.⁹⁵

Much of the support for the benchmarking approach stems from doubts raised about the claims of savings attributed to

⁹⁵ Mr M Paddon, Director, Public Sector Research Centre, University of Sydney, Transcript of Evidence

outsourcing, particularly in relation to accounting for transaction and transition costs. Furthermore, there is concern about the impact of substantial contracting out on local communities in relation to such matters as employment and service quality.

The Committee is of the view that benchmarking is of little merit unless applied to services where significant change can be effected rapidly. Market testing, and the threat of competition, are seen by the Committee as being significant drivers in the attainment of efficiencies where an appropriate market exists. Benchmarking represents a difficult option in that a suitable model has to be found against which performance can be targeted, and this may prove unattainable. On the other hand, competitive tendering and contracting, where it is open and fair, allows for the involvement of all interested parties in the process. To the extent that the specification of service requirements is completed satisfactorily and ethics and probity requirements are met through the tendering process, CTC should produce the desirable outcome of lower cost at the same or enhanced quality.

4.9 Employee welfare

As a result of outsourcing services, there may be a reduction in the number of staff employed and a shift in emphasis in the type of work being undertaken within an agency. The Committee believes that these issues highlight the significance of the change that is taking place and why it needs to be well managed.

The Civil Contractors Federation was of the view that governments should think carefully about imposing input constraints that might extend, for example, to conditions of employment that were involved in the delivery of services.⁹⁶ With regard to the latter, the Committee has noted the practice, particularly in Europe, to provide guarantees of employment in an outsourcing situation for periods of time.

The Federation advised the Committee that when they took over responsibility for providing a service in the local government area:

we have within our industry a very strict set of awards ... we work under federal awards - we always have ... it is fair to say that through EBAs and general market trends at the moment we are probably running around 7 to 8 per cent above the award in terms of the existing industry rate of payment ... the people who used to work for local government and are now working for contractors who provide that service would be at

⁹⁶ Ibid., p. 34

*least a couple of dollars better off per hour as a general rule*⁹⁷

A consultant advised the Committee that minimum employment clauses are a common practice in Australia in situations where one of the key objectives (but not the sole reason) of outsourcing was to place public sector employees into the private sector, or when the organisation believed there was a duty to the employees and/or unions, or a minimum period of employment was necessary to ensure service continuity. Guaranteed employment clauses may range from six months to two years.

It is understood that these arrangements may also be the case in certain instances in the contracting out of Information Technology by the Commonwealth Government.

The number of existing staff who transfer to a contractor depends on the nature and complexity of the services being outsourced. Ms Sarah Cullen advised the Committee that in her research of Information Technology organisations the retention rate was around 50 per cent. The need to transfer is dependent on the need of prospective suppliers to structure service provision around the skills and expertise of the staff whose positions are being outsourced.⁹⁸

An interesting perspective on the matter of transition is the manner in which the move to outsourcing is handled by management and the extent to which staff are kept informed of key decisions, and even participating in the process. Many witnesses were concerned with the impact on the morale of the remaining staff following the transfer of staff to service providers and the imposing of purchaser/provider split where in-house bids were successful. Even the conduct of reviews of existing operations as part of the contestability framework can have the potential to be disruptive.

The Committee formed no view as to whether staff transferred are better or worse off or no change had occurred. However, it was concerned by evidence from the Community and Public Sector Union that, with respect to the Corrections area within the Department of Justice, that:

a large number of prison officers ... were taken at very low wages - basically the training wage ... their conditions were

⁹⁷ Mr R Jeffrey, President, and Mr I Jacka, Chief Executive Officer, Civil Contractors Federation, Transcript of Evidence, pp. 155-156

⁹⁸ Ms S Cullen, Principal Consultant, Deloitte and Touche Consulting, Background Briefing, Transcript of Evidence, p. 56

actually reduced quite dramatically ...” and that “... It needs to be made very clear that they were working under different conditions, and that they had to accept different terms and conditions of employment if they wanted to continue to work in that particular field. ⁹⁹

A further example of the change given by the Union in respect of the outsourcing of certain prisons related to training. It was indicated to the Committee that the nature and extent of training courses now provided was substantially less than previously made available in the public sector. ¹⁰⁰

The Committee noted that the area of employment transaction is a rapidly evolving one. In a recent Federal Court case, pursued under the transmission of business provisions of section 149 of the *Workplace Relations Act (Clth)*, Justice Marshall ruled that workers should maintain their core public sector award entitlements when their jobs are transferred to another employer. While this case related to the outsourcing of Victorian psychiatric services, it has significant ramifications for all agencies and departments when they are preparing business cases to evaluate the benefits and cost savings resulting from outsourcing a service.

⁹⁹ Mr P Bertoulous, Community and Public Sector Union, Transcript of Evidence, p. 28

¹⁰⁰ *Ibid.*, p. 28

CHAPTER 5 QUALITY OF GUIDANCE PROVIDED

At a Department of Treasury and Finance monthly outsourcing seminar,¹⁰¹ the then Minister for Finance referred to the key issues of probity and contract management. With respect to probity, the Minister made reference to various guides that are available to departments and agencies to ensure that the integrity of the outsourcing process is consistently protected and is beyond reproach.

As pointed out to the Committee, contractual terms are self-executing. The right wording has to be incorporated into the contract to ensure that the intentions of the contractual parties have been properly expressed in written form. Furthermore, service recipients are not parties to the contracts and rely upon the purchasing agency to enforce the terms of the contract. Therefore it is imperative that appropriate guidance be provided to public sector managers to ensure that outsourcing is handled in an appropriate manner.

5.1 Contracting out guidelines

In 1993 the Victorian Governments' Management Improvement Initiative introduced *Contracting Out Guidelines* to assist public sector agencies in assessing opportunities to contract out services and to provide an overview of the contracting out process. Intended as a general reference to enable these agencies to manage the preparation, monitoring and evaluation of contracts, the guidelines were to be supplemented with specific advice from other sources, particularly where the services to be contracted out were substantial and complex in nature.

Most importantly, the guidelines emphasised the need for the precise identification of the in-house function, to be properly costed at the defined level of service delivery to serve as a benchmark for comparison with contractor bids. This costing exercise was to include a consideration of the following items:¹⁰²

- *direct costs* - labour, materials and equipment;
- *indirect costs* - overheads (e.g. electricity, rental), use of support areas (e.g. personnel, training) and

¹⁰¹ October 1997

¹⁰² *Contracting Out Guidelines*, Office of State Owned Enterprises, Revised February 1994, p. 35

financing commitments (e.g relating to leasing arrangements);

- *contracting out costs/revenue* - costs of reviewing or monitoring contracted out services, legal costs of setting up the contract, once-off revenue from sale of assets freed up as a result of contracting out, retrenchment payments, cost of retraining and relocating staff and on-going costs of employees whose employment cannot be terminated or effectively redeployed immediately;
- *opportunity cost/benefit* - space that becomes available might be rented out; and
- *tax savings/costs* - associated with the contracting out process.

The guidelines did not seek to put specific limits on the outsourcing process but indicated that:

*contracting out non-core activities allows executive management to devote more time to critical business activities.*¹⁰³

There was no definition in the guidelines as to what were 'core' and 'non-core' activities. However, the Committee noted that the guidelines provide indicators of functions and situations where competitive tendering and contracting should be considered and where more attention and care would be required when specifying a possible opportunity for outsourcing, for example, a non-routine, highly complex and sophisticated activity

5.2 Outsourcing and contract management guidelines

When the Committee received submissions to the initial terms of reference for this inquiry, many departments and agencies were concerned at the lack of central agency involvement in outsourcing developments within the Victorian public sector. At that time, detailed guidelines were being prepared by the Department of Treasury and Finance to assist with the identification and management of outsourcing opportunities.

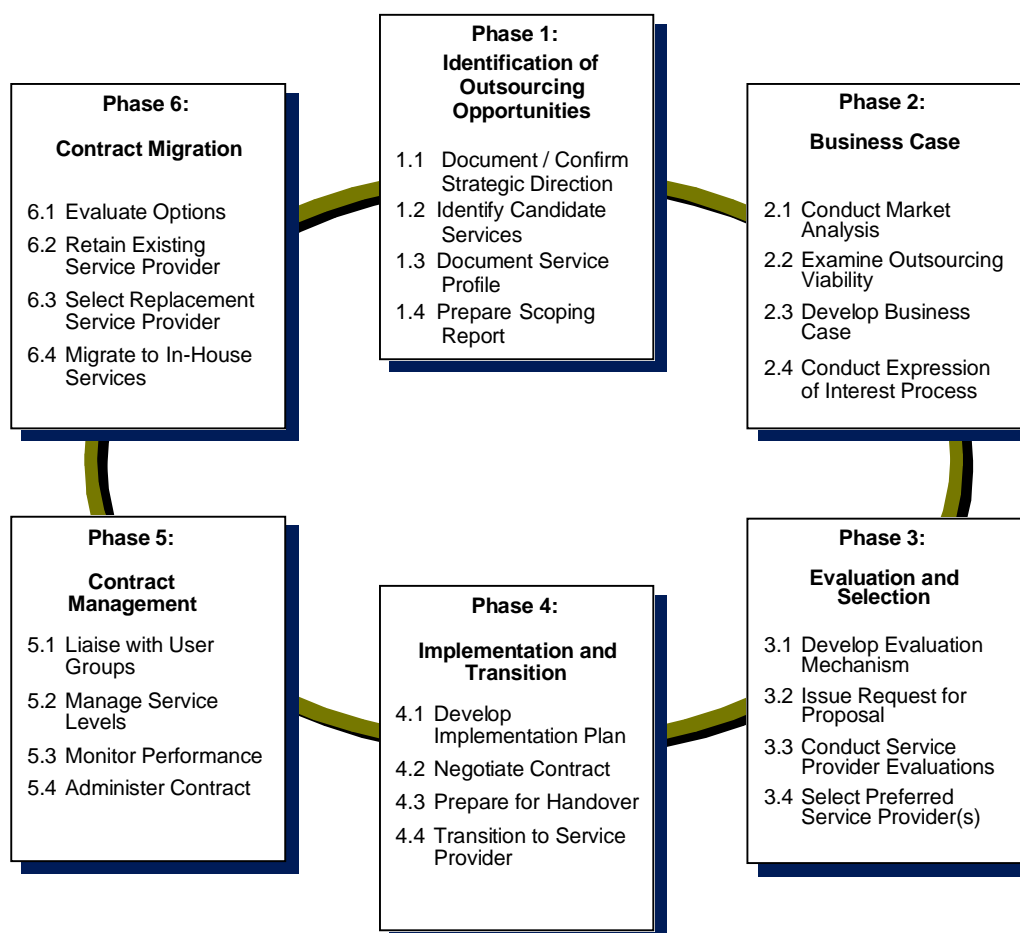
In December 1995, the Department of Treasury and Finance issued the *Outsourcing and Contract Management Guidelines*, for use by departments and agencies, which expand upon earlier broad guidelines. The department is of the view that the more recent guidelines contain:

¹⁰³ Ibid., p. 2

*a methodology for pursuing and implementing outsourcing/contracting out projects to maximise the benefits and provide a consistent decision-making framework for such projects.*¹⁰⁴

These guidelines have been developed around a six phase life-cycle approach for outsourcing projects with medium to large projects in mind, for example, where the annual contract price is likely to be in excess of \$250 000 but the guidelines also remain useful for smaller scale projects. Each phase of the cycle requires a decision to be made by executive management of the department or agency to ensure a consistent approach is taken.

An overview of the framework detailing the phases and sub-phases for which individual tasks are specified together with the objective to be achieved, steps to be taken, the output requirements and the matters to be considered, is provided below.



The latest publicly available Victorian Outsourcing Activity Survey conducted by CTC Consultants indicated that the

¹⁰⁴ Department of Treasury and Finance, *Outsourcing and Contract Management Guidelines*, December 1995, preface p. i

Outsourcing Contract Management Guidelines, issued by the Department of Treasury and Finance, were used in 36 per cent of the contracts awarded by departments and was the single most common general framework for outsourcing used by departments.¹⁰⁵

The Department of Treasury and Finance has not been able to clearly discern whether or not, and the extent to which, the guidelines have been referred to in practice.

Accordingly, in relation to the Committee's terms of reference for the Outsourcing Inquiry, it would be difficult, at present, for the Committee to properly evaluate the effectiveness of the guidelines. However, in terms of appropriateness, the Committee is of the view that the guidelines generally meet their intended purpose, that is, to facilitate the integrity, quality, success and probity of the contracting out process.

The Committee concurs with the view held by the Department of Treasury and Finance that the designated tasks for each of the sub-phases of the process provide for a robust, comprehensive approach to be taken by departments and agencies. Furthermore, the guidelines represent an important aspect of the overall purchasing framework within Victoria, since use of the guidelines in an outsourcing project would be accepted as compliance with the policy guidelines of the Victorian Government Purchasing Board (VGPB).

The guidelines have recently been extensively revised reflecting a positive approach to continuous improvement. The revised guidelines include more tools in the form of checklists to facilitate the process. The Committee would expect that any useful set of guidelines should be updated regularly to reflect changing requirements. In addition, their future use by departments and agencies should be monitored, to assist identification of further amendments necessary to ensure that they continue to be a useful tool.

5.3 Other initiatives by the Department of Treasury and Finance

5.3.1 The Former Outsourcing and Contract Management Unit

Until recently the Outsourcing and Contract Management Unit¹⁰⁶ within the Department of Treasury and Finance played a

¹⁰⁵ Victorian Government Services Contracting Survey 1996-97, p. 26

¹⁰⁶ The Unit was disbanded on 5 November 1999

significant role in assisting agencies in the transition phase to outsourcing. The Unit had the following functions:

- to promote and disseminate best-practice outsourcing methodologies through the Victorian public sector;
- to promote and facilitate specific outsourcing projects; and

- to provide advice to the Minister for Finance and to the government on issues relating to outsourcing projects and the development of policies in this area.¹⁰⁷

The need for the development of appropriate training courses and establishment of forums/seminars/discussion groups was identified by the Department of Treasury and Finance and action had been taken to address what the Office of Procurement regards as a major gap in contract management skills across the public sector.¹⁰⁸

The Unit conducted workshops and monthly seminars and kept in close contact with the many public service staff now involved in the outsourcing process. Furthermore, there were a number of specific interest groups chaired by public service staff, that focused on particular areas of outsourcing activity and interfaced with private sector counterparts. In conjunction with the VGPB and specific training providers, training programs were developed in recognition of the need to develop skills within the Victorian public sector in relation to all aspects of the outsourcing process.

In respect of specific outsourcing projects, the Unit was represented on steering committees, participated on selection panels within project teams, and provided assistance in selecting management and legal consulting support. There was no compulsion to use the resources of the Unit, however, staff from the Unit participated in meetings and discussions on outsourcing activities in relation to specific projects and provided advice when requested by departments and agencies. The Unit also established a whole of government panel for the provision of advisory services on all aspects of outsourcing.

In its background briefing to the Committee, the Department of Treasury and Finance indicated that the Unit had been involved in five major projects:¹⁰⁹

- IT services for the Public Transport Corporation and VicRoads Corporation - a \$100 million plus five year contract which claimed savings of at least \$4 million a year;

¹⁰⁷ Mr B Williamson, Assistant Director, Outsourcing and Contract Management Unit, Background Briefing, Transcript of Evidence, p. 4

¹⁰⁸ Mr L Bailey, Executive Director, Office of Purchasing, Background Briefing, Transcript of Evidence, p. 83

¹⁰⁹ Mr B Williamson, Assistant Director, Outsourcing and Contract Management Unit, Background Briefing, Transcript of Evidence, pp. 11-14

- a joint venture between the Department of Treasury and Finance and the Department of Premier and Cabinet to outsource the full range of their human resource functions - claiming savings of \$800 000 per year with an outsourced cost of \$1.6 million over the five years of the contract;
- the outsourcing, within the Department of Justice, of the Victorian Police air wing equipment and maintenance will result in an estimated benefit in the order of \$16 million over the seven year contract;
- undertaking the Victorian Student Achievement Project for the Board of Studies in the Department of Education, a new initiative; and
- the outsourcing of the operation of five outdoor recreation camps across Victoria for Sport and Recreation Victoria within the Department of State Development.

A further important aspect of the Unit's activities was its involvement in various working groups within the Department of Treasury and Finance, such as those relating to employee entitlements and competitive neutrality which ensured that policy issues were dealt with in a consistent manner.

5.3.2 The Procurement and Contracting Centre for Education and Research

The Procurement and Contracting Centre for Education and Research (PACCER) was established to address the training needs of departmental and agency staff. The Centre supplies contracting services in legal, accounting and other issues relating to contract management and coordinates research to identify the results being achieved, as well as gathering general purchasing statistics. Research activities undertaken by PACCER include identifying new research needs, establishing a national purchasing research database, developing electronic commerce, benchmarking procurement and contracting.

The Committee believes that the various initiatives taken by the Department of Treasury and Finance reflect the department's commitment to the extension of competitive tendering and contracting within Victoria. While the Committee has not examined the work of the Department's Outsourcing and Contract Management Unit in depth, the Committee is satisfied that measures such as the establishment of PACCER will greatly assist the contracting out process.

5.4 Status of Commonwealth guidance

All Australian governments have general purchasing policies and procedures. Some have also developed guidelines specifically related to competitive tendering and contracting. In addition, it is understood that a number of individual departments and agencies have developed their own guidance materials.

A number of publications have been released by the Commonwealth to provide guidance on the outsourcing process:

- *Before You Sign the Dotted Line - Ensuring Contracts can be Managed*, MAB/MIAC, Special Report No. 23; and
- two exposure drafts - *Competitive Tendering and Contracting, Guidance for Managers* and *The Performance Improvement Cycle, Guidance for Managers*.

On examining these publications, the Committee noted a number of matters that have been considered in this report:

- the MAB/MIAC report refers to the development and use of partnering arrangements which are designed to facilitate a cooperative working relationship between the parties; and
- the CTC Guide requires the identification of opportunities for industry development, advocates taking a non-legalistic approach to dispute resolution and acknowledges that short-listed tenderers may wish to perform due diligence checks on cost information.

Importantly, the MAB/MIAC report indicates two primary sets of skills that are required for effective contract management, viz:

- interpersonal skills - communication and negotiation skills, project management skills; and
- subject specific expertise that includes knowledge of, and skills relating to, the relevant industry, procurement, accountability requirements and contract law, financial management and human resource management.

The Committee notes that the Commonwealth approach to the implementation of competitive tendering and contracting is much the same as Victoria's.

5.5 Code of tendering

The *Code of Tendering*, developed with local government and private sector input, sets out the principles which underpin good tendering practice for local councils and gives guidance on the way each stage of the tendering process should be conducted. The Code is supported by the *Competitive Tendering Procedures Manual* which builds on councils' extensive experiences with tendering and has been designed to assist the councils to better understand the requirements of the compulsory competitive tendering environment.

A program of auditing local government contracts entered into under competitive arrangements provides an independent check on whether councils are following the guidelines. In addition, the Office of Local Government examines complaints relating to CCT and conducts investigations, where appropriate. The Minister for Planning and Local Government 1998¹¹⁰ report indicated that complaints had been received in respect of poor management, inadequate financial control and reporting systems, lack of processes to deal with compulsory competitive tendering and unacceptable client/provider split, inadequate tender documentation, costs of tenders being made public, unacceptable client/provider split, contracts being awarded to in-house teams and poor evaluation teams.

5.6 Concerns about guidelines

A number of witnesses to the Outsourcing Inquiry have commented on the plethora of guidelines available, which they believe has led to inconsistencies in approach by purchasing departments and agencies.

One witness indicated that the different approaches reflect the options available and the fact that what is appropriate for one outsourcing exercise is not necessarily appropriate for another. The key to determining the right approach is experience and acumen.¹¹¹

The Community and Public Sector Union¹¹² believes that deficiencies in the approaches taken indicate that inadequate consideration was being given to a number of factors impacting upon the evaluation of outsourcing opportunities in the guidance materials, for example:

¹¹⁰ Department of Infrastructure, *Competitive Tendering – Competition and Quality Services – Minister's Report on the Fourth Year of CCT*, December 1998.

¹¹¹ Ms Sarah Cullen, Transcript of Evidence, p. 52

¹¹² Community and Public Sector Union, submission

- absence of conflict of interest or probity concerns;
- existence of a real market;
- capacity of the agency to supervise the contract;
- democratic accountability;
- convergence with economic growth policy such as the promotion of regional growth, regional development and fostering of a trained, skilled and employed workforce;
- full cost attribution including cost of redundancies;
- consequences of loss of organisational memory; and
- capacity for ease of changes in policy direction.¹¹³

In its submission to the Committee, the Union was particularly critical of the outsourcing guidelines for Information Technology which the Union describes as 'woefully inadequate'.¹¹⁴

The Union suggested alternative guidelines for the decision-making process for the contracting out of government services, to be followed on a case by case, agency by agency basis.¹¹⁵ The key objectives of the Union's guidelines would include transparency; efficiency; privacy; security; accountability; equity; consultation and government strategic priorities.

The proposed guidelines relate to the following matters¹¹⁶:

- consumer groups, unions and the general public should be consulted about decisions to contract out significant functions;
- for some government functions, there must be a strong presumption that contracting out is inappropriate;
- the insertion of clauses which commit the contractor to maintain the wages and conditions of transferring workers;
- the length of contracts to be dependent on the circumstances of the function, but a preference for shorter rather than longer contracts with built-in review periods;
- provision for a third party to assist in the settling of disputes between purchasing agencies and service providers;

¹¹³ Ibid., p. 3

¹¹⁴ Ibid., p. 3

¹¹⁵ Ibid., pp. 23-26

¹¹⁶ Ibid., pp. 23-26

- government support for in-house tendering as a normal course and support for the inclusion of guidelines in relevant industrial instruments; and
- the removal of the compulsion at local government level for competitive tendering.¹¹⁷

The Committee recognises that outsourcing is still developing as a discipline and considers that initiatives such as the establishment of PACCER will provide for the necessary research to be conducted to determine which model is more appropriate for Victoria.

Furthermore, acceptance of recommendations that have been made in this report with respect to the provision of information to the Parliament and the public on the process and outcomes of the tendering and contracting process, should ensure that any identified deficiencies will receive immediate and effective attention.

The Committee recommends that:

Recommendation 5.1:

The Department of Treasury and Finance undertake a review of the Outsourcing and Contract Management guidelines and the guidelines of the Victorian Government Purchasing Board to ensure both sets of guidelines are consistent.

During the inquiry, the Committee became aware that there may be inconsistent interpretations of what constitutes outsourcing.

The Committee recommends that:

Recommendation 5.2:

The Department of Treasury and Finance:

- **adopt a clear definition of outsourcing ; and**
- **develop a methodology so that consistent and meaningful information on the level of financial savings achieved may be collected for analysis and reporting.**

¹¹⁷ Ibid., Drawn from Alternative Guidelines included on pp. 23-26

5.7 Ethics and Probity

The importance of probity and ethics in the outsourcing process cannot be overstated. High standards of probity and ethics are integral to ensuring that the process of awarding contracts is fair. Due to the size of the contracts outsourced and the fact that public money is being expended, it is of particular importance that the public sector meets its duty of care to the community by ensuring probity and ethics are given appropriate emphasis.

Similarly, it is important that private contractors and consultants acknowledge, and are aware of, the public sector requirements. The New South Wales Independent Commission Against Corruption in a report on *Private Contractors' Perceptions of Working for the NSW Public Sector*, reported that 19 per cent of respondents to its survey indicated that they considered that the public sector was more ethical than the private sector. The reasons given to respondents to support this include that the public sector:

- is governed by strict rules and guidelines;
- has accountability bodies watching over it;
- has a commitment to equity and social justice;
- is motivated by the ethic of 'public good';
- is more aware of mechanisms to support ethics; and
- is concerned to protect the public purse.

Other witnesses suggested that the public sector had to be seen to be more ethical, but that it was not necessarily more ethical.¹¹⁸ The majority of witnesses to the survey believed that *when NSW public sector organisations hire private contractors they should accept that the private sector does things differently*. However, the majority also agreed that *it was important to adopt public sector ethics when working for the public sector*.¹¹⁹

In order that appropriate standards of ethics and probity are applied to any outsourcing process, both by public servants and contractors, the Committee believes it is essential that they are aware of the principles and understand the importance of compliance. This is particularly true for the staff involved in the preparation of tender documents and evaluation of bids.

¹¹⁸ New South Wales Independent Commission Against Corruption, *Private Contractors' Perceptions of Working for the NSW Public Sector: a survey of consultants and contractors*, January 1999, p.11

¹¹⁹ *Ibid.*, p. 32

The Committee is aware that:

- in 1995, the Office of Public Employment published a *Code of Conduct for the Victorian Public Sector* (reprinted with corrections in 1998). The Code provides general high level principles for ethical behaviour for public servants in performing their duties;
 - the VGPB has issued a series of guidelines and best practice papers on public sector procurement and specifically addressed probity in its *Probity Guidelines for Tendering and Contracting*. In addition, its best practice guide on Operation of Tender Evaluation Teams covers documentation of processes for accountability and probity purposes; and
 - training courses on various aspects of procurement are run throughout the year by the PACCER, the training arm of VGPB.

The Committee believes it is essential that these sources provide a significant focus on probity and ethics. It is also important that agencies involved in outsourcing and indeed in tendering of any type, are aware of the resources available or seek other resources that address their training needs. When undertaking outsourcing, public sector managers should consider the provision of information to the private sector identifying the expected standards of ethics and probity to be observed.

The Committee recommends that:

Recommendation 5.3:

Departments and agencies ensure that adequate training on probity and ethics issues is undertaken by staff involved in the tender process to ensure they are fully aware of their duties and responsibilities.

Recommendation 5.4:

Departments and agencies ensure their staff and potential contractors are aware of the principles of ethics and probity applicable to public sector tendering and that they understand the importance of compliance with those principles.

5.8 Appointment of a probity auditor

As indicated above, the VGPB has issued guidelines for probity in tendering and contracting. One of the practices suggested by the VGPB guidelines is the appointment of a probity auditor to oversee and progressively sign off on the tender process to indicate that it has been open and fair and that the required probity considerations have been addressed. The probity auditor is valuable in providing assurance to tenderers and third parties and to improve the defensibility of actions should a legal challenge arise at a later date.

The Committee believes that the appointment of a probity auditor should be encouraged particularly where large contracts are involved. The Committee also believes that to protect the independence of the probity auditor, he or she should be appointed by the agency's Accredited Purchasing Unit rather than by the tender team itself. The probity auditor may be appointed from the internal resources of the agency but must be independent of the team and other agency influences. The probity auditor should report directly to the agency head.

The Committee recommends that:

Recommendation 5.5:

The appointment of a probity auditor to oversee the tendering process should be encouraged by departments and agencies. The probity auditor should be appointed by the Accredited Purchasing Unit and report directly to the Chief Executive Officer of the agency.

CHAPTER 6: COST SAVINGS DERIVED FROM OUTSOURCING

The Committee focused some attention on the cost savings attributed to outsourcing, although it was pointed out by some witnesses that every outsourcing arrangement should use a balanced scorecard approach to managing and reporting on outsourcing which tracks cost, quality (through Key Performance Indicators), relationship management, and risk. It was emphasised to the Committee that because outsourcing is not purely a cost reduction exercise, a more appropriate balanced picture of the arrangement is required.

However, when seeking to identify, measure and compare the cost of internal provision and contracting out of services, it is essential that a framework be established for the assessment of the relevant costs. The Committee believes that there should be an emphasis in this exercise on including all costs that would normally be incurred in delivering the service by either means.

Using this full cost approach is preferable, in the Committee's view, to only considering the avoidable costs, that is, the costs a department or agency would avoid by the use of alternative means of service delivery, because of the nature and magnitude of costs incurred by internal provision and a contractor. There appear to have been some failures in this area, which have led to increased costs to the outsourcing agency. However, some large projects such as the Department of Veteran Affairs in the Commonwealth have been considered to be successful with significant savings expected to be achieved for the outsourcing of all Commonwealth Information Technology needs, which is now taking place through cluster tendering.

One witness, Ms Sarah Cullen, noted that many organisations choose not to take into account in the assessment the overall organisational costs that can be reduced as the result of outsourcing a function. For example, the organisation may not take the opportunity to reduce its human resources section. The Committee believes that total organisational cost reduction opportunities should be taken into account when considering outsourcing.

6.1 Nature and extent of cost savings derived from outsourcing

The Productivity Commission reviewed extensive empirical evidence into the impact of contracting on the costs of service provision to governments.¹²⁰ Most of the evidence examined by the Commission came from studies into the impact of outsourcing on the ongoing (or recurrent) costs of service provision at all levels of government. Although the majority of those studies were from the United Kingdom and the United States, the Commission also referred to recent studies undertaken in Australia.

In its report, the Commission pointed out that the cost changes were to be viewed only as estimates of the ongoing cost changes as a result of outsourcing, since few of the studies included estimates of transition costs such as redundancy payments, or the costs of reorganisation which government departments and agencies may incur. Similarly, the costs that may be incurred in conducting a tendering process and/or specifying contracts (termed contract costs) were not included in most of the studies.

The main finding of the Productivity Commission was that just over half of the individual services examined in the studies estimated cost savings of between 10 and 30 per cent with the remaining estimates distributed reasonably evenly on either side of this range.¹²¹

The Commission reached the following conclusions:¹²²

- the evidence reviewed suggests that, in general, contracting reduces the ongoing costs of service provision, however, the actual size of these savings is highly variable;
- while the cost changes from contracting vary, the available empirical evidence does not provide sufficient information to determine whether service type or market characteristics drive these differences;
- despite institutional and other differences between the United States, the United Kingdom and Australia, the evidence does not suggest substantial differences in the cost effects from contracting across these countries;
- the evidence suggests that cost savings are obtained over the long term, although they may be higher in

¹²⁰ Productivity Commission (formerly Industry Commission), *Competitive Tendering and Contracting by Public Sector Agencies*, January 1996

¹²¹ *Ibid.*, pp. 532-533

¹²² *Ibid.*, pp. 528-540

the short term because (a) contractors may initially submit tenders at unsustainably low prices, either through incomplete knowledge of the full costs of providing the service, or through loss-leading pricing strategies; or (b) the cost of internal provision may fall over time, as a consequence of the (actual or threatened) competition;

- for the most part, the estimates of the effects of contracting on costs appear to be similar across studies employing different methodologies; and
- the evidence suggests that any cost savings are lower if an in-house team wins the contract.

While the Productivity Commission report concluded positively with respect to the development of competitive tendering and contracting, the findings of that Commission need to be considered in the context of the validity or otherwise of criticisms levelled by various researchers at the studies conducted.¹²³ These include the following:

- the accuracy of the estimated cost savings may be compromised by not accounting for all relevant costs;
- cost savings may be achieved through a decline in service quality;
- the statistical approach taken in studies in support of conclusions reached may lack integrity;
- the level of cost savings to be achieved may vary with the general state of the economy;
- the cost savings may result from other factors, such as technological change rather than the contracting process; and
- it may not be appropriate to generalise reported cost changes to all instances of contracting.

The range of savings reported on by the Productivity Commission has been referred to in various forums, mainly to demonstrate that outsourcing results in cost reductions. Even considering the criticisms referred to above, savings of the magnitude indicated by the Commission, if achieved, would have a significant impact on the Australian economy through:

¹²³ Ibid., pp. 540-550

*the so-called indirect effects that may arise as governments spend their money on doing other things that need to be done, instead of higher cost services.*¹²⁴

Some witnesses to the inquiry referred to other factors, apart from cost savings, that affect the decision to outsource. For example, one witness¹²⁵ indicated to the Committee that non-financial factors were being considered in council tenders and that costs were not the driving factor. While the weighting attached to these non-financial aspects would be dependent on the nature of the service being outsourced, Mr Rohan indicated that it would be important to ensure that service standards are set at an appropriate level and that there has been no undue trade-off between costs and the quality of service provision.

Another consultant, Ms Sarah Cullen, concurred with this view. Her team has led over 130 outsourcing projects in recent years and found that outsourcing is rarely pursued purely to provide cost savings.

The Committee noted the extensive research undertaken by the Productivity Commission which, in part, has confirmed the outcomes of the Victorian outsourcing survey but remains uncertain, along with apparently many other commentators, whether the level of savings indicated are achievable for all services and sustained over time. As a consequence, the Committee looks forward to examining the results of future outsourcing surveys when more substantive empirical data is made available on the impact of outsourcing within the Victorian public sector and in Australia generally.

While many witnesses indicated the annual savings achieved in respect of particular services, these figures were often not expressed as a percentage of the ongoing operating costs of the existing service provider, as was attempted in the outsourcing survey. Similarly, no conclusion could be reached by the Committee regarding the level of monitoring costs that were being incurred in relation to the contracts. The Committee noted from submissions received that, in a number of cases, estimates of cost savings could not be provided for a number of reasons including impact of restructuring, inadequate costing systems and changes to service requirements.

¹²⁴ Mr R Kerr, Head of Office, Productivity Commission (formerly Industry Commission), Transcript of Evidence, p. 44

¹²⁵ Mr P Rohan, Principal, Ernst & Young, Transcript of Evidence, p. 8

Nevertheless, the Committee is of the view that the various examples of cost savings provided and referred to during Committee hearings suggest that savings have been achieved.

While the evidence to date appears to be that direct savings will be derived from outsourcing, the Committee believes the overall impact of contracting out in an economic sense has not yet been indisputably determined either way.

The Committee believes that more comprehensive data should be accumulated on the nature and extent of these cost savings to enable meaningful conclusions to be reached.

The Committee recommends that:

Recommendation 6.1:

The Department of Treasury and Finance examine the coverage of the current outsourcing survey and seek further enhancement of the questions posed to departments and agencies regarding:

- (a) the significant contracts entered into by departments and agencies and the nature and extent of financial savings achieved;**
- (b) an analysis of the major contributing factors for such savings;**
- (c) whether those savings continue to be achieved over time and reported on;**
- (d) an assessment of the adequacy of the initial cost and service level estimates prepared as the basis of the tender evaluation;**
- (e) contracted service levels in relation to service quality and value for money;**
- (f) the cost of contract establishment and management to gain the complete cost picture; and**
- (g) compare the results to previous years and other jurisdictions.**

6.2 Sources of the Cost Savings

While acknowledging that outsourcing may achieve, in some cases, significant cost savings, the Committee firmly believes that the source of these savings needs to be closely analysed. If the savings result from the better utilisation of resources, whether in the public or private sector, the savings can be released for other uses in the economy. The possible sources of the cost savings resulting from competitive tendering and contracting include:¹²⁶

- improvements in the productivity of labour and capital through better planning, coordination and management of the service provision;
- less costly combinations of factors of production by the use of new or different technology;
- reductions in payments to capital and labour e.g. by way of reduced wages and/or conditions;
- cost-shifting e.g. through the taxation system, downsizing, differential funding arrangements;
- use of centralised service centres;
- innovative employee reward structures and flexible work forces; and
- economies of scale and scope.

The Committee notes that, at this time, the empirical evidence as to how cost savings are achieved under contracting out is mainly based on general observations and anecdotal evidence though, in the Australian context, an effort is being made to gauge the level of such savings through surveys of departments and agencies.

In its report, the Productivity Commission indicated that very few studies have attempted to identify the probable sources and quantify their effects.¹²⁷

Some witnesses remained doubtful of the nature and extent of the savings purported to have been achieved. The Community and Public Sector Union indicated to the Committee that:

*Typically, savings are made where a different service is provided, but to compare the two is to compare apples with oranges.*¹²⁸

¹²⁶ Productivity Commission (formerly Industry Commission), *Competitive Tendering and Contracting by Public Sector Agencies*, January 1996, pp. 550-555

¹²⁷ *Ibid.*, p. 552

¹²⁸ Mr P Keogh, Community and Public Sector Union, Transcript of Evidence, p. 20

The Union also referred to the need to consider the degree of cost shifting that has taken place, particularly on the taxation side and raised some doubt that a level playing field did exist. The main criticism by the Union was in respect of the reduction in wage levels that ensued from the outsourcing process.

The Union made particular reference to the experience with school cleaning where significant savings have been assessed by the Department of Education to have been achieved, in excess of \$47 million per annum. But, as the Union pointed out to the Committee, there has been no external reporting on the magnitude of the savings and how the savings have been utilised in other areas. Of concern to the Union is the nature and extent of reported savings put forward since cleaners were:

*the sorts of people who usually lived near schools ... they still spent a large amount of their time doing all the odd jobs for which there was no official recompense.*¹²⁹

Through the outsourcing process,

*Most of the cleaning contracts went to the existing cleaners, who were provided with basic information on how to set up their own companies, and who found they were doing exactly the same job for considerably less pay.*¹³⁰

The Union suggested to the Committee that cleaners are seeking other local paid work to supplement their cleaning contract.

In the Union's view, the move to greater autonomy at schools has placed a significant burden on the Councils and management at those schools to properly deal with the devolution of power. The Union indicated that there was anecdotal evidence that difficulties had been encountered in the outsourcing of canteens and Information Technology. The concern with Information Technology is that, while purchases in this area are covered by a financial subsidy from the Department of Education, the purchases made in schools will be on the basis of price considerations.

Submissions provided many examples of cost savings having been achieved, but no indication was given on how those savings were derived and whether effective base line costing comparisons had been undertaken. In the Committee's view, where the savings resulted from a redefinition of service requirements, the difference should not be regarded as savings *per se*.

¹²⁹ Mr C Smith, Research Officer, Australian Education Union, Victorian Branch, Transcript of Evidence, p. 70

¹³⁰ Ibid., p. 70

The Committee considers that there should be substantial analysis of at least the more significant contracts entered into by departments and agencies to determine the level of real savings achieved and how those savings arose.

The Committee recommends that:

Recommendation 6.2:

Departments and agencies undertake analysis of their significant contracts and determine the level of real savings achieved and how those savings arose.

6.3 Staff transition costs

During the inquiry, the Committee was made aware of many views on the treatment of transaction and transition costs particularly relating to redundancies. The impact of redundancies was highlighted to the Committee by Ms Cullen who indicated that, in her experience, the transfer rate for public sector employees was five times that of the private sector, with the clean break approach tending to be the preferred option.¹³¹

Differences in the treatment of transition costs are important because, where such costs are significant, their consideration may impact on the choice of contractor, whether in-house or external. There are a number of alternative approaches that can be taken with respect to redundancy costs, including:

- treating redundancy costs as sunk costs and excluding them from the competitive tendering and contracting analysis; or
- accounting for redundancy costs in the decision to introduce competitive tendering or when selecting a preferred tenderer.

The relevant merits of the alternative treatments for redundancy costs have been considered by State governments and differing approaches taken. In Victoria, local government tendering guidelines recommend that redundancy costs, which need to be met as a result of CTC, should be regarded as a capital cost and amortised over a period of not less than five years. This approach is consistent with the view of the Productivity Commission which indicated that:

Agencies should estimate redundancy costs, include them in the tender documentation and take them into account in the evaluation of external tenderers. Redundancy costs should be

¹³¹ Ms S Cullen, Principal Consultant, Deloitte and Touche Consulting, Background Briefing, Transcript of Evidence, p. 56

*amortised over a suitable period, which is likely to be between five and ten years.*¹³²

Mr Rohan indicated to the Committee that when internal and external bids in local government are considered, appropriate adjustments for assets, redundancies, etc. are made in line with competitively neutral pricing principles. The Committee was advised that the comparison of in-house and external bids in local government had been undertaken on the basis that superannuation was fully funded, which was subsequently found not to be the case.¹³³

The Civil Contractors Federation expressed concern to the Committee at the practice of double-dipping which the Federation was attempting to have changed in the construction industry. In the Federation's view:

*True redundancy means that there is no hope of the guy being employed for at least the period of the contract.*¹³⁴

Furthermore, because skilled people are leaving employment through downsizing, the Federation believes there is now a real lack of expertise in training and experience in contract management.

The question arises as to whether through outsourcing an organisation is right-sizing to meet the challenges of the future. The process of privatisation, contracting out, market-testing, re-engineering services, slimming down, de-layering and other similar initiatives are all important elements in the management reform process within Victoria. However, the Committee noted that the push for leaner government through the reduction of costs may have long term effects which will only become apparent in future years. Much of the success of outsourcing will revolve around the continued capacity of the private sector to provide the contracted services in an efficient and effective manner.

The Committee recommends that:

Recommendation 6.3:

The Department of Treasury and Finance develop guidelines for the treatment of staff costs in developing and assessing a business case for outsourcing.

¹³² Productivity Commission (formerly Industry Commission), *Competitive Tendering and Contracting by Public Sector Agencies*, January 1996, Recommendation C 5.8, p. 315

¹³³ Victorian Auditor-General *Report on Ministerial Portfolios*, May 1997, pp. 210-213

¹³⁴ Mr Jacka, Chief Executive Officer, Civil Contractors Federation, Transcript of Evidence, p. 157

6.4 Linking outsourcing with the Management Reform Program

The legislative foundation for contracting out within the Victorian public sector is largely found within the *Public Sector Management Act 1992* and the *Financial Management Act 1994* and has the following main features:

- greater devolution of financial and other management responsibilities to departments;
- improved cost attribution to support more informed decision making; and
- enhanced focus on performance reflected by the delivery of agreed outputs.

It will be important, under the Management Reform Program (MRP), that departments and agencies have adequate contract recording and reporting systems which provide complete and accurate information as to the actual costs incurred through internal or external service provision. This will provide the support for regular reporting on business performance.

CHAPTER 7 OUTSOURCING WITHIN DEPARTMENTS AND AGENCIES

7.1 Introduction

The Committee met with representatives from the Departments of Infrastructure and Human Services to gain an appreciation of their experiences with outsourcing. The experience of these departments was of significant interest to the Committee and provided a practical view of outsourcing to date.

7.2 Department of Infrastructure

The Committee was advised that the infrastructure component of the department's current budget outlays of \$1 billion amounted to \$460 million of which \$300 million (sixty-five per cent) is spent on outsourced services.¹³⁵ This covers in excess of 1,500 contracts spanning activities such as private route bus services, private school bus services, privatised passenger rail services, internal audit and IT.

The department advised that amounts are also expended on service agreements with other government agencies e.g the XPT rail service between Melbourne and Sydney which is provided by the State Rail Authority of New South Wales, based on a service agreement.

A further 15 per cent is provided to external parties by way of grants for services rendered, including amounts paid to local government for library services and beach cleaning, and the cost of Victoria's contributions to the national road and rail bodies.

The department indicated to the Committee that outsourcing was significant within its two major agencies, Roads Corporation (VicRoads) and the Public Transport Corporation (PTC) the levels being 70 per cent and 30 per cent respectively of their operating budgets.

In the department's submission to the Committee, it was stated that the cost savings from the public transport outsourcing were in excess of \$10 million per annum but the department did not elaborate on the nature and source of these savings. Monitoring costs for this area of outsourcing were stated as being \$80,000 per annum.

¹³⁵ Mr J McMillan, Deputy Secretary, Contracts, Regulation and Compliance Services, Department of Infrastructure, Transcript of Evidence, p. 123

Difficulties encountered by the department in monitoring its contracting out arrangements included:

- reliance on survey data for the accurate payment of subsidies to contractors; and
- lack of expertise in contract management with departmental capability to be enhanced via recruitment and training.

In line with many other departments and agencies, the Department of Infrastructure has outsourced its corporate Information Technology. In its submission, the department indicated that the organisational Development and Corporate Services Division now manages the provision of full Information Technology services by a third party. Through that Division, the department “*is responsible for IT strategic planning, policies and management of the contract with the third party.*”

The Committee noted that the department was unable to provide the level of savings achieved through this initiative:

*Given the constantly changing IT environment and greater range of services available, cost comparisons of outsourced activities are not meaningful.*¹³⁶

The department was, however, able to advise the Committee that annual monitoring costs comprised the equivalent of two staff and up to \$50 000 on external consultancy fees.

The department advised that it had also encountered difficulties in this outsourcing arrangement. In this instance, the department described the difficulties as being ‘major’ and related to the design and implementation of clear and measurable targets with the result that:

*Despite extensive investment in the establishment of 175 service targets and comprehensive reporting against these, there is still great disagreement between the Department of Infrastructure and its outsourcer on whether or not the overall level of service is at the agreed level.*¹³⁷

With respect to the manner in which the contracting was undertaken, the department indicated that many of the arrangements had been entered into prior to the issue of the Outsourcing and Contract Management Guidelines by the Department of Treasury and Finance. At the time, the Department

¹³⁶ Department of Infrastructure, submission
¹³⁷ Ibid.

of Infrastructure had consulted with the Department of Treasury and Finance on matters relating to the outsourcing of services.¹³⁸

On the level of the overall recurrent expenditure that the department intends to contract out, the department indicated that there was no overall figure but that the impending franchising of the public transport sector would make a tremendous difference to the amount of work being done by private operators.¹³⁹

The department advised that many of the details relating to its outsourcing arrangements were likely to be reported in its annual report, particularly with reference to consultancies for which the department provided a description of all contracts and contract performance in that area. By way of example of the nature and extent of disclosures made, the department indicated to the Committee that the annual report would include:

*a section that goes to buses, how they fared against the quality service standards, times of running, delivery of timetables*¹⁴⁰

7.3 Department of Human Services

The Department of Human Services differs from many other departments in that over time the major part of its total budget has been spent on externally provided services. The department advised the Committee that the level of this external provision (to hospitals, community health centres, local government and non-government organisations) was in the order of 86 per cent of total operating expenditure and that the department had moved from historically based funding to funding based on the identification and purchasing of outputs on the basis of service agreements.¹⁴¹

While the present arrangements have not substantially been subjected to the competitive tendering and contracting process, the department is increasingly looking to introduce contestability into its arrangements with external service providers, such as those in the mental health area, which are provided as community or hospital based services. The department has also entered into service agreements with internal service providers and, in so doing, the department has sought to benchmark the relative costs of both internal and external provision. Another initiative taken by the department has been the establishment of an internal group

¹³⁸ Mr J McMillan, Deputy Secretary, Contracts, Regulation and Compliance Services, Department of Infrastructure, Transcript of Evidence, p. 124

¹³⁹ Ibid., p. 126

¹⁴⁰ Ibid., p. 126

¹⁴¹ Mr A Clayton, Acting Secretary, Department of Human Services, Transcript of Evidence, p. 58

to examine the department's outsourcing and contestability arrangements from a strategic viewpoint.

The department views the provision of internally and externally provided services under agreements including mental health services, aged care services, acute services and housing, as not being the department's core activity on the basis that the department has not directly delivered those services for years.¹⁴² In relation to internally delivered services, such as child protection, intellectual disability, juvenile justice and statutory services, the department expects that:

*the measures and tests are the same as the checks and balances we use for the external services sector*¹⁴³

All these activities are considered by the department as mainstream. Non-core areas are those such as corporate services, that are considered non-critical. The department has contracted out a significant proportion of its corporate service activities in the areas of Information Technology and staff development and training.

In its submission to the Committee on the initial terms of reference, the department had advised that:

*In response to the government's policy agenda for contracting out and contestability, the Department has built on existing arrangements through a program by program assessment and implementation for those services suitable for outsourcing ... the approach has been to take a "whole of service" rather than a piecemeal approach to outsourcing.*¹⁴⁴

The need to properly manage the outsourcing program had meant that at the time, the department had sought both formal and informal advice from central agencies - the State Owned Enterprises (SOE) Working Party, the Outsourcing and Contract Management (OCM) Unit of the Department of Treasury and Finance, the Superannuation Board and the Department of Business and Employment. Specialist legal advice had been sought on federal industrial implications. In relation to the use of central agency guidance, the department indicated that it sought to apply contracting out guidelines, where appropriate.

In its later submission, the department made reference to the existence of Department of Human Services Contract and

¹⁴² Ibid., p. 62

¹⁴³ Ibid., p. 62

¹⁴⁴ Department of Human Services, submission dated 18 December 1995

Tendering Guidelines which define the department's policy for outsourcing in a contestable environment and which complement a monthly training program targeted at staff who manage service tendering processes. In addition, the department indicated that it had developed more rigorous service purchasing models across the department that would support the contestability program.

The Committee notes that, in the more recent submission, the department indicated that in respect of aged care service developments:

*The actual savings from outsourcing services was indeterminate due to the various structural and organisational changes that have taken place in recent years ... the cost of monitoring the outsourced services is not significant as the structure and reporting mechanisms reduce direct costs to the Department.*¹⁴⁵

For most of its activities the department was unable to provide the Committee with an assessment of the total savings derived by the department through the outsourcing program. The department has contracted out significant areas of its Information Technology function including the personnel and payroll system, psychiatric services database and the Housing Division's Information Technology needs.

In the acute health services area, the department advised that:

*the individual acute health hospitals in the State (some 130) have continued their own outsourcing activities in respect of non-core business e.g. cleaning, food, laboratory, pathology, etc. ... the savings and costs of monitoring these endeavours will become apparent as the Department moves to accrual accounting.*¹⁴⁶

The department undertook two major service redevelopments in relation to mental health, and alcohol and drugs. The department indicated to the Committee that it was unhappy with the institutional service system in place and believed that:

*We could get better value for money, service quality and a whole range of things to redevelop those service systems using a mixture of providers, and not necessarily just government ones*¹⁴⁷

¹⁴⁵ Department of Human Services, submission dated 14 April 1997

¹⁴⁶ Ibid.

¹⁴⁷ Mr A Clayton, Acting Secretary, Department of Human Services, Transcript of Evidence, p. 66

This redevelopment initiative was not intended by the department to be a cost saving exercise alone but rather, resources previously tied up in non-direct care areas would be released for the purchase of a wider range of locally based services. The department's Business Improvement Branch may be expected to look at establishing the framework under which such decisions may be considered on the basis of getting better value-for-money and higher quality service provision.

In relation to the external disclosure of service agreements, the department indicated that it had something like 3,500 organisations providing services. This information is held on a computer database and is not included in the department's annual report. Nevertheless, the department felt that with well-trained departmental and regional staff as contact points, the public was well aware of the manner in which complaints would be dealt with. At this stage, because of the nature of service agreements that have been in place for some years, the department has not sought to introduce customer service charters *per se* but would closely examine the experience of the United Kingdom before considering their introduction to the health sector.

The department advised that both quantitative and qualitative performance measures/targets were available and key indicators were reflected in the Budget Papers.

The Committee is aware of the considerable work that is being done in the area of performance measurement by COAG in the assessment of the provision of government services through the development of a wide range of nationally consistent benchmarks. The department has indicated its intention to review its existing range of indicators and develop new measures/targets based on the benchmarks adopted in the Productivity Commission's Annual Report on Government Service Provision.

The Committee was advised that the department has provided intensive training in respect of the preparation and monitoring of service agreements.

Further comment on the Department of Human Services can be found in Chapter 8.

7.4 Local Government

From 1996-97, councils were required to competitively tender work equivalent to at least 50 per cent of their total expenses. In 1997-98, 74 out of the 78 Victorian local councils exceeded the 50 per cent target.

Pursuant to section 208B of the Local Government Act, there were four types of competitive tendering arrangements a council could enter into.

Types of arrangements and the values of each, entered into by councils in 1997-98:	
Type	Percentage
A contract entered into after the council has conducted a competitive process	48
An in-house agreement	40
A contract for the supply of goods, services or works, to or for another party (usually another council)	2
A contract or in-house agreement approved as an alternative competitive arrangement by the Minister, including approved purchasing schemes	10

The mandating of outsourcing within the Victorian local government appears to have provided the necessary impetus to drive the competitive tendering and contracting initiative. However, as indicated in the review panel's report¹⁴⁸, some adjustments needed to be made in relation to the adequacy of self-regulation, modification of purchasing arrangements and corporatisation of business units.

This conclusion is in line with the position held by the Municipal Association of Victoria which indicated to the Committee that it had:

no difficulty at all with the concept of outsourcing and the market testing of council services

However, the Association expressed some concern with the provisions of the legislation mandating a percentage of expenditure:

¹⁴⁸ *Review of CCT Implementation*, Report of the Review Panel to the Minister for Planning and Local Government, December 1996

*(it) probably forced them (the councils) to make a number of organisational and structural decisions that are now currently under review*¹⁴⁹

A number of practical difficulties were encountered in the implementation of compulsory competitive tendering:

*none the least of which is how councils do their splits, how they define core and non-core, how they define which community service obligations they want to try and fulfil*¹⁵⁰

Furthermore, the Association's President, Cr Matheson, made the observation that in seeking to meet the legislated targets, councils *...put out to tender the most easily identifiable things...* and from this sprang a range of contract specifications for these services.¹⁵¹

In Appendix 1, the Committee reviewed the report of the Minister for Planning and Local Government on compulsory competitive tendering. The Committee believes that the information contained in the document could be enhanced.

Since this report was prepared, the Bracks Government has enacted legislation to implement the government's election commitment to abolish compulsory competitive tendering for local government. In future, councils will be required to adopt a new approach based on best value principles.

In determining the most effective means of providing a service to the community, councils will now be able to take into account a range of local considerations, such as the retention of skills and jobs within the community and the economic impact on the community.

These new arrangements will provide greater flexibility by enabling councils to determine whether there is value in going to tender. It will remove the requirement for councils to tender for small value contracts solely in order to meet the statutory CCT threshold. Councils will apply the best value principles to their services as existing CCT arrangements expire.

The principles place an onus on councils to ensure that their services:

- offer the best possible quality and value for money;
- are responsive to community needs;

¹⁴⁹ Ms H Proctor, Acting Chief Executive Officer, Municipal Association of Victoria, Transcript of Evidence, p. 147

¹⁵⁰ Ibid., p. 148

¹⁵¹ Cr B Matheson, President, Municipal Association of Victoria, Transcript of Evidence, p. 149

- are accessible to the people they are intended for;
- show continuous improvement; and
- are subjected to regular community consultation.

Councils are required to report regularly to the community on how their services measure up against the best principles.¹⁵²

The Committee noted this development and hopes that it will remove the inflexibility of imposing targets on all councils.

The Committee recommends that:

Recommendation 7.1:

Annual reports of councils should include an overall assessment of the level of real financial savings and other benefits achieved by councils through outsourcing services, and how those savings arose.

Contractors are concerned about how outsourcing is proceeding in the local government sector. One witness indicated to the Committee his concern that in the trade sector the *cheapest rates* are being sought by the council purchasing schemes resulting in a short term gain to the council, but this practice *crushes the market*.¹⁵³ Furthermore, the company has *steered clear of council outsourcing* for a number of reasons including doubts as to whether councils could handle the enormous amount of work required through compulsory competitive tendering and the view that the tender would initially be awarded in-house.¹⁵⁴

Accordingly, the company felt it appropriate to *wait and see* and consider tendering at the end of the first contract period. The company's policy is that if there is an in-house bid, it does not usually bid since:

*While we go along to many of the seminars and conferences and they talk about the level playing field, our experience is that in reality its somewhat different.*¹⁵⁵

The concern with in-house bids was reiterated by the Civil Contractors Federation who perceived the separation of the client and services groups as: ... *one hell of a problem and nobody knows how to handle it yet*. The Federation suggests that, as a consequence of

¹⁵² *Local Government (Best Value Principles) Act 1999*

¹⁵³ Mr R Cheffers, Corporate Services Manager, Skilled Engineering Limited, Transcript of Evidence, pp. 133-134

¹⁵⁴ *Ibid.*, p. 134

¹⁵⁵ *Ibid.*, p. 134

an uneven playing field, significant losses may be borne by councils who have supported in-house bids over well-credentialed external bids. Furthermore, some councils are: ... *unable to attract bids for projects*¹⁵⁶

At a background briefing for the Committee, Mr Vern Robson, a member of the CCT Implementation Review Panel, made the observation that:

*The overwhelming criticism by the private sector was that councils lacked transparency in handling the CCT process and that some councils were biased and favoured in-house bids.*¹⁵⁷

The concern with in-house bids was further commented on by Mr Robson who referred to:

an instance in the Office of Local Government where a number of in-house teams have already blown their contract amounts in their first year of tendering ... there have been examples where budgets have been blown in excess of \$100,000 in some road construction projects and some in the parks and garden area ... they were well over what the tendered amount was ...; and

*much of the evidence to date is that in-house teams are battling to make the tender price they submit. There is substantial evidence that many are exceeding the tender price.*¹⁵⁸

The Committee noted with interest the comments of Mr Jacka who indicated that, while the Federation believed it had *an excellent relationship* with the Office of Local Government, few of the recommendations were picked up in subsequent legislation.¹⁵⁹ For example the rejection of the suggestion: ... *to produce a standard industry document for service provision, for tenders and whatever else.* The development of best practice documentation, in the Federation's view, would have been advantageous for councils which: ... *are still not sure how they should be running competitive tendering and contracting.*

The Committee recommends that:

Recommendation 7.2:

¹⁵⁶ Mr Jacka, Chief Executive Officer, Civil Contractors Federation, Transcript of Evidence, pp. 153-154

¹⁵⁷ Mr V Robson, Department of Infrastructure, Local Government Planning and Market Information Services Division, Background Briefing, Transcript of Evidence, p. 24

¹⁵⁸ Ibid., pp. 27-28

¹⁵⁹ Mr I Jacka, Chief Executive Officer, Civil Contractors Federation, Transcript of Evidence, p. 155

Annual reports of councils should disclose such matters as:

- **the comparative level of in-house and external service provision;**
- **the extent of corporatisation of in-house business units;**
- **the manner in which decisions on contracting out are made, i.e. are all contracting out decisions considered by the Council or are some delegated; and**
- **the nature of the commercial arrangements entered into e.g. partnering, strategic alliances.**

These disclosures should be designed to demonstrate transparency and the existence of a level playing field.

A further indication of progress by local councils is outlined in the report of the review panel to the Minister for Planning and Local Government titled *Review of CCT Implementation* issued in December 1996.

In concluding, the review panel was:

*Heartened that, whilst submissions from the private sector related instances of council tendering which could have been conducted with more regard for due process, the authors of those same submissions were convinced that CCT could and must be made to work better.*¹⁶⁰

Accordingly, the thrust of the recommendations related to the development of best practice guides would provide the basis of future reviews of the implementation of CCT in local government.

The main findings of the review panel were as follows:¹⁶¹

- the effects of CCT implementation experienced by small rural shires are experienced by all councils;
- self-regulation by local government has not resulted in adequate financial and performance monitoring systems and auditing arrangements for CCT, particularly for in-house units;

¹⁶⁰ *Review of CCT Implementation*, Report of the Review Panel to the Minister for Planning and Local Government, December 1996, covering letter to Minister

¹⁶¹ *Ibid.*, pp. 1-7

- organisational structures of councils are not adequate in all cases to separate purchaser and provider functions in accordance with CCT and National Competition Policy principles;
- the competitive process and competitive arrangement as currently defined for the purposes of CCT require public tendering and do not assist councils to optimise the benefits of CCT;
- ratepayers' interests will not be protected unless councils are held accountable for the higher risks and are required to provide a return on the assets involved in any external tendering (from a ratepayers' perspective, there is little difference whether a council's external tendering is for the government or the private sector); and
- the *Victorian Local Government Code of Tendering* has been effective in guiding good tendering practice.

In making its recommendations, the review panel was guided by four fundamental principles:¹⁶²

- promotion of best practice - time constraints and lack of experience have made the achievement of best practice in the first round of tendering difficult - best practice will be needed, when it comes to re-tender, to ensure the effectiveness of councils' tendering process, particularly where in-house bids are included;
- improving transparency - what is needed now is a far greater acceptance of the spirit as well as the letter of the Code by all councils - this will be achieved, not by legislating for transparency, but by local government self-regulation;
- rewarding rather than regulating - councils which are demonstrating that they are operating in accordance with best practice should be given recognition - there is scope, in time, for the government to reward best practice councils, for example, relaxing certain of their CCT obligations; and
- restoration of flexibility - current pressures on councils to achieve legislative targets tend to encourage uncompetitive and inappropriate packaging, inaccurate costings and overhead

¹⁶² Ibid., pp. 11-12

allocations and contract awards that cannot be justified by the evaluation process - a realistic CCT target should be set that will allow councils to select services for competitive tendering at their discretion.

Overall, the Committee believes that the experience gained in the application of compulsory competitive tendering to local councils will be invaluable in evaluating outsourcing in departments and agencies. Of particular interest are the matters identified by the CCT implementation review team such as the promotion of best practice, improving transparency of contract outcomes, rewarding rather than regulating and restoration of flexibility in contractual arrangements.

CHAPTER 8: IMPACT OF OUTSOURCING ON HUMAN SERVICES

8.1 Background

In considering the potential impact of outsourcing on this area of the public sector, the Committee noted that human services encompasses the broad grouping of health, welfare and community services.

Victoria was the first state to introduce wholesale reform of funding for human services. In the late 1980s, a move was made from decisions based on historical allocations and submissions, to the introduction of service agreements. This was followed in the mid 1990s by the introduction by the Department of Human Services of output-based funding.

The change to output based funding within Victoria has been implemented in several phases:

- developing and introducing standard funding agreements;
- consolidating the implementation of service agreements with differential information and reporting requirements;
- moving from inputs to outputs in determining the level of subsidies; and
- reviewing where contestability should be introduced.

The Australian Council of Social Service has described this particular reform as ... *the most radical and zealous implementation of competitive tendering practices of all States ... and which has ... caused major upheaval and concern within the community sector.*¹⁶³

In the Victorian model, the Department of Human Services determines the framework, policies and funding parameters for service purchasing. Purchasing decisions and the management of service agreements are devolved to regions.

¹⁶³ Joint submission from ACOSS (Australian Council of Social Service) and the State and Territory Councils of Social Service to the Inquiry into Competitive Tendering of Welfare Service Delivery by the House of Representatives Standing Committee on Family and Community Affairs, August 1997, p. 47

8.2 Models of government funding of human services

To put the outsourcing of human services into context, the Committee has noted that, in Australia, there are a “myriad of different models” including:¹⁶⁴

- *government as philanthropist model* - where organisations take the initiative and seek a contribution and or support for a particular project or activity;
- *submission model* - where the government indicates there are funds to support particular services or activities, and invites proposals from the public within program guidelines;
- *planning model* - where the government takes responsibility for collecting data and consulting on needs and services, and directs resources to areas or population groups on the basis of need - funding agreements might be negotiated with existing providers, or steps taken to locate new providers;
- *competitive tender model* - where the government prescribes what services are to be purchased, and selects agencies following a competitive tender process. Government then contracts with providers to deliver the specific service;
- *brokerage or fund holder model* - where a case manager receives funds to negotiate a package of care services for an individual client, from an existing service provider - until now, brokerage models have remained at the margins of the main service delivery systems for older people and people with disabilities; and
- *quasi-vouchers model* - direct payments of subsidies to the consumers of services (usually referred to as individualised or consumer-focused funding).

The Executive Director of VCOSS informed the Committee that VCOSS does not support any particular model. The planning model was considered a good one because it was based on needs. On the other hand, VCOSS did not support the submission model since, in its view, it did not allow for the equitable allocation of resources. At that time, the competitive model had still to be tested as to whether or not it is more effective.¹⁶⁵

¹⁶⁴ Ibid., pp. 11-12

¹⁶⁵ Ms P Morrison, Executive Director, Victorian Council of Social Service, Transcript of Evidence, p. 79

While there are differences in the type and mix of funding models used by Australian governments, and the extent to which competitive tendering and contracting is used, there appear to be a number of common features reflected in current arrangements across Australia for the funding of human services:

- moves to clearly separate the roles of government (purchaser) and health and community organisations (providers);
- a shift from funding organisations to funding individual services or a range of integrated services, with governments taking the prominent role in service specification;
- funding to be provided on outputs or outcomes rather than inputs; and
- wider use of contracts to define the services being purchased, and the expectations in relation to performance and accountability.

The Committee was advised that

*the models for providing community services have been diverse because we had a notion of fostering diversity in order to encourage innovation*¹⁶⁶

¹⁶⁶ Ibid., p. 76

VCOSS views the introduction of output based servicing as being contentious mainly because of the disagreements about what should constitute a fair price for the services provided. There has been considerable discussion between VCOSS and the government about

*what should be encompassed in the framework for a unit cost ... what per centage of administrative costs to build in, whether to fund for overheads or infrastructure costs in a unit price, and whether to go the full corporate way and build in profit margins which will allow for risk management, research funding, and so forth*¹⁶⁷

The Committee was further advised that these deliberations have also extended to whether outputs or outcomes should be measured, how readily qualitative outcomes can be measured and who should set the criteria that would indicate whether outputs and/or outcomes have been successfully achieved. VCOSS is concerned that the method of consultation of performance measurement is very fragmented, tending to go by program areas, and in its view, has been *one of the greatest weaknesses in implementing* competitive tendering and contracting in the human services area.¹⁶⁸

In contrast to the approach being adopted in Victoria and Western Australia for human services, the experience of the other states has been to become more prescriptive in specifying what services government will fund, and for whom, with funding being provided under a mix of the planning and submission models.

ACOSS holds the philosophical view that the market approach to human services is not appropriate as these services are *fundamentally different from other types of business and production, and this needs to be reflected in the way governments fund and deliver human services*¹⁶⁹ and also believes that community service organisations should be recognised for their diversity, quality, innovation and caring ethic.

While acknowledging that, when managed well, the use of outsourcing offers many potential advantages, ACOSS has

¹⁶⁷ Ibid., p. 76

¹⁶⁸ Ibid., p. 76

¹⁶⁹ Joint submission from ACOSS and the State and Territory Councils of Social Service to the Inquiry into Competitive Tendering of Welfare Service Delivery by the House of Representatives Standing Committee on Family and Community Affairs, August 1997, p. 2

expressed a number of broad concerns about contracting out human services:¹⁷⁰

- the inappropriate use of competition in the selection of agencies results in efficiency taking precedence over quality and equity and unnecessary closure of services and loss of community infrastructure;
- for consumers and communities, it can result in uncertainty and insecurity, reduced access to services, less choice of agency and service model, increased charges and reduced quality of services; and
- forced competition will also undermine inter-agency cooperation and collaboration at a time when much of the reform agenda at the State and Commonwealth levels is being directed towards achieving better coordination and integration between services.

ACOSS concluded that the major risks for community organisations in the new contracting culture are loss of autonomy and flexibility, and distortion of purpose - ... *the danger is that community organisations become little more than agents of government*¹⁷¹

While the potential disadvantages of contracting out human services have been identified, there have been no major studies to assess the impact of contracting out in this service area. Extensive research is required to assist in the determination of needs and trends, the definition and monitoring of progress towards best practice and the evaluation of outcomes and results from initial forays into contracting out.

VCOSS is particularly concerned at the lack of adequate consultation by the Department of Human Services with the community services sector and the consumers:

*largely not been regarded as experts in the field ... have been advised rather than consulted ... consultation with consumers is a worry - generally, it has not happened*¹⁷²

VCOSS's Executive Director indicated that it was important that a long term perspective be taken as to:

¹⁷⁰ Ibid., pp. 2-3

¹⁷¹ Ibid., p. 3

¹⁷² Ms P Morrison, Executive Director, Victorian Council of Social Service, Transcript of Evidence, p. 78

*whether the market paradigm fits these human services ... this encompasses the whole question of the role of government ... and the role of the community sector ... a strong message from my members and others in the sector that they want to develop an alternative paradigm ... so we are working on that trying to find solutions for the future that will involve stepping aside the market paradigm altogether*¹⁷³

The concern by the community services agencies is that their objectives are being skewed under the competitive model and that they are just becoming arms of government policy.¹⁷⁴

Mindful of the nature and extent of the provision of human services, the Committee believes that more attention could be given to the appropriateness of the competitive tender process.

This was reflected in the findings of the Inquiry into Competitive Tendering of Welfare Service Delivery conducted by the House of Representatives Standing Committee on Family and Community Affairs which recommended that before new welfare services are considered for contracting out, a contestability continuum for welfare services should be developed. That Committee also recommended that detailed research should be undertaken on the impact of contracting out of welfare services on service quality issues; on volunteerism; and on small rural and remote communities.

This Committee supports those suggestions and believes there would be merit in the Department of Human Services funding independent studies into the impacts of outsourcing and competitive tendering on the quality of services delivered.

The Committee recommends that:

Recommendation 8.1:

Further research should be undertaken by the Department of Human Services on the potential impact of the competitive tendering model on the delivery of services for which the department has responsibility.

Recommendation 8.2:

Consideration be given to the quality of the performance indicators or measures

¹⁷³ Ibid., p. 80

¹⁷⁴ Ibid., p. 81

on which contractor performance in the human services areas is evaluated.

8.3 Lessons from the Review of the Implementation of Compulsory Competitive Tendering by Councils

Witnesses have advised the Committee that there have been no major studies to date of the impact of competitive tendering and contracting, particularly with respect to the human services area of the public sector.

The Municipal Association of Victoria indicated that the University of New England was about to embark on a *fairly exhaustive analysis of compulsory competitive tendering* funded from a number of sources, including the New South Wales Government.¹⁷⁵

The Committee received a submission in respect of a Victorian research project which was being undertaken on the impact of compulsory competitive tendering (CCT) on consumers of aged care and disability services provided by councils. Ms Sharon Moore, its team leader, gave evidence to the Committee on the status of the project.

The study focused on people with care and support needs and family carers, rather than being purchaser or provider focused. The project team believed that consumer perspectives are critical in evaluating the impact of change in service delivery within the human services area. The project centred on the conduct of surveys and focus groups dealing with consumer satisfaction, quality of care and service, changes in service delivery, consumer involvement in the CCT process, grievance procedures and contract management, and coordination and service planning. A limitation on the outcomes of this work is the extent to which change can be assessed to have resulted from the outsourcing decision itself or from the amalgamation process of local government.

At the time of giving evidence to the Committee, Ms Moore advised that a number of issues had been identified:

- reduced attention appears now to be given to the less tangible, human care and concern aspects such as company, friendship, empathy and trust;

¹⁷⁵ Ms H Proctor, Acting Chief Executive Officer, Municipal Association of Victoria, Transcript of Evidence, p. 146

- changes have been experienced by consumers with respect to the availability of, and access to, services; and
- while many consumers were aware of their council's involvement in contracting aged and disability services, few had been given the opportunity to participate in any planning and decision making.

A concern expressed by Ms Moore to the Committee was that contractors were:

*finding it really hard to attract staff because the jobs have become fairly unattractive ... they are casual jobs ... front-line, intensive, hard-work jobs such as feeding people, showering people, toileting people*¹⁷⁶

Ms Moore informed the Committee that the project team found that a significant problem with the CCT process had been a lack of appropriate feedback mechanisms available to consumers. Prior to CCT, Ms Moore suggests, the process of dealing with complaints was *fairly simple and direct*. Now, with the advent of a purchaser/provider split, the establishment of business units within councils, and the involvement of external providers where council in-house bids were not won, the avenues for consumer access have been complicated and blurred. Ms Moore's concern with feedback mechanisms is borne out in the surveys where 67 per cent of consumers surveyed stated that they had not been given details of any grievance procedure.¹⁷⁷

At present, most consumers are learning about CCT developments from their care workers. Of the 12 councils interviewed by the RMIT CCT project team at the time of Ms Moore's evidence, none had customer service charters.

However, it is pleasing to note that Ms Moore's work indicated that the majority of local councils relied heavily on the use of surveys for service user feedback.

Subsequent to Ms Moore's discussion with the Committee, a copy of the final report for the project was obtained. The report showed that 23 Victorian local councils had participated in the research. This represents 30 per cent of local governments in the State.

¹⁷⁶ Ms S Moore, RMIT CCT Research Project Leader, Transcript of Evidence, p. 104

¹⁷⁷ RMIT University School of Management, *Contracting Care – The Impact of Competitive Tendering on Victorian Local Government Aged and Disability Service Users*, January 1999, p. 116

Conclusions arrived at by the project team included: ¹⁷⁸

- service users were not central to service planning and development and services continued to be provider driven;
- there was little evidence to suggest that contracting had improved service quality, quantity or flexibility;
- changes are required to improve service quality and delivery, for example, service users should be regarded as central stakeholders in the policy development process and the relationship between workers and users needs to be seen as critical to service delivery; and
- current feedback and policy development processes are inadequate and need to incorporate user feedback in a meaningful and useful way.

¹⁷⁸ Ibid., pp. 165-166

Overall, the team concluded that:

*competitive tendering has had little impact on aged and disability services from the service user perspective. Given that service users were largely unaware of specific changes to services, it was not surprising they considered the impact minimal... There is little evidence to support the assumptions that competitive tendering has actually improved service quality or provided better value for money.*¹⁷⁹

The Committee recommends that:

Recommendation 8.3:

Consideration be given by departments and agencies to the conduct of customer impact surveys to complement the annual outsourcing activity survey.

Recommendation 8.4:

Departments and agencies with responsibility for community and welfare service delivery should fund independent empirical studies into the impacts of outsourcing on service users and providers and other relevant stakeholders including rural communities.

8.4 Need to merge service providers

VCOSS raised the issue of the impact of competition on the structure of the community services sector. From evidence given at the inquiry, the Committee is aware that the impact has varied – it has given some larger agencies a chance to expand and threatened the viability of smaller ones.

¹⁷⁹ Ibid., p. 166

For example, Palliative Care Victoria has expressed the opinion:

the process for tendering ... is ... designed to integrate and decrease the number of providers ... with the prospect of 'one provider per region.' ... It has been clearly stated that even if the services were to demonstrate that the status quo could deliver the outcomes expected, this would not suffice. Therefore, it is seen by many providers that the main aim is to reduce the number of providers and that the process of tendering is the vehicle.¹⁸⁰

On the other hand combined organisations could offer potential strengths. This issue was illustrated by Anglicare Victoria:¹⁸¹

- greater influence in negotiations with government bureaucracies and the political system, and a sounder foundation from which to speak out strongly for the poor and disadvantaged;
- significant opportunity to develop skilled planning and research into the effectiveness of current services and the need for new ones;
- enhanced capacity for fundraising based on the higher profile afforded larger organisations;
- reductions in overheads which offers the possibility to economise on infrastructure, thus ensuring that maximum resources are made available for service delivery; and
- the establishment of a single human resource strategy will facilitate staff development and career paths and contribute to a more stable and committed workforce.

Anglicare Victoria represents a merger of three well established community organisations, the Mission of St James and St John, the Mission to Streets and Lanes, and St John's Homes for Boys and Girls. The Committee initially received a submission from the Mission of St James and St John which raised a number of concerns in relation to the outsourcing process, concluding that:

There is a need for closer partnership with the welfare sector, to work out funding arrangements which ensure the efficiency and accountability of government-funded programs, while avoiding rigid, costly and legalistic tendering process.¹⁸²

¹⁸⁰ Quoted in *Turning People into Commodities* – Report on the Public Hearings on Competitive Tendering in Human Services, March 1998, p. 6

¹⁸¹ Anglicare Australia, additional submission

¹⁸² The Mission of St James and St John, submission

A major concern of the community services sector is that there is an enormous amount of work required from program and management staff in preparing for, writing, submitting and attending interviews relating to the tendering process, all of which are unfunded, and require a diversion of staff from the agency's core function.

As outlined to the Committee by Berry Street Incorporated¹⁸³, smaller organisations do not have the human and financial resources to spend the time necessary to win tenders. On this matter, the Department of Human Services advised the Committee that it is not predisposed to funding the preparation of tender bids as such an approach would diminish the benefits to be derived from the competitive tendering process.¹⁸⁴

The Department's attitude towards the costs of tendering has impacted upon community service organisations such as Berry Street Inc., a child and family welfare organisation with 160 full-time staff, which has needed to dedicate one senior manager position to the tendering process.¹⁸⁵ Mr McDougall from Berry Street Inc. indicated that small single-service organisations would be disadvantaged and threatened while, as a merged organisation, Berry Street Inc. has gained a competitive edge through a reduction of administration costs and the capacity to cross-subsidise particular program areas. But, as indicated by Mr McDougall, these advantages have been derived at a cost in that

*the local focus that used to be present is not as attuned as it is in a small organisation*¹⁸⁶

Berry Street Inc. expanded on VCOSS's concerns regarding the impact of competitive tendering and contracting on the non-government sector, stating that:¹⁸⁷

- it is incredibly costly in staff time and administrative resourcing;
- because there are no measures of outcomes, judgements of successful tenders are made on superficial factors;
- competitive tendering destroys collaboration within the field;

¹⁸³ Berry Street Incorporated, additional submission

¹⁸⁴ Mr A Clayton, Acting Secretary, Department of Human Services, Transcript of Evidence, p. 59

¹⁸⁵ Ms P Morrison, Executive Director, Victorian Council of Social Service, Transcript of Evidence, p. 88

¹⁸⁶ Ibid., p. 89

¹⁸⁷ Berry Street Incorporated, additional submission

- the purchasers do not have the skills to develop adequate briefs so specifications are poor;
- timelines are often extended creating significant issues for providers particularly when there is a transition of existing services to a new provider; and
- there is the potential to further downgrade staff skills if tenders are going to be awarded on the basis of price resulting in a decreased capacity to meet service standards.

Mr McDougall particularly referred to the change in the relationship between government and non-government organisations since the introduction of CCT. His view was that non-government organisations were no longer working closely together because of the need to compete. The non-government organisations were concerned that to collaborate may be perceived as possibly collusive and, hence, an anti-competitive practice.¹⁸⁸

The likelihood of amalgamations/mergers within the community services sector was made apparent to the Committee by VCOSS which indicated that the majority of service provider agencies have fewer than five employees, with most of these people being involved in the direct provision of services. The introduction of competitive tendering and contracting impacts directly on the capacity of these smaller organisations to operate since they do not have the necessary funds for research, evaluation, monitoring, and other matters such as change management. The result is that some not-for-profit organisations do not tender because of the time and money involved in the process and some have ceased to operate or are likely to do so.

While recognising that competitive tendering and contracting may effectively lead to a rationalisation of the community services sector because of the influence of competition, the Committee is concerned that, despite the significant benefits that may accrue to amalgamated/merged organisations, there is potential for reductions in service quality where the competition results in a lessened collaboration within that sector.

The Committee recommends that:

Recommendation 8.5:

The Department of Human Services provide training and research for the community services sector to assist those

¹⁸⁸ Mr J McDougall, Senior Manager, Northern Accommodation and Support Services, Berry Street Incorporated, Transcript of Evidence, p. 91

service providers to achieve required standards of service delivery.

Recommendation 8.6:

For significant tenders, the Department of Human Services should make allowances for non-recurring costs incurred in the preparation of tenders by non-government organisations, to ensure that as wide a range of service providers is involved in the tender process as is possible.

8.5 Introduction of customer service charters

Whichever way consumer needs are determined, the Committee has found general acceptance that not only should all matters of importance to the consumers be documented in the contract specifications but also that the consumers should be made aware what those contractual arrangements mean. One way of providing this awareness is through service charters which are an integral part of the government's reform program in the United Kingdom. The Committee has noted from witnesses some reservations as to the application of service charters in the Australian context, mainly on the basis that such documents, to be effective, need the commitment of service purchasers and providers under a competitive tendering and contracting regime.

The usefulness of customer service charters was questioned by Ms Moore, RMIT CCT Project Team Leader, who advised the Committee that such charters may be less relevant for many of the human services areas. In her view, the customer service charter only flags the desirable outcomes and does not ensure that there is commitment in the workplace. Much of the work by non-government organisations revolves around the quality-care ethic of workers who must receive full support from their management. The maturity, capability, flexibility and responsiveness of workers to consumer needs should be measured by less technically-focused and more qualitative benchmarks.¹⁸⁹

The Commonwealth Government has introduced service charters for all departments, agencies (including statutory authorities) and Government Business Enterprises (GBEs) which impact on the public. Customer service charters are required where services are directly provided by departments, GBEs and agencies or where services are provided by indirect means such as contracting out.

¹⁸⁹ Ms S Moore, Project Leader, RMIT CCT Research, Transcript of Evidence, p. 101

These Commonwealth charters require agencies to set standards of service or key undertakings seen as important to consumers. A framework has been developed to assist public sector organisations prepare, monitor and review service charters and is outlined in the Department of Industry, Science and Tourism publication *Putting Service First - Principles for Developing a Service Charter*. The guide provides the purpose and key features of a number of principles to be embodied in customer service charters within the Commonwealth:¹⁹⁰

- content of the charter - identification of the organisation and its customer; communication; customer service standards and customer rights and responsibilities; customer feedback and complaints;
- development and support of the charter - consultation in charter development; format, style and promotion; complaints handling process; and
- monitoring, reviewing and accountability arrangements.

The Committee considers that the key to whether customer service charters will be effective, revolves around the review and accountability mechanisms, which ensure that there is an appropriate level of commitment by the service provider and purchasing agency. In addition to internal review and monitoring, the Commonwealth guide requires that the purchasing agency:

- commit to an independent external review of the charter once every three years inviting comments from customers, stakeholders and staff; and
- publish annually information based on monitoring and review outcomes and include details of the agency's performance against the standards established in the charter; the number of customer complaints and the nature of their resolution; and the level of awareness of the charter.¹⁹¹

Furthermore, the Committee sees the development of customer service charters as an important element within the outsourcing process. In its May 1999 *Report on Annual Reporting in the Victorian Public Sector*,¹⁹² the Committee noted that the Victorian Auditor-General had earlier reported on the need to extend the use of

¹⁹⁰ Department of Industry, Science and Tourism (Commonwealth), *Putting Services First - Principles for Developing a Service Charter*, March 1997

¹⁹¹ Ibid.

¹⁹² Public Accounts and Estimates Committee *Report on Annual Reporting in the Victorian Public Sector* (Report No. 28), May 1999, p. 81

customer service charters within the Victorian public sector to agencies other than in the water industry.

Aware of the benefits that would accrue from the introduction of customer service charters, the Committee in its April 1997 report, recommended that each department and agency:

- develop and publish a customer service charter which specifies the standards of service that a customer can reasonably expect; and
- include a statement in its annual report on the level of service achieved against the benchmarks set out in its customer service charter.¹⁹³

In this report, the Committee acknowledged the supportive views of the Consumer Law Centre Victoria Inc. which distinguished charters from service or consumer guarantees which are very similar but relate to a number of services rather than the full range of services provided by an agency.¹⁹⁴

In its response to the Committee's report in October 1997, the Department of Treasury and Finance indicated its concern that:

*Experience has suggested overseas that mandated customer service charters often generate compliance type responses and therefore do not achieve their main objective.*¹⁹⁵

Furthermore, the Department indicated that it was difficult to design single purpose charters for departments that had a range of customer interests.

It is likely that, in practice, purchasing departments and agencies and service providers may pay 'lip service' to the undertakings within the customer service charters. However, the Committee is of the view that such documents are essential to provide assurance to consumers that service quality under competitive tendering and contracting is maintained, if not improved.

¹⁹³ Public Accounts and Estimates Committee, *Report on the 1996-97 Budget Estimates and 1995-96 Budget Outcomes*, April 1997, pp. 10-12

¹⁹⁴ *Ibid.*, p. 11

¹⁹⁵ Response by the Minister for Finance on the Committee's April 1997 *Report on the 1996-97 Budget Estimates and 1995-96 Budget Outcomes*, Recommendations 2.3 and 2.4

The Committee recommends that:

Recommendation 8.7:

The Committee's previous recommendations on the introduction of customer service charters into Victoria be reconsidered and, at a minimum, departments and agencies be required to include details of service standards, rights and obligations and other matters, in their annual reports with a statement as to whether such commitments have been met.

CHAPTER 9: IMPLICATIONS FOR THE PARLIAMENT

9.1 Accountability

Submissions to the Committee and other literature reveal a considerable variation of opinion on the issue of accountability and contracting out of services. In particular, there appears to be a fundamental disagreement about whether contracting out lessens the accountability of government for the provision of public services. Supporters of contracting out claim that accountability can be maintained, and even enhanced, while critics argue that accountability is seriously compromised.

There is no doubt that the introduction of outsourcing has both extended and blurred the accountability chain. Some key questions need to be answered including whether or not Ministers should be responsible for the integrity of the outsourcing process even though the Minister cannot exercise direct control over contractor operations.

The then Premier of Victoria provided a submission to the ARC in respect of the Council's Issues Paper *Contracting Out of Government Services*. The thrust of the government's position is summarised in the opening comment of that submission:

*The use of contracting out does not imply in our view a diminished accountability for ensuring delivery of services on the part of government as the purchaser of those services.*¹⁹⁶

The submission indicates that appropriate levels of accountability can be maintained by setting out in the contract between the department or other agency and the service provider the following matters:

- the precise scope of the services which must be delivered;
- the quality of the services required;
- the means of achieving the delivery and quality; and
- the criteria upon which the contractor's performance shall be evaluated.¹⁹⁷

such that:

¹⁹⁶ Hon J Kennett, Premier of Victoria, June 1997, Submission to the Administrative Review Council on the Council's Issue Paper, *Contracting Out of Government Services*, p. 1

¹⁹⁷ Ibid.

*an effective contract management and monitoring regime open to public scrutiny ensures that government retains accountability.*¹⁹⁸

The matter of accountability was seen by Ms Sussex, then Head of Cabinet, Department of Premier and Cabinet, as being an important issue to be addressed. In her view:

where a service is outsourced, the Government at the end of the day remains accountable for that service...

and furthermore:

*where a service is privatised, it (the Government) remains politically accountable for ensuring that services are provided, in a broad sense*¹⁹⁹

Ms Sussex indicated to the Committee that accountability depended on the adequacy of the systems in place to record information regarding the tendering process and the contractual arrangements entered into, and to provide a basis for the monitoring of contractor performance. This was seen as essential since, while private sector contracting was to some extent considered an organisation's own business, there are clearly many mechanisms that impact on the manner in which the public sector goes about outsourcing. When services are contracted out, such arrangements may be the subject of public scrutiny under the Freedom of Information Act, by the Auditor-General and Parliamentary Committees, and through the political process generally.

¹⁹⁸ Ibid., also introductory comments

¹⁹⁹ Ms M Sussex, then Head of Cabinet Office, Department of Premier and Cabinet, Background Briefing, Transcript of Evidence, p. 45

The Committee considers that right of access to information should not be lost or diminished because of changing mechanisms of government service delivery or because a document relating to the provision of services under a government contract is in the possession of a contractor and not a government agency.

These issues are considered in greater detail in the Committee's Report on Commercial Confidentiality and the Public Interest.

9.2 Current external reporting requirements

The external reporting obligations of departments and agencies are embodied in the *Financial Management Act 1994* which requires an annual report, comprising a report on operations and audited financial statements, to be tabled by the responsible Minister within four months of the end of the relevant financial year.

At present, there is no requirement in the Act for departments and agencies to provide for contractual details in their annual reports other than disclosing:

- capital commitments and contingent liabilities within the audited financial statements; and
- the total of amounts paid to consultants during the year and amounts in excess of \$100 000 paid to individual consultants together with the nature of the consultancy and the total approved value of the consultancy.

Within the Victorian environment, local councils are also required under the *Local Government Act 1989* to include an audited statement of compliance with compulsory competitive tendering (CCT) requirements and have records and registers relating to contracts available for inspection by ratepayers. This disclosure is in addition to the annual report on CCT tabled in the Parliament by the Minister for Planning and Local Government.

There is evidence that departments and agencies have substantial information on outsourcing available to them on databases or in other forms. The Department of Human Services indicated to the Committee that it funds approximately 4,000 organisations annually, in some cases for a number of separate services being provided on an integrated basis, but no details of these arrangements are included in the department's annual report despite reporting on service provision internally.²⁰⁰

²⁰⁰ Mr A Clayton, Acting Secretary, Department of Human Services, Transcript of Evidence, p. 63

This lack of information was pointed out to the Committee by the Australian Education Union which indicated that:

*It was almost impossible to find out what has been outsourced, how effective that outsourcing has been and who has actually received the contracts for outsourcing. The only ways are through questions in the Parliament, keeping an eye on the tender notices in the newspapers and ... the Internet. Otherwise, there is no regular open public access.*²⁰¹

The Committee considers that the present external reporting requirements on outsourcing by departments and agencies could be improved. It is important that the performance measures/targets embodied in the contractual arrangements properly reflect requirements of the purchasing agency and the consumers and that these indicators also be reported on.

The Committee recommends that:

Recommendation 9.1:

The annual reporting requirements under the *Financial Management Act 1994* be amended to mandate departments and agencies to disclose the nature and extent of outsourcing undertaken during the current financial year and the impact of outsourcing on the manner in which those departments and agencies have sought to achieve their operational objectives.

²⁰¹ Mr C Smith, Research Officer, Australian Education Union, Victorian Branch, Transcript of Evidence, p. 69

9.3 Roles

9.3.1 The role of the Ombudsman

The Victorian Office of the Ombudsman has a staff of around 23 and a budget of approximately \$2.1 million. Each year the Office receives around 5,000 written complaints and between 16,000 and 18,000 telephone inquiries. A large number of the telephone inquiries come from people seeking advice.

The Victorian Ombudsman advised the Committee that he held concerns with the contracting out of services in relation to the integrity of the tender process itself and the accountability for the services being contracted out.²⁰²

In relation to dealing with complaints in the local government area, the Ombudsman distinguished two sets of circumstances in which he would have an involvement:²⁰³

- where a complaint was made to the Ombudsman directly about the conduct of the contractor and how the contractor was performing under the terms and conditions of the contract, the Ombudsman would suggest that the complainants immediately contact the council, and that if they are unhappy with that response they come immediately back to the Ombudsman; or
- on the other hand, if the problem was with the tender document itself, the Ombudsman would approach the council directly on the basis that he, rather than the complainant, has the capacity to have the difficulty remedied.

The role of Ombudsmen has become increasingly important in dealings with consumers both in the private and public sectors. Mr Nelthorpe, Executive Director, Consumer Law Centre Vic. Ltd, indicated to the Committee that, in respect of the public sector contracting out the delivery of services, he saw:

*accountability of the system and redress for individuals for the services they receive as paramount*²⁰⁴

However, while enforcement of public accountability may be seen to lie with the State Ombudsman, Mr Nelthorpe was of the view that the State Ombudsman was:

²⁰² Dr B Perry, Victorian Ombudsman, Transcript of Evidence, pp. 48-50

²⁰³ Ibid., pp. 52-53

²⁰⁴ Mr D Nelthorpe, Executive Director, Consumer Law Centre Vic Ltd, Transcript of Evidence, p. 83

*never the appropriate office to be used as a mechanism for complaints about local government*²⁰⁵

The Committee understands from Mr Nelthorpe that one or two councils have established local government ombudsmen and he suggested that this practice would result in more complaints being received.

As indicated earlier, the Victorian Ombudsman legislation has been extended to deal with the contracting out of services within the Corrections and Health sectors.

The continued need for an Ombudsman has been recognised by many witnesses but there was agreement that resorting to the Ombudsman should only be a *fall back* position.²⁰⁶

9.3.2 The role of the Auditor-General

As with the Ombudsman, the Auditor-General has the capacity through special reviews or performance audits to provide assurance to the public and the Parliament as to whether outsourcing decisions have been soundly based and do not disadvantage the consumer. Any significant concerns raised by the Auditor-General as to the contracting out process would be made apparent in his reports to the Parliament.

The Committee is aware that the Auditor-General has undertaken a State-wide performance audit on various aspects of outsourcing which will provide a comprehensive, independent assessment of the outcomes of competitive tendering and contracting.

The Committee will maintain a keen interest in the conclusions reached during the audit process and the implications that any findings and recommendations might have on the future direction of outsourcing within the State of Victoria.

²⁰⁵ Ibid., p. 84

²⁰⁶ For example, by Professor M Neave, former President of the Administrative Review Council, Transcript of Evidence, p. 116

CHAPTER 10 CONCLUSIONS REACHED BY THE COMMITTEE

10.1 Approach

Based on submissions and evidence given by departments, the Committee formed the view that all departments were actively pursuing strategies for the increased outsourcing of their activities. The Committee believes that the results of outsourcing are mixed. It further believes that the provision of central guidelines was a significant step in encouraging departments to take a more strategic approach to outsourcing. However, the Committee believes there is scope for revision of the guidelines to ensure consistency in approach and that they are relevant. The Committee makes the following recommendations to enhance outsourcing practice.

The Committee recommends that:

Recommendation 10.1:

Departments and agencies should ensure that service agreements contain explicit statements covering:

- **the purpose of the agreement;**
- **the specific parties to the agreement;**
- **the specific duration of the agreement;**
- **the price to be paid for the specific outputs and outcomes and the circumstances in which prices may be varied. Where the price to be paid does not cover the full cost of service provision, the contracting department or agency should clearly specify this, stating that the service provider is expected to make a contribution to the cost of providing the service. The full amount of this contribution should be specified in the service agreement;**

- **the times, amounts and methods by which performance will be assessed. Where outcomes are difficult to measure, these should be in terms of policy objectives;**
- **the penalties and rewards for performing below or above agreed standards. Consideration should be given to the increased use of rewards/incentives where service providers exceed the agreed performance standards; and**
- **a requirement for compliance with relevant State laws.**

Recommendation 10.2:

A clear statement of the contractor's responsibilities and those of the contracting agency be set out in the service agreement. This statement should cover:

- **accountability of the service provider to the contracting agency for the services that they are providing. The government must be able to ensure that the contract is being fulfilled in a timely and appropriate manner;**
- **accountability of the service provider to the consumer of the service. Where community welfare services are contracted out to non-government organisations, the consumer is the third party. As consumers of the service are not a party to the agreement, they may not necessarily have directly enforceable rights against the service provider, such as the provision of information access rights, privacy protection and complaints mechanisms;**
- **accountability of the contracting agency to the service provider. Questions of accountability in contracting out often focus solely on**

the responsibilities of the service provider. However, it is also important that contracting agencies acknowledge their responsibilities to service providers by ensuring that the tender process is transparent and encompasses adequate mechanisms for unsuccessful tenderers to seek review, as well as adequate mechanisms for successful tenderers to seek redress for problems faced in performance of the contract.

Recommendation 10.3:

The Department of Treasury and Finance extend the outsourcing activity survey process to include details of methodology for contracting out adopted by departments and agencies and how the integrity of these procedures was confirmed as being satisfactory, whether by internal quality assurance or external independent examination.

Recommendation 10.4:

Departments and agencies develop a comprehensive quality assurance program that incorporates:

- **a quality accreditation program to ensure that prospective contractors are capable of achieving the standards expected under the contract;**
- **a performance monitoring regime to ensure that the contractor is providing the service specified in the contract. Monitoring should be on-going which will facilitate identifying any difficulties or problems in a timely manner so that corrective action can be taken;**
- **appropriate performance measure to enhance accountability and enable the performance of government services to be opened to greater public scrutiny; and**
- **an evaluation process to determine outcomes achieved under the contract.**

10.2 Cost savings

Furthermore, the inability of departments and agencies to provide details of the make-up of cost savings is seen by the Committee to be a significant shortcoming in the implementation of competitive tendering and contracting. The Committee is concerned that no information on cost savings is provided in departments or agencies annual reports. This information should be provided.

10.3 Evaluation of benefits

Various witnesses ²⁰⁷ indicated that it was important for organisations to evaluate whether they received the benefits they wanted. ²⁰⁸ The Committee believes that this evaluation should not take place merely at the expiration of a contract, but should be ongoing during the contract period. This requires rigorous analysis as to whether performance indicator targets have been met and, if not, what action has been taken to bring the service quality to an acceptable level.

10.4 Looking to the future

After considering departmental submissions to the Inquiry and meeting with representatives from the Department of Infrastructure and the Department of Human Services, it is clear to the Committee that individual departments are seeking to address some of the problem areas, such as the need to enhance contract management skills and refine performance measurement.

The Committee is pleased to note that departments and agencies are making efforts to improve their capacities to cope with further outsourcing of services. Departmental initiatives such as the establishment of groups similar to the Department of Treasury and Finance's former Outsourcing and Contract Management Unit, the issue of additional guidance and conduct of specific training courses, should provide a firm basis for departments to manage existing contracts and to favourably negotiate future contracts for increasingly more complex and sensitive service areas.

In light of the issues that were raised in connection with the human services area, the Committee intends in the next session of Parliament to report on service agreements and service charters relating to the community welfare sector.

²⁰⁷ For example, Ms Cullen, Background Briefing, Transcript of Evidence, p. 51

²⁰⁸ Ibid.

APPENDIX 1

Surveys on Outsourcing

1.1 Background

The first significant Australian study on outsourcing was undertaken by the CTC Research Team from the Graduate School of Business, University of Sydney.²⁰⁹ This survey was designed to gather information on the nature and extent of competitive tendering and contracting in the Commonwealth Government for the 1994-95 financial year, similar to surveys completed in Victoria, New South Wales and Western Australia.

These surveys centre around key aspects of the outsourcing process, including the level of contracts entered into by departments and agencies, the nature of services being contracted out, who the selected contractor was, the manner of contractor selection, the rationale for contracting out, assessment of the outcomes from outsourcing and, importantly, the level of financial savings achieved and contract management costs incurred by those departments and agencies.

Only contracts for services over a specified amount were required to be reported on in these surveys and there are certain exclusions from the survey, such as capital works and construction projects.

The Commonwealth survey was sent to 126 budget-funded agencies but not all agencies could provide information on the full extent of their contracting activity and, in total, 43 agency returns were included in the survey results. For those 43 agencies, there were 51,842 contracts with a value of \$1.8 billion. The Department of Veterans Affairs was the significant contributor to outsourcing in the Commonwealth with 44,295 contracts at a value of \$824 million, the greater portion of which related to health care provision.

A key finding from the 1994-95 Commonwealth survey was that there were average gross savings of 18.1 per cent achieved on non-Defence contracts and 35.7 per cent on contracts under the Defence Commercial Support Program. Average management costs were assessed as comprising 2.32 per cent of the contract value,

²⁰⁹ *Competitive Tendering and Contracting in Commonwealth Government Agencies: The 1995 Survey Findings* by Simon Domberger, Christine Hall and Matthew Jeffries, September 1995

indicating a high overall level of net savings derived from outsourcing. However, as has been the case with surveys for the States, the calculation of average gross savings and management costs needs to be qualified to the extent that the figures are based on a low level of survey response on these aspects.

Much of the information derived from the Commonwealth and State surveys relating to the nature of services outsourced, financial savings achieved and contract management costs incurred were reported on in the January 1996 Productivity Commission Report No. 48 *Competitive Tendering and Contracting by Public Sector Agencies*.

1.2 Results of surveys in other jurisdictions

As well as the Victorian survey, CTC Consultants have also conducted surveys in New South Wales and Western Australia for the 1995-96 financial year.²¹⁰ Governments in both states have been studying the extent of contracting out in departments and agencies since 1993, through annual surveys which permit a more informed assessment of the results of competitive tendering and contracting within Australia.

CTC Consultants are economic and management advisers who seek to analyse the latest research on market based approaches. Professor Simon Domberger, who founded the organisation from the Graduate School of Business, the University of Sydney, is a known authority on outsourcing, contracting and competitive processes.

Given the importance of these surveys to an understanding of the progress that has been made with outsourcing in the Victorian context, the Committee felt that it was appropriate to provide a comparison between these two States for the 1995-96 financial year against which the results of the Victorian survey for that year could be assessed.

Exhibit 1 details the scope and key findings of the 1995-96 surveys conducted for New South Wales and Western Australia.

Comparison of 1995-96 CTC Survey Results for New South Wales and Western Australia		
Survey	New South Wales (NSW)	Western Australia (WA)

²¹⁰ *Contracting for Services in the NSW Public Sector - 1996 Survey Findings*, TRP 97-2, New South Wales, Research and Information Paper, February 1997 and *Contracting for Services in the WA Public Sector 1995-96*, A Report to Public Sector Management Office, Western Australia, CTC Consultants, May 1997

Report on Outsourcing in the Victorian Public Sector

Coverage	61 budget sector agencies	99 budget sector agencies
Minimum value of contracts examined	\$50 000	\$20 000
Exclusions	Capital works, consultancies and employment contracts	Purchase of goods, capital works and employment contracts
Reported expenditure - current year	\$1.762 billion (increase due, in part, to the inclusion of health and legal aid contracts)	\$1.099 billion (34per cent of WA public sector total expenditure - proportion varies between agencies - includes grants to non-government agencies)
- prior year	\$966 million	\$691 million
Total contracts - current year	28 479	11 266
- prior year	13 852	11 617 (the practice of consolidation of smaller contracts into larger parcels was reported by agencies)
Proportion of service contracted out	No overall per centage given but proportions provided by agencies ranging from a low of 4per cent to a high of 100per cent for a number of agencies.	34per cent (contract expenditure of \$531 million compared with \$2.079 billion service expenditure)

Survey	New South Wales (NSW)	Western Australia (WA)
Main contributors	TAFE Commission, Department of Health, Legal Aid Commission of NSW	Health Department of WA, Main Roads WA, Contract and Management Services
First time contracts	\$31 million (219 contracts) (relate mainly to health & welfare, security and correctional, information technology)	\$103 million (963 contracts) (includes Main Roads WA \$27.4 million (224 contracts) - decline in contracts relating to telecommunications services)
Degree of concentration	10 agencies accounted for >90per cent of the total contracting expenditure	20 agencies accounted for >90per cent of the total contracting expenditure
Contracts for next year	\$125 million (341 contracts)	\$257 million (963 contracts) (includes Westrail \$74.1 million [20 contracts], Main Roads \$61.7 million [270 contracts])
Five main contracted services	Health and welfare, transport, property, training and education, information technology	Property services, equipment maintenance and works related services, transport, and research, scientific and technical services, information technology (in total - 59 per cent)
Average savings achieved	19.6per cent (based on a restricted sample)	22.5per cent (based on a restricted sample - 127 contracts with contracted cost of \$23.2 million)
Average cost of managing contracts	2.7per cent	6.3per cent (relates to 898 contracts)
Primary reasons for contracting	Efficiency and effectiveness (respondents felt that objectives had been achieved)	Efficiency and effectiveness (respondents felt that objectives had been achieved)
Instances of premature termination of contracts	Not encountered frequently, representing only 0.32per cent of contracting expenditure	Not referred to
Duration of contracts	63per cent of contracts had a duration > 1 year and <5 years	Only 2.5per cent of contracts had a duration of >5 years
Basis of pricing	Half of the contracts were based on schedule of rates	Not referred to

	pricing, with remainder equally between total/annual tendered prices	
Existing employees	Almost half of in-house staff retained, with remainder either redeployed to other agencies, transferred to the contractor, or accepted voluntary redundancy	Almost 15 per cent of in-house staff retained, with remainder either redeployed to other agencies, transferred to the contractor, or accepted voluntary redundancy
<p>Source: <i>Contracting for Services in the NSW Public Sector - 1996 Survey Findings</i>, TRP91-2, New South Wales Research and Information Paper, February 1997 and <i>Contracting for Services in the WA Public Sector 1995-96</i>, A Report to the Public Sector Management Office, Western Australia, CTC Consultants, May 1997.</p>		

It is important to note that the surveys also collected information on levels of current in-house expenditure and staffing which resulted in companion reports being provided to the respective State Governments prior to the release of the findings relating to competitive tendering and contracting. This initiative resulted from the survey questionnaire for 1995-96 being substantially redesigned to capture more detailed information on contracts, and to provide agencies with greater assistance during the data collection process.

There has been some discussion on the quantum of annual gross savings. Savings were based on the annual cost of providing services prior to contracting of \$17.4 million (NSW) and \$30 million (WA) respectively, around 1 per cent of total contracted expenditure. The small sample on which the savings were computed was due to the relatively low response rate to questions relating to the cost of providing a service, numbers of staff involved, and expenditure on in-house resources, prior to contracting.

While CTC Consultants have acknowledged, in their various reports, concern about the integrity of the savings figures, restricted sample sizes have meant that it was impossible to provide reliable estimates of the average savings by service. However, CTC Consultants were of the firm view that the level of financial savings were consistent with those reported in earlier surveys and similar studies on contracting.

In the May 1997 WA report, CTC Consultants sought to make a comparison between the two States but found that, because of the differing scope and parameters for each of the surveys, any comparison made would be *illustrative only and would highlight areas where more detailed analysis and investigation may be required.*²¹¹

CTC Consultants did look to similarities between New South Wales and Western Australia in relation to the general results obtained from the surveys, the contracting expenditure proportions by service, the level of proposed new contracts, the outcomes of qualitative measures as to efficiency and effectiveness of the contracting out process, and distribution of in-house staffing, but, in so doing indicated that there were differences in the data for both States which would impair comparison:

- unlike WA, the NSW results excluded corporatised agencies and government trading enterprises; and
- the NSW survey was restricted to contracts with a minimum value of \$50 000 over the duration of the contract.²¹²

The matching of the respective State surveys is summarised in Exhibit 1 and indicates some consistency in the results such as the proportion of contracting expenditure by service and the degree of importance attached to efficiency and effectiveness as reasons for contracting out.

An important recommendation of CTC Consultants concerning the WA survey was that:

*Given that twenty agencies account for approximately 90 per cent of the total contracting expenditure, there would be value in undertaking a more detailed quantitative and qualitative analysis of how contracting is being implemented in these agencies ... Such analysis may provide useful information on how contracting is being practised.*²¹³

²¹¹ *Contracting for Services in the WA Public Sector 1995-96, A Report to Public Sector Management Office, Western Australia, CTC Consultants, May 1997, p. 31*

²¹² *Ibid.*, p. 31

²¹³ *Ibid.*, p. 33

The Committee fully concurs with this assessment and notes the extensive work that is currently being undertaken in New South Wales in relation to the cost of government services in that State. The Council on the Cost of Government has issued a number of reports which have examined the overall trend in expenditures within the NSW public sector with particular attention being focused on the benchmarking of corporate service activities to identify cost cutting opportunities.

The Council acknowledged that, in many areas of the NSW public sector, there were little or no cost comparisons being made to assess the relative efficiency and effectiveness of departmental/agency operations.

The Committee considers that there would be a significant benefit in conducting a similar analysis in Victoria at departmental/agency levels of expenditure in addition to the completion of an annual survey on outsourcing, as this would clearly demonstrate the impact that competitive tendering and contracting would have on operating costs and ensure that the cost savings achieved are utilised to the benefit of the community.

1.3 Results of surveys conducted in Victoria

1.3.1 Department of Premier and Cabinet

The first survey of outsourcing for Victoria was conducted by the then Office of Public Sector Management and Coordinator General within the Department of Premier and Cabinet for the 1993-94 financial year. This survey indicated that there was a total of 289 contracts in place with a total value of \$336 million. Of these contracts, 122 (\$171.5 million) related to the period up to and including 30 June 1992 and 167 (\$164.5 million) to the period between 1 July 1992 and 30 June 1994.

The survey revealed that the major service types contracted out included works related services (21.9 per cent), cleaning (20.6 per cent), building maintenance (15.7 per cent), and transportation services (11.2 per cent). In order, the next three were information technology, technical services and training (a combined 13.9 per cent). The level of outsourcing included in the survey encompassed 3.5 per cent of recurrent expenditure, excluding human services, and reflected annual financial savings of 25 per cent.

The Head of the Cabinet Office offered the following observations on this first survey for Victoria:²¹⁴

- departments reported an improvement in the quality of services in 35 per cent of cases, the quality was comparable in 60 per cent of cases, and it had reduced in only 5 per cent of cases;
- contracting out processes were generally sound and consistent with the guidelines issued by that Department;
- however, there was a need to improve the costing of in-house services, pre-tendering processes and practices, and make greater use of post-implementation reviews and qualitative rather than quantitative performance indicators; and
- very importantly, more rigorous business case assessments were required.

The Committee has noted that these concerns have been addressed in the development of the Outsourcing and Contracting Out Guidelines issued by the Department of Treasury and Finance in December 1995 and will be further strengthened by the recent release of the Management Reform Framework which puts developments in competitive tendering and contracting into context.

1.3.2 Department of Treasury and Finance

Subsequent to the Victorian Outsourcing Activity Survey conducted in 1995-96 by CTC Consultants on behalf of the Department, a follow up survey was undertaken in respect of the 1996-97 financial year with a view to monitoring contracting trends within the Victorian Budget Sector.

Intended to provide an indication of the scale and scope of outsourcing by departments and agencies, the Victorian survey was restricted to contracts valued at \$50 000 or more over the life of the contract term. The survey excludes contracts for capital works and construction; licence arrangements; lease and rental arrangements; employment contracts processed through the payroll system; and grants to external parties. Information was requested on contracts that operated in the 1996-97 financial year and information on new contracting initiatives proposed for the 1997-98 and 1998-99 financial years as well as an assessment of the level of total service expenditure contracted out.

²¹⁴ Ms M Sussex, Head of Cabinet Office, Department of Premier and Cabinet, Background Briefing, Transcript of Evidence, pp. 41-42

To ensure any meaningful comparisons with the survey results reported in 1995-96, the Committee noted two key factors which need to be considered when interpreting the survey results. These factors are:

- the Public Transport Corporation was included in the 1995-96 survey but not the 1996-97 survey. To enable comparison, the results of the 1995-96 survey, as reported in the 1996-97 survey report, were excluded from the Department of Infrastructure's figures; and
- contracting by the Department of Human Services was not included in the 1995-96 report. However, the 1996-97 survey included the department's contracting activities for the 1996-97 financial year.

All eight departments and their respective agencies responded to the survey. The results were detailed in a final survey report released by the Department of Treasury and Finance in November 1998. The main findings of the 1996-97 Victorian survey report included:

- the total value of contracts in operation in 1996-97 increased by approximately 29 per cent to \$1,480 million, from the 1995-96 comparable result of \$1.149 million;
- the total annual expenditure on contracting was \$841 million in 1996-97, an increase of approximately 29 per cent on the reported results for 1995-96;
- departments reported a total of 8 305 contracts in 1996-97, which is 9 per cent lower than the number reported for 1995-96;
- the proportion of contracts awarded through open tender rose from 31 per cent in 1996-97. More than half the contracting expenditure in 1996-97 was a result of the open tender system; and
- private sector contractors were engaged in 88 per cent of contracts, and accounted for 93 per cent of contracting expenditure. In-house teams were the successful tenderer in 6 per cent of contracts.

Most of the contracts were for periods up to five years, and only five per cent of contracts had terms in excess of five years. On average health and medical services had the longest term contracts – 3.7 years, while transport contracts had decreased from an average of 4.7 years in 1995-96 to 2.9 years in 1996-97. Contracts awarded in 1996-97 had an average term of 13 months, which is almost half the average duration of contracts awarded in 1995-96.

The range of contract values covered in the survey varied, around 41 per cent of the contracts each had an annual expenditure up to \$100 000, 70 per cent were under \$250 000 and only one per cent of contracts had an annual expenditure figures exceeding \$1 million.

In their response to the survey, departments rated a number of reasons for contracting in terms of importance and results:

- access to skills and expertise;
- improved quality;
- management demand fluctuations;
- access to technology;
- lower cost; and
- better accountability.

Access to skills/expertise and improved quality remain the two major reasons for contracting out and both are expected to continue to be the main sources of satisfaction in the future. In addition, all departments rated cooperation, trust, flexibility and information exchange as the main attributes of a contractual relationship irrespective of who was the service provider – external contractor, other government agency or in-house team.

Excluding service agreements of the Department of Human Services valued at \$3.57 billion, the Department of Infrastructure accounted for more than half of the contract value and service expenditure (\$391 million, mainly for transport services) followed by the Department of Justice (\$168 million, mainly for private prisons), Education (\$108 million, approximately half for school cleaning), Treasury and Finance (\$66 million, mainly for expert advice on energy reform) and Natural Resources and the Environment (\$51 million). The outsourcing survey found that the remaining departments of State Development and Premier and Cabinet contributed to less than 7 per cent of the contract activity.

Of the 17 service categories identified in the 1996-97 survey, 13 had annual outsourcing expenditure in excess of \$10 million (7 for 1995-96) which accounted for 98 per cent of the total expenditure incurred by departments for 1996-97. The major service categories were – transport services \$299 million; information technology \$89 million; infrastructure maintenance \$82 million; building and property services \$78 million; legal services \$66 million; and community and welfare services \$56 million.

The survey disclosed that there were 4 687 first term contracts in 1996-97 – twice the number in 1995-96. These contracts accounted for \$476 million in contracting expenditure. The services with the largest reported expenditure on first-term contracts were transport

services (21 per cent), infrastructure maintenance (16 per cent) and information technology (14 per cent).

Four services (legal services, building and property services, transport services and training and education in that order) accounted for around 83 per cent of the total number of contracts, with bus passenger services (Department of Infrastructure) being the most significant activity. Information Technology accounted for 11 per cent of the departments' contracting expenditure, almost half of this expenditure was for 10 contracts to provide integrated IT services to all departments. Infrastructure maintenance accounted for 10 per cent of total contract expenditure, mainly related to road maintenance.

Average contract expenditure by service disclosed that community and welfare services and infrastructure and maintenance had significantly higher average expenditures than all other services (\$2.06 million and \$1.02 million respectively). The next highest was Information Technology at \$261 700, while the average contract expenditure for the remaining 15 services was only \$133 000.

The survey report indicated that 80 per cent of contract expenditure and 69 per cent of the number of contracts were classified by departments as core services. For the departments with significant contracts, the extent of such contracting out varied markedly – Justice (97 per cent), Education (34 per cent) and Human Services (26 per cent).

The survey indicated that there would be an increase in expenditure of \$148 million over the period 1997-98 and 1998-99. The largest increase is expected to occur in the Department of Justice with \$68 million for information technology and new contracts for prisons. In addition, the Department of Treasury and Finance is expected to award \$32 million in contracts for public sector reform projects.

With respect to the manner in which departments went about the outsourcing, the report indicated that guidelines developed within departments were used in 49 per cent of cases with the Outsourcing and Contract Management Guidelines issued by the Department of Treasury and Finance being the next most commonly used approach (36 per cent). Contracting frameworks developed by external consultants were utilised in only 9 per cent of cases. The guidelines issued by the Department of Treasury and Finance were most commonly used by departments, however, the report did not indicate whether there was satisfaction with the form and content of these guidelines nor refer to any concerns

with the implementation process whether in understanding the market, preparing a business case, having the requisite level of skills and expertise within the department.

While accounting for only 20 per cent of total contract expenditure, approximately half of the contracts were fixed price contracts. Schedule of rate type contracts, where the amount involved depended on some measure of the volume of work undertaken by the contractor accounted for 42 per cent of the contracting expenditure. The Committee noted that on average around 24 per cent of contracts with external contractors and other government agencies incurred price variations (17 per cent in 1995-96).

The survey indicated that the most common reasons for price variations were changes in the scope of the work (71 per cent) and changes in the term of the contract (19 per cent). Contracts for infrastructure experienced the highest frequency for price variations being 80 per cent while technical services and training and education had the least variations.

The report provided confirmation that in-house teams and other government agencies were not favoured as providers of core or non-core services within Victoria, represented by only 6 per cent of contracts entered into by departments. With service delivery being essentially contracted out to the private sector, slightly more than half of the internal staff either resigned or accepted voluntary redundancy soon after a service they had previously been provided internally was awarded to a private sector contractor. Only 10 per cent of the staff were retained in the organisation, (compared to 25 per cent in 1995-96) and around 38 per cent were re-employed by the new contractor.

The report noted that savings from contracting in 1995-96 was around 28.2 per cent of the cost prior to contracting and that in 1996-97 the level of savings surpassed the previous year. The report also indicated that internal costs associated with managing contracts averaged 1.8 per cent of contract expenditure. This is similar to 1995-96 where internal costs averaged 1.9 per cent.

To be meaningful, surveys need to be representative and timely in publication. The 1995/96 Victorian survey was finalised in December 1997, some eighteen months following the year end to which the survey relates and the results of the 1996/97 survey were published in November 1998. Details of the 1997-98 survey have not been publicly released.

Given the various contract exclusions from the survey, the non-participation or absence of certain agencies, and the apparent variance in the nature and extent of responses, the Committee believes that every effort should be made to enhance the quality of information gathered in future outsourcing surveys and the completeness and accuracy of the reports emanating from the survey process.

1.4 The Victorian local government experience

Under amendments to the Victorian Local Government Act in late 1999, councils were required to competitively tender 20 per cent of their total expenses in 1994/95, rising to 30 per cent in 1995/96 and 50 per cent in 1996/97 and subsequent years.

The more open and performance based approach taken to competitive tendering contracting for local government in Victoria has been different to that which occurred in the UK where outsourcing is mandated only to the degree that the nature and extent of services have been specified.

Performances by local councils against the mandated levels in the first four years of CCT have been the subject of reports by the Minister for Planning and Local Government. The Minister's December 1998 annual report in respect of 1997/98 found that:

In 1997/98, 74 out of Victoria's 78 councils exceeded the legislated competitive tendering target of 50 per cent. Overall, in 1997/98, \$1.777 billion worth of local government work was subject to market testing. This represents some 60.9 per cent of the aggregate operating expenditure of Victorian councils.

Examples were provided in the Minister's annual report as to the extent of financial savings achievable under compulsory competitive tendering.

The majority of the Victorian Councils achieved CCT returns in the 50 per cent to 70 per cent range. However, 12 councils reported achievements in the 70 per cent to 80 per cent range and four reported achievements in excess of 80 per cent. Of the four councils that did not reach the 50 per cent target, explanations were provided to the Minister for Planning and Local Government.

The Minister made the following observations:

- overwhelmingly, councils have embraced the concept of competition and the opportunity to provide more efficient and effective services to

their communities. Market testing has fundamentally changed the way councils go about their operations.

- a number of initiatives implemented or commenced during the year will provide significant assistance to councils in monitoring the performance of their market testing programs and in improving the operation of those programs.

APPENDIX 2

Submissions received - 1995

Association of Consulting Surveyors	Department of Health and Community Services
Association of Professional Engineers, Scientist & Managers	Department of Planning and Development
Banyule City Council	Department of Premier and Cabinet
Barwon Water	Department of Transport
Bayside City Council	Department of Treasury and Finance
Cardinia Shire Council	East Gippsland Shire Council
City of Casey	East Gippsland Water
City of Greater Geelong	Education Victoria
City of Kingston	Energy Brix
City of Knox	Environment Protection Authority
City of Maroondah	Frankston City Council
City of Melbourne	Gas and Fuel
City of Monash	Gas Transmission Corporation
City of Port Phillip	Generation Victoria
City of Whitehorse	Gippsland Water
City of Whittlesea	Glenelg Shire Council
City of Yarra	Goulbourn Valley Water
City West Water	Goulbourn-Murray Water
Delatite Shire	Governor of Victoria
Department of Agriculture, Energy and Minerals	Grampians Region Water Authority
Department of Arts, Sport and Tourism	Greater Shepparton City Council
Department of Business and Employment	Hazelwood Power Corporation
	Hobsons Bay City Council
	Horsham Rural City Council
	La Trobe Shire
	Lower Murray Water

Manningham Shire Council
Maribyrnong City Council
Moyne Shire
Melbourne Parks and
Waterways
Melbourne Water
Mid-Goulbourn Water Board
Moonee Valley City Council
Moorabool Shire Council
Office of Public Prosecutions
Otway Region Water
Ovens Water
Portland Coast Water
Public Accounts Committee -
Northern Territory
Rural City of Ararat
Rural Finance Corporation of
Victoria
Shire of Colac Otway
South East Water
South Gippsland Region Water
Authority
South Gippsland Shire Council
Southern Grampians Shire
Council
Southern Hydro
Southern Rural Water
Stonnington City Council
Sunraysia Rural Water Authority
Surf Coast Shire

Transport Accident Commission Insurance
The Geomet Group
Victorian Auditor-General's Office
Victorian Power Exchange
Victorian Superannuation Board
Western Region Water Authority
Wimmera Mallee Rural Water Authority
Yarra Valley Water

APPENDIX 3

Submissions received - 1997

Anglicare Victoria	Department of Justice
Association of Hospital Pharmacists	Department of Natural Resources and Environment
Australian Education Union (Victorian Branch)	Department of Premier and Cabinet
Australian Services Union	Department of State Development
Bayside City Council	Department of Treasury and Finance
Berry Street Inc.	East Gippsland Shire Council
Borough of Queenscliffe	Education Victoria
Carers Association of Victoria	Environmental Protection Authority
Children's Welfare Association	Ernst & Young
City of Greater Geelong	Faulding Healthcare Pty Ltd
City of Monash	Frankston City Council
City West Water Limited	Gas & Fuel Corporation
Committee for Ageing NSW	Gas Transmission Corporation
Community and Public Sector Union	Gippsland Water
Consumer Law Centre Victoria Inc.	Goulburn-Murray Water
Corangamite Shire	Grampians Water
Corporate Kudos Pty Ltd	Greater Shepparton City Council
Deloitte & Touche Consulting	Indigo Shire Council
Department of Human Services	Integrated Pharmacy Services
Department of Infrastructure	

James Cook University	Transport Accident Commission
LaTrobe Shire	Transport Workers Union
Lower Murray Water	Victoria Police
Maribyrnong City Council	Victorian Auditor-General
Mental Health Legal Service	Victorian Power Exchange
Mid-Goulburn Water	Wimmera Mallee Water
Mission of St James and St John	Yarra Valley Water
Monash University	
Municipal Association of Victoria	
National Institute of Accountants	
Ovens Water	
Parks Victoria	
RMIT CCT Research Project	
Rural Finance Corporation	
Small Business Victoria	
South East Water	
South Gippsland Water Authority	
Stonnington City Council	
Sunraysia Rural Water Authority	
Swinburne University of Technology	

APPENDIX 4

Witnesses to the Inquiry

List of organisations and witnesses who gave evidence at public hearings and private briefings in Melbourne, Canberra and Sydney

Private Briefing 27 February 1997

Department of Premier and Cabinet	Ms M Sussex Ms M Van Rees
Department of Treasury and Finance	Mr J Perham Mr P Noble Mr B Williamson
Local Government Planning and Market Information Services Division, Department of Infrastructure	Dr T Ward Mr V Robson

Private Briefing 6 March 1997

Deloitte and Touche Consulting	Ms S Cullen
Victorian Government Purchasing Board	Mr R Jervis-Read Mr L Bailey Mr J Peachey

Public Hearing 28 July 1997

Community and Public Sector Union	Mr P Keogh, Assistant Secretary Mr T Monagle, Industrial Officer Mr P Bertolus
Ernst and Young	Mr P Rohan, Principal

Public Hearing 25 August 1997

Industry Commission	Mr R Kerr, Head of Office
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Ms L Maddock,
Assistant Commissioner

Ombudsman

Dr B Perry

Private Briefing 9 September 1997

Australian Consumers
Association

Ms Mara Burns, Manager,
Policy and Public Affairs
and Mr Peter Kell, Senior Policy
Officer

NSW Auditor-General

Mr Tony Harris

NSW Council of Social
Service

Mr Gary Moore

University of N S W
Public Sector Research Centre

Mr Michael Paddon

University of Sydney
Graduate School of Business

Professor Simon Domberger

Private Briefing 10 September 1997

Australian Competition and
Consumer Commission

Mr Hank Speir,
General Manager

Department of Finance

Mr Graeme Moffatt, First
Assistant Secretary, Corporate
and Business Services; and
Dr Sylvie Trosa

Department of Industry,
Science and Tourism

Mrs Janet Murphy, Assistant
Secretary, Access Education
and Finance Branch

House of Representatives
Family and Consumer Affairs
Committee

Mr Bjarne Nordin,
Secretary

Office of Information

Mr Alan Macdonald,

and Government Technology Chief Government Information Officer

Senate Committee on Finance and Public Administration Senator Kate Lundy, Member; and Mr Tony Abbott, Secretary

Public Hearing 29 September 1997

Anglicare Victoria Mr J Wilson, Director

Australian Education Union Victorian Branch Mr C Smith, Research Officer

Berry Street Inc. Mr J McDougall, Senior Manager, Northern Accommodation and Support Services

Consumer Law Centre Vic Ltd Mr D Nelthorpe, Executive Director

Department of Human Services Mr A Clayton, Director, Corporate Resources; Mr L Wallis, Financial Controller; Ms L Dormer, Manager, Business Improvement; and Mr L Ulrick, Manager, Infrastructure Investment-Acute Health

RMIT, CCT Research Project Ms S Moore, Project Leader

Victorian Council of Social Service Ms P Morrison, Executive Director

Public Hearing 27 October 1997

Administrative Review Council Professor M. Neave, Immediate Past President

Civil Contractors Federation Mr R Jeffrey, President
Mr I Jacka, Chief Executive Officer

Report on Outsourcing in the Victorian Public Sector

Department of Infrastructure	Mr J McMillan, Deputy Secretary, Contracts, Regulation and Compliance Services; and Mr L Thompson, Director, Corporate Information Technology
Municipal Association of Victoria	Cr. B Matheson Ms H Proctor Ms J Willis
Skilled Engineering Ltd.	Mr L Edwards, Victorian Trades Division Manager; and Mr R Cheffers, Corporate Services Manager
Yarra Valley Water	Mr C Peeters, General Manager - Finance