



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

**Reference: Contract management in the Australian Public Service**

TUESDAY, 22 FEBRUARY 2000

CANBERRA

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## JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Tuesday, 22 February 2000

**Members:** Mr Charles (*Chairman*), Mr Cox (*Vice Chairman*), Senators Coonan, Faulkner, Gibson, Hogg, Murray and Watson and Mr Andrews, Mr Brough, Mr Georgiou, Ms Gillard, Ms Plibersek, Mr St Clair, Mr Somlyay and Mr Tanner

**Senators and members in attendance:** Senator Gibson and Mr Charles, Mr Cox and Ms Gillard

### Terms of reference for the inquiry:

To inquire into and report on the management of Commonwealth contracts focusing on:

- the adequacy of contract specifications including the design and framing of the initial contract documentation;
- the adequacy of mechanisms for ensuring management accountability and facilitating Parliamentary scrutiny of contracts, including the method by which the Auditor-General is given access to the accounts of contractors;
- quality assurance and performance monitoring of contracts—adequacy of documentation of contract deletions, side agreements, and amendments;
- risk allocation and risk management;
- levels of accreditation and expertise of contract management personnel; and
- the extent to which corporate memory is being preserved in agencies to a level sufficient to protect Commonwealth interests.

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**Committee met at 9.41 a.m.**

**CHAIRMAN**—I declare open this public hearing of the Joint Committee of Public Accounts and Audit inquiry into contract management in the Australian Public Service. The search for excellent contract management is arguably one of the most pressing challenges for the Australian Public Service. With the move to greater outsourcing of programs, public sector agencies must equip themselves with a range of skills, knowledge and experience to ensure that contract management is effective and efficient. This inquiry will examine the adequacy of contract management across the Australian Public Service. The emphasis will be on the resources, skills and knowledge that agencies bring to bear in providing good contract management. A key objective of the inquiry will be to identify better practice approaches that can be applied across government agencies. The committee will examine the performance of Commonwealth agencies in delivering efficient and effective contract management. Some of the key areas the JCPAA will focus on include the adequacy of contract specifications, the adequacy of accountability mechanisms and access by the Auditor-General to contractor records and premises, quality assurance and performance monitoring of contracts, risk allocation and risk management, levels of accreditation and expertise of contract management personnel and the extent to which corporate memory is being preserved.

Today the JCPAA will take evidence from the Master Builders Australia, the Institution of Engineers, Australia, AusAID, Australian Business, the Royal Australian Institute of Architects, Canberra Business Council and PricewaterhouseCoopers. Before swearing in witnesses, I refer members of the media who may be present at this hearing to a committee statement about the broadcasting of proceedings. In particular, I draw the media's attention to the need to fairly and accurately report the proceedings of the committee.

[9.43 a.m.]

**HARNISCH, Mr Wilhelm, Deputy National Executive Director, Master Builders Australia Inc.**

**SOLLING, Mr Guy Michael Macintyre, National Director Legal Services, Master Builders Australia Inc.**

**CHAIRMAN**—Welcome. Before we proceed, I do not think there is any conflict of interest but I need to declare that I am a former member of the Master Builders Association of Victoria. Thank you for your submission. Do you have a brief opening statement you would like to make before we ask you questions?

**Mr Solling**—The basis of my opening remarks is that I would like to thank you for giving Master Builders a forum and an opportunity to express its views and concerns. We welcome it.

**CHAIRMAN**—It is a very comprehensive submission. One of the things you said that interests me is that the recent trend has been for design professionals to minimise their design risk liability by dispensing with both scopes of works and bills of quantities in preparing specifications, resorting instead to references to general standards. Can you elaborate on that a bit?

**Mr Solling**—Yes. It is seen by our builder members as the big picture in which your inquiry is looking at the problem of how to best manage the contract management function within government. In effect, what we are talking about here is not only private sector; we are also talking about the public sector and the interrelationship between the two, but those two elements are seen within the bigger picture of what is happening in the industry. This is the point I wanted to bring out in our paper to you, that in a sense there is a general trend in the marketplace to subtly transfer the building risk further down the chain to the builder, to the contractor. There is a subtle movement of responsibility for design and leaving the baby at the door of the contractor who at the end of the day bears the risk of producing the product.

The point that has been made in our submission at this stage is that there is a schism going on. If that subtle distinction is not recognised by procurement units, whether they are public or private sector, then right from the start there is not only an unequal bargaining power but allocation of risk, even before the parties start to talk to each other. That is an ongoing concern to our members.

**CHAIRMAN**—The Institution of Engineers, in their submission – I had better declare another interest; I am a fellow of the Institution of Engineers, Australia – argue that the public sector has lost engineering and architect expertise. In that little bit I read out to you, you said that the design professionals are trying to minimise the Commonwealth risk. We used to have a Department of Housing and Construction.

**Mr Solling**—Yes.

**CHAIRMAN**—They put out very detailed specifications – drawings and bills of quantities. I know because I built for them. What sort of specification are your members now getting?

**Mr Solling**—Our members are reporting that they rarely see either a properly constructed, in their view, scope of works, and bills of quantities are becoming quite rare.

**CHAIRMAN**—What do they get instead?

**Mr Solling**—They get general references to design standards, normally set out in documentation prepared by Standards Australia, which on its face looks perfectly acceptable, but, when you have a close understanding of the standards themselves, you realise that they are just a very general documentation which then has to be taken one step further and actually topped and tailed for the particular design circumstances in which they are expected to be used.

**CHAIRMAN**—Do you get drawings?

**Mr Solling**—You get drawings.

**CHAIRMAN**—But you do not get detailed specifications?

**Mr Solling**—You don't.

**CHAIRMAN**—And the design standards are how many pages now, the Standards Australia –

**Mr Solling**—It is getting bigger all the time. We are talking comprehensive documentation of a large scale.

**CHAIRMAN**—It is bookshelves of documents?

**Mr Solling**—It is getting to that stage.

**CHAIRMAN**—Are you also finding that the individual departments that your members deal with are running into difficulty finding engineering architectural expertise within their organisations, understanding how buildings are constructed and what it takes to work together to get the thing built?

**Mr Solling**—In a word, yes, but it does vary from state to state and from department to department. There is a broad range of skills within departments, so it does vary.

**CHAIRMAN**—Are you talking about states or about Commonwealth?

**Mr Solling**—Commonwealth as well.

**CHAIRMAN**—We are not really concerned about the states.

**Mr COX**—Commonwealth variation across the states?

**Mr Solling**—Yes, indeed, and departments. It is geographical and departmental.

**Mr COX**—Which ones are better and which ones are worse?

**Mr Solling**—The department which stands out as being one of the poor performers is Defence. That has been clearly demonstrated and the institution make the point in their recent report on the Collins class submarine program.

**Senator GIBSON**—We have noticed that.

**CHAIRMAN**—I have not seen criticism of Defence in terms of buildings. In fact, with the over-the-horizon radar into which we have inquired, the one thing that went really smoothly was the building side of the contract.

**Mr Solling**—It does at times go well, yes.

**CHAIRMAN**—Even in remote areas.

**Mr COX**—But buildings in Defence are not universally done well, despite the fact that they are the biggest property owner in the Commonwealth and ought to have the greatest expertise.

**Mr Solling**—I would agree with that. One of the difficulties we had in preparing our submission was that, although we have been getting consistent reports from members for over a decade about these sorts of issues, there needs to be an understanding that government is a very large and repeat customer for member services and, understandably, when asked to give specific examples, people are not prepared to stand up and put up their hands because it will have an effect on their ongoing relationships and businesses.

**Senator GIBSON**—A submission from the Institution of Engineers said basically that not only in the public sector but also in the private sector there are often deficiencies in both technical expertise, such as engineering expertise – what is required and the setting of specifications – and managerial expertise, such as calling for tenders and either managing from the purchaser or the provider point of view. Does your organisation have any views about how to set standards or goals for achieving both those ends within Commonwealth departments, either internally or by buying in the expertise? If there was recognition by the Commonwealth agencies of these deficiencies and they had guidelines about what to chase and where to get it, they could then make the judgments about whether they had it internally or whether they had to go out and buy it in for a specific job. Would you care to comment?

**Mr Solling**—It is an extremely difficult question and I understand it is the nub of the problem that you are grappling with. It is something that we, at a national level within Master Builders, have to think about all the time. The difficulty with the whole concept of contracting in is that there is a presumption that there must be someone in-house who understands who to contract in, why they are doing it, whether what they produce is valuable and whether it fits with the criteria that the department or the procurement unit needs it to comply with. That requires a degree of skill already in-house. I think the institution have made the point very well that there has to be a degree of the informed government procurement agency already having some knowledge base from which to draw. It is not going to be easy to pull somebody, if you will, off the shelf to do a particular job for you if you do not know whether, firstly, they have the capacity or, secondly, what your job is.

A difficulty with building instruction is that no client, public sector or private sector, is ever going to know what they want. They know what they are needed to do, but even once you have got to the level of where you know what your design requirements are you are already presuming some level of knowledge in-house, and this is the problem that you are going to be grappling with at the end of your hearings and in writing your reports. It is a very difficult question. I am sorry that I am not Solomon and I do not know the answer, but I do not believe that wholesale contracting in is going to solve your problem, because I have seen to date – and my members report to date – that over the past decade a trend in this direction is not producing the results that we in the industry would like to see and we do not believe it is giving the public best value for money for their taxpayers' dollar.

**Senator GIBSON**—Is that because the agencies contracting in the so-called expertise, to help them set the goals and the outcomes they want and the specifications to go with it and manage it through, have not correctly identified the sets of skills that are required?

**Mr Solling**—I believe so.

**Senator GIBSON**—Is that something on which we as a committee can help set guidelines for Commonwealth agencies, saying, ‘Here are some hurdles you need to be able to jump over. You have got them inside or, if you haven’t, for your sake, go out and buy them.’

**Mr Solling**—This again is the problem that you are grappling with, because there is a prevailing attitude within government that devolution and cost cutting have been extremely important and there needs to be a change in the ethos on which the public sector operates. It needs to develop more private sector principles as far as getting value for money is concerned and look to ensure that money is not simply spent for the sake of spending money but that there is a real outcome at the end. The problem that our members report back to us is that in the process of attempting to achieve an outcome, effectively what is happening is that it is a commodification of the very procurement principle that you are grappling with. I use the example of soap powder. It is extreme, but the life cycle of soap powder is between three and nine minutes, depending on what the washing cycle is. But we are talking about public building stock here which has a life cycle of at least 30 years if it is well built. I would imagine that most of us expect Parliament House to be around for a lot longer than that.

**Mr Harnisch**—While we have no problem with the issue of the Commonwealth outsourcing its work, it seems to me that the dilemma that it is currently facing is that, on the one hand, the government wants to outsource a lot of things and, on the other, it still wants to have some of the assets itself. Fundamentally you could argue that one way of solving this problem is to say that the Commonwealth does not own any assets at all; all it does is lease its physical assets. One way perhaps of overcoming the problem, which may be an extreme one, is to go down the design and construct route where, in that sense, on the issue of risk that Guy has been talking about, the builder or the contractor, once given the brief by the Commonwealth, takes on both the design and construction risk for the particular asset. Therefore, we do not have the problems that Guy has been talking about where, because of the approach of some agencies looking at purely the lowest price in terms of tender and getting the design expertise where everything is done on a time basis they say, ‘This job is only worth X thousand dollars; therefore, we will allocate only X number of hours to it.’ One way of cutting costs or making sure that they make a profit in terms of design – I am certainly not criticising the design professions – is to allocate the risk down the chain which, in many cases, goes to the contractor and the subcontractor, and you have the problems that some of our members are facing because of these practices that are now occurring. One extreme would be that the Commonwealth contracts out on a design and construct basis as an option. The other option is to recognise that if it does want to obtain value for money, or pursue the value for money approach, it must have the expertise to ensure that it is getting that value for money, which is not the lowest price.

**Mr COX**—Are you saying that the designer-construct approach and then leasing buildings is not likely to be value for money?

**Mr Harnisch**—I think that designer-construct and value for money would not necessarily be in conflict with each other.

**Mr Solling**—I, in fact, would see it as a very good win-win solution – for both parties.

**Mr Harnisch**—As long as the client understands that they cannot get a Rolls Royce for a VW price.

**CHAIRMAN**—Does it not also demand that the client have the expertise to evaluate the design at the design stage before the thing gets built?

**Mr Harnisch**—Correct.

**Ms GILLARD**—My question is on another topic. On page 5 of your submission you make reference to another problem arising from the GST. You actually use the term ‘looming crisis’. Can you explain the nature of that problem?

**Mr Solling**—Yes. It is an issue that has become apparent to us in the process of literally going around Australia and explaining the GST to our members, listening to their feedback and having them begin to understand what they need to do to make their businesses go through the transition. In the process of preparing the seminars – and Wilhelm and I have been giving quite a number of them – it has become clear that, like all of these things, the devil is in the detail and, when you start to understand the implications of what happens, you realise that there is a very real issue there. It does not just apply in our industry; it applies Australia wide. It is an issue I am very happy to talk about.

If you look at the fundamental nature of the GST and how it works, you realise that there are a couple of thresholds involved. Those thresholds are (1) \$1 million annual turnover for accrual accounting and (2) \$20 million annual turnover for remitting GST on a monthly as opposed to a quarterly basis. That means that, at \$20 million, the big boys, the big suppliers, the big contractors – the big end of town – are effectively on a 30-day credit collection regime because they need to be GST cash flow positive to pay their GST at the end of the

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month, which means that we are about to see a change in cash flow cycles in the Australian business sector. I understand that small business is a driver of employment, but big business is a driver of market behaviour. That means that, from 1 July, we are going to see a system where invoices will be issued for the first few days of every month and there will be beefed-up credit control departments in all large suppliers, contractors and companies Australia wide who will be looking to be paid before the end of that month. Twenty-eight days will be the absolute maximum credit period – I suggest it will be 14 – and there will then be a very important period at the end of each month when they will see how much money will come in.

That is going to drive the way people do business. As Wilhelm and I discovered when we started to look into this, the first sign of a company becoming insolvent is when it starts relying on the Australian Taxation Office for a refund cheque because there is a fundamental imbalance between the input tax credits that you can claim and the GST you have to pay. If you have to effectively go into overdraft to pay your GST liability, it is the first sign your business is in trouble. This is the point we wanted to make in our submission. Like all these things, if you are an employee – as we are – or if you are a bureaucrat and you are going to be paid fortnightly anyway, there is no imperative to understand what the GST means. The only people at the moment who need to understand what the GST means are people who have to get their businesses through the first two remitting periods after 1 July. The overseas evidence shows that, if you can get your business through the first two remitting periods – if your turnover is over \$20 million, that is the first two months; if it is under \$20 million, it is the first two quarters – the chances are that you are going to survive.

In other words, the accent is on businesses at the moment to get themselves GST ready. We are concerned that a fundamental change is under way in the way the Australian private sector does business but that, if there is no realisation in the public sector that for GST purposes they are a business as well and they have got to do this as well, and if the procurement units are isolated from each other so that the payment departments do not realise that they have to fundamentally change the way they do business as well and that when a contractor is screaming at them, 'We need to be paid, we need to be paid!' it is not just another excuse or pretext to get the money but that the world has fundamentally changed, there will be very real trouble after 1 July.

**Ms GILLARD**—In current arrangements under contracts your members have with the Commonwealth, what would be the generally contracted payment cycle? Would it be a month or a period longer than a month?

**Mr Solling**—It is longer than a month.

**Ms GILLARD**—Do you have any idea what the average period in those contracts is?

**Mr Solling**—It varies wildly.

**Mr Harnisch**—Our concern is not so much the period; there have been instances where there have been no late payments.

**CHAIRMAN**—There have been no what?

**Mr Harnisch**—Late payments, once a claim has been lodged. The dilemma is that, if a contractor issues a tax invoice, he incurs a GST liability.

**CHAIRMAN**—But, with respect, most of your contractors largely rely on subcontractors, and they would place all of their subcontract orders or contracts on the basis that they get paid when the contractor gets paid. You know that as well as I do.

**Mr Harnisch**—But under the security of payment legislation that is now changing. In a number of states the head contractors have a legal obligation to meet their subcontractors' payments within the prescribed statutory period, which is less than a month or two weeks.

**CHAIRMAN**—Regardless of whether they have been paid?

**Mr Harnisch**—Yes.

**Mr Solling**—Yes. The pay when paid and payment if paid clause is about to become illegal in New South Wales.

**CHAIRMAN**—Where?

**Mr Solling**—In New South Wales.

**Mr COX**—Aren't you glad you got out of the building business?

**Ms GILLARD**—Is that true only in New South Wales?

**Mr Solling**—Queensland is about to follow suit and, when those two states assume a mantle, it very quickly runs through the rest of the country – it is only a matter of time. I would suggest it is probably going to be more like months rather than years.

**Mr COX**—Have you made any estimates of how much additional working capital the building industry is going to need to cope with the GST?

**Mr Harnisch**—No, no-one has done those – the so-called focus on that sharp end. I am sure some of the bigger companies have, but I have been unable to get that sort of commercial-in-confidence information from them.

**Mr COX**—But it will be significant?

**Mr Harnisch**—It will certainly be significant for companies that debt-finance their projects. It is not going to be that significant for companies that are fully equity funded some of the large ones like Leighton who do not debt-fund and people like Meriton who are self-funding. But, certainly, the vast majority of builders or contractors of medium size have some sort of debt-funding to undertake a project.

**CHAIRMAN**—In your introduction you were talking about the international experience of value added taxes. Is it also true that the international experience shows that, within the accounting time frame you are talking about, there has been a significant increase in accounting expertise across the sector?

**Mr Solling**—Yes, it is.

**CHAIRMAN**—That is to say, current companies are running their businesses better.

**Mr Harnisch**—We are not saying that. Our observation was not in a pejorative sense. We were saying that, in fact, our members are gearing up.

**CHAIRMAN**—But it is not positive because, in my view, there are too many companies in the contracting sector that do not pay enough attention to costing. They do not really know where they are until they finish the project.

**Mr Solling**—We absolutely agree.

**CHAIRMAN**—And the retention money seems to be a very poor business practice.

**Ms GILLARD**—The concern that is being articulated here is not about your members' practice although, as you say, they are gearing up for the GST. It is about the government's payment practices and how that compares with –

**Mr Solling**—We absolutely agree. Master Builders' view is that the GST is very good for the economy. One of the points we make to people in our seminars is that the good news about the GST is that you are going to get to know your business a whole lot better, but the bad news is that you are going to get to know your business a whole lot better. In other words, if you are going to survive, you have got to get with it.

**CHAIRMAN**—If you do not know how to manage your cash, you had better learn to manage it bloody quick.

**Mr Solling**—Absolutely. We have members from one end of the spectrum to another, and there are quite clearly some quite small house builders out there who do not know whether or not they make a profit every year. They simply do not know that they are working for wages and are not making a profit.

**Senator GIBSON**—This will smarten them up.

**Mr COX**—It will kill them.

**Senator GIBSON**—Some of them are going to die anyway. The evidence from New Zealand that came before the Senate select committee on tax was that a hell of a lot of people were forced to learn the viability of their business a lot earlier than they otherwise would have.

**Mr Solling**—I think that is a good thing. Frankly, if people cannot make money, they should not be in business.

**Senator GIBSON**—Can I get back to the original discussion about the nub of our problem. Mr Solling, you were saying before that the Commonwealth agencies really needed expertise within their organisations to set the goals and the outcomes required to go ahead with a particular building project. I have run a manufacturing company in the past and when we wanted to expand – and it was with hundred of millions of dollars in expenditure – we did not have the expertise within the company. We had to go out and buy it, because we only wanted the expertise for a couple of years as we could not afford to run with that within the organisation. Why shouldn't Commonwealth agencies do exactly the same thing? There is no point in their having the expertise for building, construction and management and the technical expertise for building contracts because they are only going to do it every now and again. It would be far better that they have guidelines as to defining what expertise they need to buy in and then some help in locating that expertise.

**Mr Solling**—The first question that comes to mind is this: in your case were you lucky with the people you found?

**Senator GIBSON**—We had a mix. We had some good ones and we had some crook ones we had to flick off halfway through the project.

**Mr Solling**—The other point I was going to make was that it seems to me that there are two types of procurement units out there. There is the type who, as in your situation, only need that expertise for a short period of time and will not use it again or will do it very irregularly, in which case it makes sense to buy it in. There will be those agencies which, by their nature, will have an ongoing stream of work and will be building up an in-house expertise anyway. Is it therefore cheaper to nurture that and keep it than to hire it occasionally? If that is the case, is there some value in subcontracting that expertise to other units, in your case those who do not use it very often?

**CHAIRMAN**—Yes, but he could well have placed the design and construct contract with a maximum price and with a sharing of any price reduction, with a fixed time limit and based on function and specifications.

**Mr Harnisch**—Most private sector clients fully understand the outcomes that they are after. They fully know the parameters of the particular asset that they are seeking to have either designed or built. They implicitly have value for money in mind because in the end they are all driven by the bottom line. Value for money does not mean it is a Rolls Royce every time, because, while you may only want a so-called ‘fairly simplistic’ warehouse, you know exactly what that warehouse is going to achieve for you in terms of your business. One of the points that we made in our submission is that one of the problems that we see within the Public Service is that there is poor specification in terms of the engagement of expertise. The problem of getting expertise in is that the people who actually then hire the consultant to do the work on behalf of the Commonwealth poorly specify the tasks of the consultant. So the process of buying in in-house expertise is not the problem per se but it still comes back to the fact that the real problem is that the Commonwealth as a client does not fully state what it requires.

**CHAIRMAN**—Were both of you around in the days of the Department of Housing and Construction?

**Mr Harnisch**—Yes, I was an employee. I did some contract work at that time. I should have declared that actually.

**CHAIRMAN**—I think so. Can you tell me then if you think the Commonwealth got value for money out of that approach, which was so bureaucratic, so overstaffed, so secure and so antirisk prone that heaven only knows how much more buildings cost than they should have?

**Mr Harnisch**—I would have to say that I agree. That particular model was at the other end of the spectrum and, therefore, I think that was an overinvestment by the Commonwealth that did not achieve the results for the investment it had made. It at least had the expertise there, particularly for specialised projects.

**CHAIRMAN**—But there was generally an inspector per employee or per tradesman.

**Mr Harnisch**—Yes, it certainly was bloated, shall we say, in terms of efficiencies.

**Mr Solling**—We certainly do not want to see a return to those days at all.

**Mr COX**—In terms of having the expertise embedded within the Commonwealth bureaucracy, would you say that the process of letting contracts has now become too decentralised?

**Mr Harnisch**—There are probably two points: it is decentralised and deskilled – or no-skilled.

**Mr Solling**—I think you have hit the nail on the head. There are essentially two points involved. The point that we have attempted to make as succinctly as possible about a very difficult point is that there seems to be an essential schism within the bureaucracy between simple supply procurement and more complex, one-off unit procurement. There seems to be a schism with, if you will, the Treasury function, which has a reductionism approach to supply which says that anything can be treated like a box of soap powder and if you specify the quality you want and you can show that it did the job that it was meant to do you get a tick for supplying a correct product which complied with specifications. Something like this building is infinitely more complex and therefore requires people who at least understand what is involved in the process.

The point we made was that on the one hand you have the simplified, outcome oriented approach and on the other hand you have the vastly more complex, process orientated approach. The two require quite different expertise. If one is given priority because there was seen to be a need – and we agree it was due; there was a need to have a look at the way in which the government did business, to make it more accountable and to get government back to its core business of governing rather than running their own businesses – then a period of pain has to be endured and a leaner bureaucracy has to result. What we are concerned about is that, if the washing powder approach to tendering becomes the norm for procurement of a vastly more complicated structure which is a building or a civil engineering works, then by replacing the clerical function of ticking boxes and seeing what the lowest cost price is, and leaving aside the more complex issue of value for money determinations, the tendering process in a sense has been hijacked. The reductionism approach has triumphed, but value for money in producing long-term building stock is going to suffer in terms of quality.

**CHAIRMAN**—Do you know how Victoria operates now and has for a couple of decades?

**CHAIRMAN**—Let us make it more specialised than totally general because most of what the state government builds now is schools. Not quite 20 years ago something like -17 years ago -I think the state of Victoria started downgrading the Public Works Department and started increasingly having private sector architects design the school buildings, and perhaps quantity surveyors if the building was big enough, and letting the school council itself place the contract. So the school council became the project manager and supervisor.

**Mr Solling**—Yes.

**CHAIRMAN**—Are you going to tell me that all those teachers and private sector individuals had this great building expertise and yet the state of Victoria has gotten such a dramatic increase in value for money out of that exercise – between 100 and 200 per cent improvement in terms of cost performance?

**Mr Harnisch**—Can I just pick up on that –

**CHAIRMAN**—Without necessarily any building expertise in the school councils.

**Mr Harnisch**—I agree that it did not help building expertise, but in quotes they would have had design expertise because they knew exactly what they wanted in terms of specifications, which they could then translate to the design professionals to enable the builder to deliver the outcomes that they wanted in the first place. In other words, the issue is that they were an informed client who knew exactly what they wanted.

**CHAIRMAN**—I accept that.

**Mr Harnisch**—They could specify exactly. They could not translate it perhaps in terms of design or the construction –

**CHAIRMAN**—They did not know what size taps they wanted or whether they wanted them chromed or brass plated or what, but they definitely knew that they wanted –

**Mr Harnisch**—Yes, they wanted a classroom or facilities which provided them these facilities.

**Mr Solling**—That is right. They did not know what they wanted but they knew what they wanted it to do.

**Mr Harnisch**—In terms of the physical stuff they did not understand, but conceptually they were an informed client.

**CHAIRMAN**—Shouldn't the Department of Defence know what they want a building to do when they build a building to house personnel, munitions or over-the-horizon radar?

**Mr Solling**—Yes, and for the sort of work they are the only people who can really do it.

**CHAIRMAN**—But you said they were very bad at it.

**Mr Harnisch**—We talked about the management of the contracts as opposed to their particular design skills, in terms of the practices that have been reported to us by our members who were successful in getting contracts from them.

**Mr COX**—In terms of this contracting out process, how does the MBA feel about the Auditor-General having access to the financial accounts and the premises of contractors?

**Mr Harnisch**—We would see that essentially as an invasion of privacy in terms of access to commercial information. The premise would be that in awarding contracts I would expect that the client would undertake the normal due diligence processes to assure themselves that the company they are about to engage is both financially and managerially adequate to perform the contract they are about to be awarded. How then that company operates internally I would have thought is subject to the normal laws of the land, and I would see no reason why the AG's would, on the basis of the Commonwealth having awarded a contract, have the right to inspect the books of the company unless there has been a proven breach, either fraudulently or otherwise. I would have thought that other agencies would have been involved at that stage rather than the Commonwealth.

**CHAIRMAN**—Why would your companies object to signing a contract when that was included as a contract condition? If they plan to do nothing wrong, why would they object to signing it?

**Mr Harnisch**—The question I would ask is why that would be necessary.

**CHAIRMAN**—Because in the very rare instances that this committee has inquired into, discovered, analysed and everything else it really is necessary, in order to find out what happened to money.

**Mr COX**—Tragically, there are instances of incompetence and also of fraud that need to be checked out, with taxpayers' money involved.

**CHAIRMAN**—Very rare, but it does happen.

**Mr COX**—With contracting out, those risks tend to fall more with contractors than they used to. Previously you would not have to go any further than the Department of Housing and Construction, but now –

**Mr Harnisch**—But in my comments I made it quite clear, except in circumstances where there have been reasonable grounds for the fact that there has been fraudulent behaviour. I cannot see that that clause would necessarily apply where things are going normally.

**CHAIRMAN**—Why would the Auditor-General bother wasting his time and his staff's time and money going to look at a contractor's records unless it was necessary? He wouldn't.

**Mr Harnisch**—But it is just a general clause in there; it needs to be specified or circumscribed as to the circumstances –

**Mr COX**—But you accept that there are instances where it would be appropriate.

**Mr Harnisch**—Guy is more the legal person.

**Mr Solling**—My view is yes, if the provision you have in mind had in mind that the Auditor-General would only be exercising that right if he felt that there were genuine reasons for investigation. After all, at the end of the day it is a cost to both the public purse and to the contractor. If the contractor has tendered to do a good job and if a job has been done according to design and within time, then, as you say, there is no reason for the AG to be involved.

**CHAIRMAN**—In your report you noted:

Members report that the devolution process appears to have been responsible for the competent public sector construction procurement experts ... leaving the public sector.

Based on your personal experience, since you were in the Department of Housing and Construction, can you tell us how fast you think that devolution has been and what percentage have gone?

**Mr Harnisch**—I worked in the Department of Housing and Construction probably well over 15 years ago. There was no contracting out at that stage, but certainly from what contact I have had the smart people have left the Public Service. They took the opportunity to take the packages that were offered. There is a view that, unfortunately, those who could not cut it in the private sector were left in the Public Service. They are the only observations I would make from comments I have received from colleagues I still have in the public sector.

**CHAIRMAN**—Thank you very much for your submission and for talking to the committee today. You have been very frank, and we appreciate that. As always, when we produce our report we will certainly send you a copy.

**Mr Solling**—Thank you for the opportunity.

[10.29 a.m.]

**BOSHIER, Mr John, Chief Executive, Institution of Engineers, Australia**

**YATES, Mr Athol, Policy Analyst, Institution of Engineers, Australia**

**CHAIRMAN**—Welcome. Thank you for your submission. For the public record, I declare that I am a fellow of the Institution of Engineers, Australia, for whatever difference that makes to this hearing. Having read your submission and your booklet *Government as an informed buyer*, do you have a brief opening statement you would like to make or shall we start asking you questions about your submission?

**Mr Boshier**—I do have a very brief opening statement.

**CHAIRMAN**—Very brief, please. Otherwise, we will not get to ask you the questions we want to ask you.

**Mr Boshier**—Thank you for the opportunity to give evidence to you. The Institution does believe that for the government to get maximum value from its contracts, it needs to be an informed buyer. The public sector has experienced a loss of technical expertise due to the substantial decrease in the number of engineers over the last decade and this loss of technical expertise increases the risk that contracts for engineering information technology, as well as other technical goods and services, will not fulfil government or taxpayer expectations. Consequently, governments need to adopt new approaches to ensure that they have access to the technical expertise required to be an informed buyer of technology.

The Institution is not arguing for more engineers to be employed by the Public Service. The critical issue is not where the technical expertise is located; the issue is that government has guaranteed access to specialist advice when it is required. Nor is the Institution arguing that the necessity for technical expertise requires the contract manager to be an engineer. The long held view that engineers are the only ones with sufficient understanding of technical issues to be able to manage technical contracts is outmoded. Likewise, the view that engineers who manage technical contracts always strive for gold plated solutions no longer applies. Our discussion needs to go beyond these simple stereotypes. It is now recognised that the only way to maximise value for money is to combine contract and technical skills.

Preliminary results from an Institution of Engineers, Australia, survey are finding that the problem of the government being an informed buyer is more common than we would like. Today, we are here to give you the preliminary results from the survey and that forms the core of our evidence. The survey has so far found that, for 33 per cent of the contracts surveyed, industry considered government was below average in being an informed buyer, that is, below an acceptable benchmark. In contrast, only 20 per cent of government contract officers surveyed considered that the government was below a benchmark as an informed buyer. The Institution has developed a model for agencies to become informed buyers. By adopting this method, agencies can ensure that they obtain the most cost-effective level of technical expertise. Our model was developed following extensive research, including interviews with 50 governmental and non-governmental contracting personnel. I will go into this model later, if you wish.

Furthermore, we believe that government agencies should adopt a methodical approach to the procurement and contracting guidelines for engineering, information technology and other technical goods and services. Such an approach ensures that government agencies have the most cost-effective access to the appropriate level of technical expertise. A tool that governments can use to ensure a high standard of technical expertise is the National Professional Engineers Register. It specifically indicates the competence of professional engineers and is being increasingly adopted throughout Australia by state and territory governments. The Institution strongly supports this register. Our recommendation is that registered professional engineers be used wherever public safety is at risk. We believe this presents an opportunity for the profession and the government to work in partnership to ensure public health and safety. This will ensure good quality outcomes for the community. We would call that coregulation of the profession with the government and it is being examined in other professions as well.

Finally, an informed buyer needs to ensure that contractors have the required competencies. Competencies are not always checked, and inappropriate contractors are chosen. This can occur for a variety of reasons. The Institution has identified numerous approaches to ensure the best value for money contractor is selected. These include project definition studies, value management and so on. Underlining these approaches is the need for the contracting organisation to have the relevant expertise to know what it is purchasing. The Institution considers that government must give more attention to the appropriate selection of contractors and particularly recommends the need for a coregulatory scheme to be developed for engineers who work in areas that are critical to safety.

**CHAIRMAN**—Thank you. One of the points that you make rather strongly is that there has been this loss of engineering expertise within the public sector. Is it not also true that the public sector, both Commonwealth and the states, have divested themselves largely of their departments of construction, whatever they called

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them, which held large numbers of technical personnel who were competent and who no longer are needed in a devolved environment where the government agency is no longer acting as both the project manager and the inspector?

**Mr Boshier**—That is absolutely true, Chairman. I am very familiar with Victoria where that has clearly happened and that is absolutely true. Our statement looks at numbers of engineers in the non-direct contracting area as well. So in the state of Victoria, for example, the SECV has been sold and huge numbers of engineers there left the public sector.

**CHAIRMAN**—How can you logically put the argument that we need more engineers in the public sector if we have devolved them into the private sector and the Commonwealth is actually using their expertise?

**Mr Boshier**—Our statement is very much that the government should not have these engineers in it. The thrust of our evidence to you is that on the basis of the survey which we have done the government is showing all the hallmarks of not having access to good engineering advice. We are definitely not saying that engineers ought to be in the public sector. They may or may not be; that is entirely up to the state and territory governments. It is not our concern whatsoever, as I said in the statement. Nor am I saying that engineers are the font of all knowledge in this area. They are clearly not. My own degree and your degree would have given you the training to do this. I find some of the practices that are reported really quite hair-raising – coming from our survey. All we are saying is that government needs to have access to good engineering advice.

**CHAIRMAN**—When you read your opening statement, you talked about qualification standards. I can tell you I still am a certified practising engineer but I can guarantee you I could not get insurance.

**Mr Boshier**—That is true.

**CHAIRMAN**—It is a good thing, too.

**Mr Boshier**—I respect your view on that, and that is why I said what I did about the National Professional Engineers Register and that to stay on the register you should be able to demonstrate competence. You or I now cannot demonstrate competence, I believe, speaking for myself, as an electrical engineer to design power systems. That means that I can still belong to the profession but I should not be hired as a professional, registered engineer. That is why we think that this coregulatory approach which checks competence is so important. At the moment, we are halfway there in developing the professional register.

**Senator GIBSON**—When you say ‘halfway there’, would you expand on that?

**Mr Boshier**—There is a move among some states – and Mr Yates can help me a little bit more on this. Queensland recognises the professional engineers register; Victoria, for example, does not. We are actively talking to state governments to encourage them to look at the merits of using the professional engineers register.

**CHAIR**—One of the things you said was that the IEAust considers that accredited procurement training should be mandatory for government purchasing officers, particularly for complex, engineering purchases of high value. Would you like to expand on that? Who is going to make it mandatory?

**Mr Yates**—It is up to the individual departments to do so because it was pulled out of the government procurement guidelines, as you noted in this committee’s last report. It has been the internal policy of a number of agencies in the past but it seems to have been reduced in significance or importance to the department over the last year or two. That is a concern. We would like to see mandatory procurement qualifications and training as an element for all contracting officers who are involved in these sorts of projects.

**CHAIRMAN**—Do you find that same level of expertise and qualification existing in the private sector?

**Mr Boshier**—In my experience, yes. It is interesting, anecdotally, that a large number of engineers, particularly chemical, are leaving and joining merchant banks.

**CHAIRMAN**—Really?

**Mr Boshier**—They do not become registered engineers but their systems knowledge is greatly valued by merchant banks. A lot of major companies with which I have been associated hire merchant banks to do their project evaluation for them. For example, Macquarie Bank is a major funder and financier of infrastructure projects. Their engineering advice is outsourced in that degree. I would say that, overall, that is where the advice is sourced from for the private sector. Sometimes it is in-house. A lot of engineers have gone into the private sector.

**Mr Yates**—In response to your question directly, one of the issues is that a lot of people who are now doing procurement or contracting activities were not doing that five years ago. They had moved out of some other area of activity within the agency. In the private sector it seems more that the people with the contracting qualifications move from job to job in that area. But there is not a skill shortage, which there is in the public

sector, in terms of procurement qualifications. This is not just our observation; industry commission reports, BIE reports and a number of reports have identified this problem.

**Ms GILLARD**—Is that because the Commonwealth is running so leanly, if you like, in that area in that it cannot offer people a career path that would retain them?

**Mr Yates**—It is partly because contracting activities has become more important to the Commonwealth. Before it was done internally, so you did not need this. The skill set just was not there.

**CHAIRMAN**—You were talking about chemical engineers becoming merchant bankers. I had not heard that one before. I must admit that in my travels around Australia I have met numbers of engineers of all sorts of disciplines as plant operators in process plants, whether chemical plants or refineries or metallurgical plants or whatever. There are heaps of them working as operators on control consoles because the money is better.

**Mr Boshier**—Certainly. That is particularly so in remote locations.

**CHAIRMAN**—You have made a big play in the press on the *7.30 Report* about the Canberra Hospital, HMAS *Westralia* and Esso Longford. You just sort of threw in at the bottom the Collins class submarines, but you had failed in your report to really demonstrate the engineering failure of the Collins project. Can you talk about that?

**Mr Yates**—The comments to do with the submarine project were sourced from the Prescott report into the Collins class submarine project. The references I made in the report were to do with access of expertise. It was noted that the Department of Defence, Submarine Corporation and other parties had the relevant amount of technical expertise. It was available in the department and in the companies, but due to the structure of the contract it was not available. That was simply the reference here. It just illustrates the fact that you may have expertise within the agency but, if you do not use it, it is worthless.

**CHAIRMAN**—Fair enough.

**Senator GIBSON**—I am quite impressed with your booklet and your six recommendations at the front. It seems to me that the key one is recommendation 3, which says:

Government agencies should employ the following model to ensure they have access to the appropriate level of technical expertise in the most cost-effective manner.

In your contacts with government agencies, do you think that government agencies recognise the need to follow through on those steps that you have set out there?

**Mr Yates**—I would have to say no. There are some more enlightened sections within departments that realise that the method we are proposing is not rocket science, but it is not being observed. That is simply a reflection, I think, of a failure to have a strategic management approach to human resources, to this issue of specialist advice within the departments or agencies.

**Senator GIBSON**—So one of the things we as a committee can do is help distribute and publicise this message amongst government agencies. It seems to me that it is a very sensible message.

**Mr Yates**—It is. What we would very much like is for some agency to be willing to undertake a project to demonstrate that this would work, to do a case study of a small department. It would highlight a number of problems and it would be done, say, in conjunction with the public sector merit protection agency and a state, federal or territory department.

**Senator GIBSON**—It is a good idea.

**CHAIRMAN**—You would not expect us to make a broad, sweeping recommendation that this sort of stuff must be implemented across all Commonwealth departments somehow or other?

**Mr Yates**—Indeed not. It would be totally inappropriate in some areas, but certainly for some functions it would be a logical step to take if they were serious about ensuring that the taxpayer gets the most value from their contracts.

**Mr COX**—Do we have a copy of the forward results of your survey? We have your submission and we have your booklet.

**Mr Boshier**—Mr Chairman, the results are still coming in, and what we are doing is giving you preliminary results, which we are happy to give you. We will be releasing this report as soon as we can; we will publish it. We are happy to give you what we have to date so long as it is agreed and acknowledged that they are just preliminary results. But the results are, I find, of great concern.

**Mr COX**—We have hearings set down until the end of March. Are you likely to complete it before then?

**Mr Yates**—Yes. In two weeks it will be completed.

**CHAIRMAN**—We will wait until you complete it, then. One of the things that we listed as an area we were concerned about, and in retrospect I wish we had broadened it slightly, was whether or not there has been a



detrimental loss of corporate memory within the public sector and whether that was bad. But we did not talk about skills, which you have brought to our attention. You said that you have concerns that the loss of corporate memory is putting the interests of the Commonwealth at risk and also that the loss of memory has resulted from the decline in the total number of specialists with long service within the public sector. That is really a value judgment, isn't it? You do recall, I assume, the olden times, when the public sector was totally risk averse, was overstaffed and inefficient. In fact, probably nothing should have gone wrong because there were enough people to make sure that every eventuality was taken care of, theoretically. Of course, that never worked. You are not implying that we needed to retain all that corporate knowledge, I hope?

**Mr Boshier**—I accept the point that you are making. In times of rapid technical change, sometimes having a lot of corporate memory can be a disadvantage because it can lock you into old-fashioned ways of doing things. But the difficulty is that if one loses too much corporate memory then one tries to reinvent the wheel and it becomes very expensive. In my personal experience, if you try to cut corners or make assumptions or assume that the people to whom you delegate a job know exactly what they are doing, then I think that can be a serious problem. Therefore, I think there has to be a middle ground, where you have enough corporate memory to ensure that the lessons which the organisation has learned, even the culture and what is important, particularly risk analysis – an evaluation of which risks you can take and not take is important – are retained. I would not want to overemphasise it, but I do take your point. Athol, who actually wrote those, may have some additional flavour on that.

**Mr Yates**—Firstly, I would say that, yes, it is a value judgment, and we have some concerns about it. That is why one of the recommendations we made in the submission was that there needs to be some formal evaluation of the issue of corporate knowledge, and particularly the way some organisations are pushing knowledge management as a solution to capturing corporate knowledge. A number of our members have been very concerned about this whole concept of electronically capturing that information, as if that is some sort of substitute for an individual.

The other issue to do with corporate knowledge is that, even if agencies do have it, because of time pressures, structures of contracts and the stovepiping of various activities with other agencies, very often people do not know who would have that sort of corporate memory and they would not be asked that and these people would not be asked to contribute to a solution. We see that coming up in our survey results; quite a significant proportion of people involved in technical contracts believe that they should have asked for advice on the issue but never did. So the issue there is not that the corporate memory does not exist, but it was not accessed.

**CHAIRMAN**—Would that not be equally true in the private sector?

**Mr Yates**—Absolutely. Nobody is denying that. This is not a unique issue. As we point out in our report, everything that is recommended in there is also applicable to the private sector, NGOs – to everything. The problem is of course that we do not have the same sort of formal investigative process of the private sector practices, and maybe that is something that should be undertaken.

**CHAIRMAN**—Might I suggest that you are unlikely to.

**Mr Yates**—Indeed.

**Mr Boshier**—I would like to make a point, if I may. In the private sector, by and large, there is the merchant banking community, the sharebroking community or the analysts who are publicly visible. So, quite often, there are third parties doing project analysis and, what is more, consulting engineers advising those merchant banks. As a result, you will find that it usually is – in my experience – put to a greater test in the private sector.

**CHAIRMAN**—But it does not always work, does it?

**Mr Boshier**—Absolutely not.

**CHAIR**—The hot briquetted iron plant for BHP in the Pilbara did not work too well, did it?

**Mr COX**—Technically it works fine; it just costs three times as much as was anticipated.

**CHAIRMAN**—But, technically, it did not work too well, and that was not all the union's fault, although I think they can bear part of the blame.

**Ms GILLARD**—And the Burnley Tunnel and City Link in Victoria.

**Mr Yates**—Also the Esso Longford explosion, where a lack of technical expertise was a contributing factor to that.

**CHAIRMAN**—I have not read the report. I have only read the newspaper reports of it. I was in process industries for some 15 years – between steel, mining and chemicals – and, in reading the report, I was appalled at the lack of knowledge of the plant operators of how the process worked. I could not believe it and could not believe that there were not procedures in place.

**Ms GILLARD**—On the question of loss of knowledge, I was interested in your recommendations about national data sets. Could you perhaps just flesh out the loss of, if you like, Commonwealth control of important data through contracting?

**Mr Yates**—Indeed. This is a long-running issue in our profession. In the past, there has been this public good equivalent of collecting data. The data was collected by scientists, engineers and so on to provide information, and they often did not know what was going to be done with it. It might have been for, say, flood levels. It is absolutely essential that this data be collected in a continuous series so that you can work out one in 100-year flood levels and so on. This information was often not used by the collecting agency but was used by local councils, developers or whatever. Because of outsourcing or contracting out, the data sets that have been collected have been transferred over to private ownership, or even worse is that the data is not being collected because it is of no direct relevance to the agency that, in the past, had collected it and, for cost-cutting measures, has stopped it. That information is absolutely essential to a vast range of activities; many we have not even thought of yet but which will be becoming more important for, say, greenhouse effects, the consequences of climate change and so on. So we would strongly advocate that there is some development of a national data set undertaken to work out what should be collected. That information should be available at a reasonable cost, not at the cost of collection but at the cost of the distribution of the information, and this should be a private-public partnership activity.

**Ms GILLARD**—So, when the Commonwealth contracts for a project of some nature, there would be a clause in that contract about data being shared back to the Commonwealth at the conclusion of the project. Is that the sort of thing you have in mind?

**Mr Yates**—Yes. During the operation of the project and at the conclusion. Whether it is supplied back to the government or supplied to some third party as a data broker is up to the individual contract. But, certainly, there needs to be a clause in it and that needs to be considered, because it is a public good; it is a public interest activity.

**Ms GILLARD**—In your submission you point to a number of difficulties with current tender processes. For example, you go through in some detail about the problem with very quick closing dates for tenders, notwithstanding that the evaluation period then seems to run out. I guess that, in looking at problems like that, I am still a little confused. You say the change in the way the Commonwealth approaches these things has been affected by two things: deskilling and the devolution from a centralised agency to various Commonwealth agencies. Do you think both of them are contributing to this problem, or is it one more than the other? Or is it a cultural problem that has always been there but just not addressed?

**Mr Yates**—I am not sure whether those two things are actually linked to this problem. This is a long-running issue to do with the request for tenders and tender documentations. The problem seems to be with the turnaround time; the amount of time established is just too short for most potential contractors. The problem is that, if you reduce that time between when you put out your call for a tenderer and when the tenders close, the shorter it is the more chance that you are going to get lowest cost type tenders because, if you have not had time to develop an innovative response to it, you are not going to put it in; you are just going to put in the same old approach that you did last time. So it does not do the Commonwealth justice if that occurs.

The other issues raised, to do with the quality of the request for tender documentations and so on, are a problem also in the private sector, but that is more related to those issues of devolution, mega-contracting and the loss of expertise to be able to define the statements of requirements or what the purpose of the whole contract is.

**CHAIRMAN**—You said you had read the McIntosh report on Collins. Did you read ours?

**Mr Yates**—Yes, the blue-covered one.

**CHAIRMAN**—Then you might recall that one of our recommendations was that the Auditor-General, as a matter of regulation, be allowed to visit contractor premises where Commonwealth property is held and to examine contractor records concerning any contract with the government, where that is deemed absolutely necessary. Do you have any objection to that?

**Mr Boshier**—If it is done as a matter of course, I do not think that it would have great efficacy. Where there is a demonstrable problem, that would be in order. But to have it as a routine way of doing business I think would lessen commercial accountability and would cause incentives to be inappropriate on the contracting bodies. I spent some time in the US a while ago and one of the main things there was in fact gaming the regulator and it becomes a diversion to the main game – the main game being running good contracts. I, and the Institution, would be sceptical of the value of that except in cases where, clearly, something has gone wrong and needs to be investigated. Our plea is for better expertise, and it is a cultural thing as much as anything. The message from all of the work that we are doing seems to be that the cost implications of not

accessing good expertise are not being appreciated and the personal danger aspects of not having good expertise have not been appreciated. Our plea is for the government to lift its game – to be an informed buyer – and this is both a cultural thing and about seeking the best advice. Our other plea is that much more attention be given to using registered and competent people. Governments should insist that they have competent people who are registered when they do this kind of work.

**CHAIRMAN**—Let me perhaps put this in the proper context. One of the difficulties that the auditor faced in the Collins contract was the cost to complete, which is something that always concerns this committee – that is, the total amount of money the Commonwealth has committed on a major project. The contract value all up, including some buildings, preliminaries and other stuff, was slightly over \$5 billion. We do not know what we are up for totally, but we could spend \$6 billion. You know as well as I that, when it comes to contract management, the total contract price may be able to be specified but determining the cost to complete – knowing what you have already spent and then determining the cost to complete to determine whether or not a contractor is going to be a viable operation to finish your job – is one of the greatest unknowns of all time. This is what occupies contractors' minds regardless of whether they are building a computer system, doing software, building a building or a complex power generation plant. The auditor, wanting to find out the cost to complete, found that the department's methodology in determining whether or not the value had been achieved was not good enough, quite frankly, and he wanted access to the contractor records and could not get them. We are not suggesting, nor would the auditor suggest, that he run around and examine every commercial contract for no reason whatsoever. But we are concerned that, when something has gone wrong and where the auditor has reason to question whether the Commonwealth should still be paying money, he has no right of access unless the contract says so, and there is no requirement that the contract says so. Do you understand the question now that I have put it in a better context?

**Mr Boshier**—Yes.

**CHAIRMAN**—Would it be impossible to write into the contract that if this whole list of circumstances arises then the auditor would have access?

**Mr Boshier**—Chairman, I think you have posed a question which is really an important issue. I would prefer to give you a written response on that matter. I think you have posed a most interesting and most important question. I would like to debate it with you, but I would rather give you a concise answer on paper, if that is all right.

**CHAIRMAN**—Thank you. If this eventually occurs, we foresee it as being an exercise on the most extreme and rare cases which might involve potential fraud or unethical trading or where the Commonwealth might be at risk of overpaying on a contract.

**Mr Boshier**—I understand the issue.

**CHAIRMAN**—That is the sort of context.

**Senator GIBSON**—In your submission, you make a strong point about the need to improve contract administration of the public and private sectors nationally. Your recommendation 15 is for the formation of an institute of contract administrators. In recommendation 20, you talk about the use of quality assurance and basically say that, provided all the conditions are met, that is a good thing too. Is an institute of contract administrators something the Institution of Engineers and perhaps the Master Builders should be setting up – in other words, a subset of your registration procedure for the Institute of Engineers? What are the practicalities of doing this?

**Mr Boshier**—Can I give a response, and then I am sure Athol will comment as the author. Yes, I do. That is why we said in the opening statement that we regard the Professional Engineers Register as a most important thing for Australia. At the moment, parts of the National Professional Engineers Register are the main pillars of engineering which are the colleges – chemical, electrical, civil, mechanical and so on. There is increasing acceptance of the register amongst state governments, particularly for pressure vessels and for public safety of structures, bridges, demolitions and all sorts of things. So we believe that the professional register should be expanded and that there should be explicit categories to do with public safety and all of that sort of thing. There is already a part of the register called 'management'. I think that is too vague and too broad, and we need to be much more specific. I will be promoting, within the profession, what you have just raised as being exactly what we need. I also think we need one on the analysis of major projects. There is a large number of engineers who do analysis, as we were saying, inside merchant banks. Some kind of quality control could be for them to demonstrate their competency and be on a register. Some banks will not worry about that; others will find it a valuable tool. So I think your suggestion is very important and goes further to demonstrate what we are on about on this whole thing. Athol may have an additional comment on that.

**Mr Yates**—As we noted in the submission, the reason the formation of a contract management institute has not occurred before is that it crosses all professional and paraprofessional areas. Therefore, any one organisation can only partly address the issue. It should be a privately run activity, funded by a large number of organisations – the MBA, ourselves and so on. The government would have an involvement in it, which I see as more in the way of facilitation, starting by bringing the players together and saying it rather than actually funding it. In fact, I would say that there should be very little or no government funding at all.

**CHAIRMAN**—Can I ask you a question about that. You propose to call it the ‘Institute of Contract Administrators’. Do you propose to change our organisation’s name?

**Mr Boshier**—No.

**Mr COX**—Is your main concern in setting it up simply to make sure that engineers are doing what they are competent to do, or is it that you think the areas in which people are not engineers should be reserved exclusively for engineers?

**Mr Boshier**—Learned societies, such as the Institution, were set up to promote and improve standards of behaviour and to promote best practice. We do that by all sorts of means, of course. What we are really saying here is that there seems to be a gap in knowledge or expertise and it is not top-of-the-mind good contract administration. We are trying to make it more top-of-the-mind. This may not be a permanent institute. Some of these things should have sunsets on them. We are really saying that we need to change the culture and improve the systems; so it might not be permanent. I do not know whether that completely answers the question.

**Senator GIBSON**—It does seem to me to be a fairly sensible idea. Just thinking aloud about government agencies looking to see where they can get hold of appropriate expertise, if in fact they can say, ‘Here is a list of 50 qualified contract administrators, and we can go through the list and see whether we can find someone who may consider coming to work for us for this particular project,’ that would be a help.

**CHAIRMAN**—Depending on what kind of contract – maybe not even depending, necessarily – a contract administrator or a contract manager might have any one of a whole broad range of initial qualifications but through experience can apply it to the business of contract management itself.

**Mr Boshier**—Exactly.

**Mr Yates**—We also see the institute improving the quality of standard forms of contracts, which is absolutely important, because often these things are developed in isolation for a particular area but they have applicability to other areas by changing it slightly or merging numbers of these together to take out the vested interests that sometimes occur because of the way a particular standard condition of contract has been formed.

**CHAIRMAN**—This committee has had complaints that some agencies are putting out contracts requiring unlimited liability. Have you had your members complain about that?

**Mr Boshier**—Yes, we have. Dr Miller is one of the main experts within the Institution on that. He is very worried about the issue of liability. It is one of the major issues that your inquiry will need to look at – I am sure you are getting into it, but it is a significant area. I do not have numbers of inquiries or concerns. Again, if you wish, I can follow that through. I am sure Dr Miller will be happy to give evidence on it.

**CHAIRMAN**—It would be valuable if we even knew anecdotally – qualitative analysis is always better but we are not likely to get it – that qualified contractors in whatever field we are talking about, whether it happened to be IT, building construction or defence stuff, were being turned off tendering, that is, refusing to even be considered to do Commonwealth work, because of unlimited liability being placed in the contract form. That is a big issue. We had some anecdotal evidence in the purchasing inquiry about that, didn’t we, fellow members? It is in the back of my mind that we did or, anyhow, that extreme contract provisions did reduce the number of players.

**Mr Boshier**—We will give you a response on that.

**CHAIRMAN**—Thank you very much for coming, thank you for your well structured report and thank you for answering our questions. We look forward to the additional information. As always, when we produce our report and we table it, we will send you a copy.

**Mr Boshier**—Thank you, Chairman and members. We have enjoyed being here.

[11.19 a.m.]

**BROUWER, Dr Elizabeth Catherine, Director, Performance Information and Assessment Section, AusAID**

**McCULLOCH, Mr Laurence, Director, Pacific Contracts and Policy Section, AusAID**

**FETTELL, Mrs Catherine Therese, Acting Assistant Director General, Contract Services Group, AusAID**

**McCRAWLEY, Dr Peter Thomas, Deputy Director General, Program Quality Group, AusAID**

**CHAIRMAN**—Thank you for your submission and for coming to talk to us once again. We like talking to AusAID. Do you have a brief opening statement you would like to make?

**Dr McCrawley**—Just a few brief opening comments, if I may. First of all, we are obviously pleased and happy to have the opportunity to talk to the committee. We would certainly be happy at any stage to provide further information or to come back again. The second thing is that on this side of the table three of us are reasonably closely involved in our contracts activity. Elizabeth Brouwer is here to talk about matters, if they arise, about performance information. She is from a separate branch of AusAID, but we are all working together on what we call the quality aspect of the delivery of Australia's aid program. We have a big emphasis on quality of contracts and we see the design, management, implementation and performance information aspects as about quality. So the theme is about quality.

The question arises of why this emphasis and why AusAID is saying this. The fact is that a lot of Australia's aid program is delivered not by AusAID but by a very wide range of other instrumentalities. In dealing with a range of other instrumentalities, we have a very large number of contracts. AusAID is pretty much intensively a contracting agency. I am not sure that many people outside in the Australian community know that AusAID is almost, in a sense, a wholesale aid organisation. The retailing, the actual delivery, is done by many agencies across the Australian community. Certainly there is the private sector and that is an important part of it. There are important parts of the public sector – different animals, if you like, in the public sector zoo. Perhaps the most well known of them would be universities and large organisations like the Australian Wheat Board which helps us to deliver food aid. We deliver quite a lot of work through non-government organisations as well.

There is a quick overview of our contracts. We are proud of this publication. It is an attempt towards transparency and provides a lot of information about what we do. If you open it at page 9, there is a very quick overview of the total value of the aid program in any particular year – \$A1.5 billion. Many contracts stretch over two or three years, so the stack of contracts varies.

There is a snapshot of the contracts given on page 10. On the next page at table 1 there is a listing of the different types of contracts. The largest single group is the so-called country and regional projects. The size of contracts for the country and regional projects varies enormously, all the way from \$100 million or more. One of our single largest contracts at present is the My Thuan bridge, which is being built in Vietnam, all the way down to quite small contracts.

At any particular time, we are managing a stock of contracts of about 1,000. Total value of those 1,000 contracts is about \$2 billion. This makes us one of the largest contracting agencies in the Commonwealth government. That means that there is an average value of contracts of about \$2 million, but that varies very widely, as I said, from \$70 million, \$80 million to \$100 million all the way down to quite a few small ones.

There is a break-up on the next few pages. I will not go through the whole thing in detail, but another quick snapshot is given on page 16, table 3, where, for convenience, we have listed our largest clients. You can see that when the document came out – we are almost a year behind now – ACIL had 17 contracts with a total value of almost \$200 million, and there is information on others. The 10 largest contracts by value are listed at the bottom of that page.

The rest of the document breaks up this information in ways that find it easy to sort it out. Table 5, which goes over 6 or 7 pages, has contracts valued \$1 million or over, so these are at the larger end of our contracts. If one turns over to table 6, there are contracts valued between \$75,000 and \$1 million, and in table 7 there are a rather large number of smaller activities. We put this information out with the aim of being fairly transparent. I should perhaps stop at this stage because you have our submission. I would be happy to either answer questions myself or pass them to my colleagues.

**CHAIRMAN**—Thank you for that. We asked you to come and talk with us and provide us with a submission because of the amount of Commonwealth money that you spend. We noted in your submission that you are presently undertaking a major review of tender and contract documentation. I understand you have over the last two or three years changed the way that you deal with these regular contractors in terms of

requiring preregistration of qualification to prove that they can do the job. What sort of major changes do you think you might be making to the tender documentation?

**Mr McCulloch**—Basically it is a review in the sense of looking at developing new major documentation. The reason for that essentially was that for quite a few years our current documentation has grown by incremental accretion as we take on board various experiences, lessons learned, changes in contract environment and legal precedents that may have been set. So we basically felt that it was time, rather than keeping modifying these documents, to start with new documents. We are in the process of doing that. It is approaching finalisation and we expect it to be implemented shortly, within probably the next month or so. That is the basis of it. The other basis was ease of use by our own staff, for example, that the suite of documents that we are currently developing is more user-friendly. It explains various clauses where you may want to use these clauses or not, for example, interactively and that will be on the screen. So it is a lot more user friendly, but it is also basically catching up. Rather than developing by accretion, we have drawn a new baseline and said, 'This is where we now are.'

**Dr McCawley**—We are trying to bring together what you might call almost scrappy documentation in the past. We are streamlining it and we are also putting it up on computer screens so that our operational areas who are not in this branch, the people out there who are running the projects, can call these things up on the screens, can work through them and can say, 'Well, this standard contract looks pretty good to me but I don't really need the following clauses.' That is the sort of thing that we are trying to do.

**CHAIRMAN**—Are you also involving your private sector in the new contract specification detail?

**Mrs Fettell**—It was a review not only of the documentation, as Laurie has said, also of the procedures, which resulted in a rewrite of the documentation that brought out inconsistencies and rectified that. Yes, we are involving the private sector community that we deal with by way of circulating the documentation to them in the final stages.

**CHAIRMAN**—And asking for comment?

**Mrs Fettell**—Yes.

**CHAIRMAN**—Will any of your contracts involve unlimited liability?

**Mrs Fettell**—Our contracts require professional indemnity that does not have a limit. But, as far as a dollar liability, no, we do limit that depending on the scale and nature of the project. The standard figure that is in our documentation to start with is usually \$5 million for a large, complex project, but if it is a small project it is removed.

**CHAIRMAN**—If I talk about culture, perhaps you can tell me whether my understanding is right or wrong. If I looked at the Department of Defence, without in any way asking you to be critical or otherwise, in the majority of contracts it would place a fixed price, fixed time contract with the contractor, stand back largely removed from the contractor and demand performance against some set of indicators. However, I understand that, with the way you operate with many of these contracts, the department is actively involved with the contractor in determining what needs to be delivered in the first place, how to go about delivering it and how to measure whether the contractor has performed or not. Is that reasonable?

**Mrs Fettell**—That is a true statement. In our larger projects, for which we have designs agreed prior to tender and to implementation, it is actually the contractors that do the designs for us. Therefore, they are intimately involved in describing the activity, what is needed and the performance standards, et cetera that are in the design and then in the scope of the documentation. Laurie, you might want to speak about what we are doing with those design documents and about the tender process on the Internet.

**Dr McCawley**—Just before you do, Laurie, I would say that, yes, it is true that AusAID is fairly closely involved in the implementation of any particular activity. We have a range of monitoring. There is always a balance of course; it would be inappropriate to micromanage the project. There is a contract and the contractor wants to get on to do the job, but at the same time we work fairly closely with contractors. Quite obviously, a particular feature of our activities is that many of them are in developing countries. So if you are in Cambodia, Eastern Indonesia or some place like that, and inevitably the situation is often quite changeable and there are diplomatic considerations both in dealing with the government and in looking after the position of Australians in the field, we have to interact quite a bit. Also, there is a high degree of risk. Usually the developing country environment is a difficult one to work in: rules are often not clear, the law is often not clear and there are often certain degrees of flexibility, and so we have quite a lot of interaction all the way through with our contractors. Laurie, would you agree with that?

**Mr McCulloch**—I would agree with that. I think there is a high degree of interaction. There is a high degree of monitoring, which we try to make proportional to the envisaged risks that we see at the start of implementation. This is covered in our submission. For example, we might consider a project a high risk or a

complex one and quite often we would supplement the monitoring by the use of technical advisory groups, which are independent groups and will go in and report on progress and any difficulties perceived, et cetera. There is a high degree not only of interaction but also of dialogue with the contractors. We are trying to increase that all the time. By that I mean the level of dialogue we enter into with contractors.

**Mrs Fettell**—Just the nature of what we do, with the exception of the construction contracts that we enter into, means we really cannot step back from it and just let it manage itself; it is just not feasible to do so. Even our construction contracts do not allow us to do a lot of that simply because, as Peter mentioned, of what might happen in the recipient country. There might be a contract signed for construction to commence on a certain date to fit in with a certain time frame but access to the land has not been provided by the recipient, so you cannot step away from some responsibilities in those respects. But it stops short of micromanagement, as Peter mentioned.

**CHAIRMAN**—Could you remind us of the last performance audit that the Auditor-General has done on AusAID projects?

**Mr McCulloch**—I could not say when the Auditor-General last did one, not off the top of my head.

**Dr McCawley**—We have a fairly intensive relationship with the office of the Auditor-General. I do not recall when they have done a performance audit on us, but the links are very close. For example, we have an audit committee which meets once a month and there is a representative of the ANAO that normally comes along to that committee. The representative has a pretty good idea of what we are doing and sits there watching our flow of audits. In addition to this regular monitoring, the ANAO usually do several reports on us a year on one or other selected aspects of our activities. But, as for an overall report, we would have to check that.

**Mr McCulloch**—The last major one I can recall was of non-government organisations, which was roughly four years ago.

**Dr McCawley**—We had better check this and give you the information.

**CHAIRMAN**—I recall us talking to you about this contracting issue in our review of one of the AG's reports some time in the last two years, I thought.

**Mrs Fettell**—It must have been before I got here.

**CHAIRMAN**—Maybe my memory is not what it ought to be. Your risk management procedure, because your risks are fairly high –

**Dr McCawley**—Yes.

**CHAIRMAN**—Obviously you take risks, therefore you need to manage them. I think I am informed correctly that there was a time when you attempted to manage as if nothing could ever go wrong, whereas now you are willing to accept that some percentage of the time something is going to go wrong and you try to manage that. Is that correct?

**Dr McCawley**—Yes. The methods of operation have changed significantly over the years. If you had looked at us 10 or 15 years ago, we did a lot of our work through Commonwealth agencies and, in a sense, in a vague sort of way, we shared a lot of these things. When activities ran into problems, which they often do, we tended simply to carry on a project for a little bit longer. Like many other parts of the Commonwealth, we have moved to a more disciplined approach to risk. We have been involved in fairly close dialogue with our private sector partners, the sorts of firms listed in this booklet. We have been discussing and defining risk more openly. We held a largish workshop with them before Christmas where about 40 or 50 of the public and private contractors came along and we discussed all sorts of risks, worked through them and put it on the table and said, 'Look, we haven't talked as much as we might have in the past about risk. Let's put it on the table. Let's define the risk and talk about who is going to accept this risk. We expect you, the private sector or the public sector agencies, to bear a range of these risks, financial risks and other sorts of risks, and we in turn will have to bear some of them.' We now have a policy towards risk and we are continuing to try to define what one means by risks, to give names to the different types of risks and to work out specifically who will carry those risks.

We are also now more explicitly saying to the firms we deal with, 'By and large, we are expecting you to bear quite a few of the risks and we would expect in turn that these will be reflected in the contracts. We understand that. Where there are risks, you might wish to insure yourself against them or you will have to make some actuarial judgments as to how those risks affect you. We understand that. But, instead of it being vague, we want it on the table, open, and we want to talk about it.' Have I summarised that correctly?

**Mrs Fettell**—That is exactly it. The issue of allocation of risk is identified in the project design at an early stage and contractors take that into account in their tender.

**Dr Brouwer**—We do work – and I think the context was referred to earlier – in a difficult environment with our partner governments. That is an element that needs to be taken on board and is taken on board right up-front, not just the contractual delivery issues that may cause risk but the relationship with the partner government and the context in which the contractor and the aid program is operating. In our design preparation process, we now require that an important element of that thinking through of the design to finalisation is to conduct a risk management workshop, not just between the contractor and the immediate stakeholders but key people within the partner government, the agency that will be involved in delivering the program, because it is a program that is delivered by the partner government with the assistance of the Australian contractor.

Other stakeholders are NGOs, community groups and other government agencies that may have a bearing on it, like finance ministries or other institutions that are interested in the performance of that agency with which we are collaborating. So that has been strengthened very much in our revised procedures for preparation of design, and some of our recent assessments of quality of projects during implementation found that those projects that are the most effective and are achieving a higher quality standard were ones that did a fairly thorough analysis of those risks prior to the contract commencement and are managing those risks through implementation.

**CHAIRMAN**—Do you keep adding new contractors to the list, or is it a closed shop?

**Dr Brouwer**—Do you mean in terms of the individual activity?

**CHAIRMAN**—No, in terms of who you do business with.

**Mrs Fettell**—Winning contracts.

**CHAIRMAN**—It is a bit of a closed shop, is it not?

**Mrs Fettell**—Yes and no. There is a perception that it is, and there is a lot of work on the part of AusAID to change that. Certainly in some sectors, for example perhaps the health sector, there is a perception that it is a closed shop, that you have to have the experience in developing countries to be able to do the work that AusAID is tendering. But to counteract that we frequently conduct what we call Access AusAID seminars around Australia and in developing countries to tell the private sector, and anyone interested for that matter, individuals and organisations, of the opportunities for work in the aid program. We do that both in sectors and just generally in different regions.

**Dr McCawley**—We do try quite hard to open up the game, but it is in the nature of the game that a lot of the new firms that come along and talk to us have almost no experience at all in developing countries. Then there is a problem we have found in the past, that if you get entirely new people who have no experience in developing countries, frankly, they are often learning on the job at quite a rate. So it is a bit of a dilemma: on the one hand you want reasonable experience, but we do not want reasonable experience to be a barrier to new entry and we try and find the middle ground. One thing that we certainly have done in the past three or four years is fairly generously and aggressively used the Internet, the web. It is now fairly easy for new firms out there to get information. But there is still that hurdle of experience. One of the things that we suggest to them is that in the first one or two projects it might often be good to work with an existing firm to get some experience, to form some joint ventures. Of course, sometimes they like doing it and sometimes they do not. It is this problem of experience in developing countries that is a difficulty.

**Mrs Fettell**—I might add that one of our reforms last year to our selection procedures that John Russell and I came and talked about last year was related to this very issue, and that was how do new people get into the game. We have introduced what we call non-scoring positions into some of our teams where appropriate. The team going into the selection of a contractor to implement a project will include the provision of a team in-country, and where possible we have designated positions on those teams as non-scoring. What it means is that in the technical assessment and the selection of the winner that position does not score, so then the winning tenderer can in fact put a new chum in it that can learn. It is not a team leader position, it is usually not a key position, but there are opportunities there for people with no experience to be included and not have the negative thought in the tenderer's mind, 'If I put someone in here that is inexperienced it is going to affect my ability to win this.' So there are quite a lot of things we have done at different levels to encourage involvement of new people and new organisations.

**Mr McCulloch**—We do try and encourage new players very vigorously. As an example of that, in Western Australia we did an Access AusAID seminar I think last August, and the Department of Commerce and Trade then got requests from various participants to get more information. So we then hosted a two-day workshop with about 20 participants, private business people, organised by the Department of Commerce and Trade in Western Australia, who came over and we explained in great detail to them about how AusAID works and how to try and break into the system. We also do a lot of briefing of contractors face to face and trying to get them



some experience in terms of the level of documentation and the type of documentation that a good bid comprises and give them various tips on how to configure, if you like, bids in a general way.

**Senator GIBSON**—I have a more general question. This committee has had a fair bit of experience going back some years of poor contract definition and management, particularly with Defence, and other examples have been brought to our attention by the Auditor-General. Many of the submissions made to the committee for this inquiry are actually saying that there is not enough technical or managerial expertise within Commonwealth agencies to do this job oftentimes. This morning we have had the builders and Institution of Engineers again making the same point. In fact, the Institution of Engineers brought to our attention their recent publication, and one of the recommendations in that, recommendation 3, says that government agencies should employ a model to ensure they have access to the appropriate level of technical expertise – I would add managerial expertise. It gives four steps for managing that. I am just wondering aloud a bit. You manage a very large number of contracts. Could this committee pick on a sample at the larger end of your contracts and ask you to go back and look at the steps in here and what actually happened in retrospect on some of the current projects, and how you identified the level of technical and managerial expertise to actually set up the contracts and then to manage them through?

**Dr McCawley**—Yes, we can do that. Should we perhaps, in cooperation with your staff, determine how many projects: five, 10?

**Senator GIBSON**—I think we as a committee could bounce that around ourselves and perhaps let the staff come back to you.

**Dr McCawley**—Okay. You have a sort of sample.

**Senator GIBSON**—That is excellent.

**Ms GILLARD**—In your submission you make reference to preservation of corporate memory. You talk about staff mobility and the difficulties and inefficiencies that are associated with the loss of staff and retraining. Given the nature of the work you do, can you explain the steps you take to make sure that staff within AusAID are across the issues that we are talking about today? I am particularly interested in how you would train people to use the computer screen contract option system that you were describing before as one of the products of the review that you are engaged in now.

**Dr McCawley**—There are two angles to it. One is the expertise, the skill and corporate memory we have in the so-called CSG, the contract services branch, which is the heart, the library, if you like, of the agency as far as contracting services go. In a sense this branch deals with a set of clients out in the agency, our so-called country program managers who are working with programs in Indonesia, the Philippines, Thailand or whatever. So there is an interaction between these two aspects of the agency. In the contract services branch we have a good core of knowledge and we also have turnover, and that has got pluses and minuses. It works in various ways. We have a stack of what we might call old hands, and Laurie and Cathy are two of them, who have been there for a long time. AusAID is extremely well served by having these old hands in our corporate memory. We also, however, are pretty nervous about all of this and we are pretty aware of the risks. Very few things have gone badly wrong. I cannot think offhand of things going badly wrong, but we feel we have to watch it. So we have got a fairly intensive system of training inside AusAID. We have got a series of short courses covering the following sorts of things: introduction to contracting, contracting terms and conditions, managing the contract – contract law is quite a popular one – and so on. We are pumping out the message to our staff that, while they cannot be specialists in this area, they have got to know enough about it to run the show. We also hire specialists, by the way, where we need specialists. We have an in-house lawyer who sits just a few doors away from each of us. That in-house lawyer is outsourced from the Attorney-General's Department. He has been with us for quite a while now, so he knows us quite well. There is a regular stream going to see this guy all the time, talking about all of these aspects. This is in the contract services branch.

There are also the people down the corridor who are running the projects. Some of them at least attend these courses; not all of them but a lot of them attend these courses. They are strongly encouraged to. More generally, we send out the message across the agency, 'Contracting is an important part of what you do. You have to have a reasonable knowledge of it and you have to know that as soon as you run into a problem of any sort you come to the contract services people or you go and see the lawyer, or if necessary we get in legal advice.' For important activities we hire in legal advice. Having done all of that, there is still some risk involved, but that is the way we tackle it. We take it pretty seriously. There would not be a week go by without discussions throughout the agency of the importance of contracts.

**Senator GIBSON**—Do other Commonwealth agencies come and seek your expertise?

**Mrs Fettell**—That has happened on many occasions. Because we have been doing this sort of thing for so long, and even though we have just done a complete review of the documentation and improved it greatly,

there have been many occasions, to my personal knowledge, over the years where other agencies have asked us for our standard pro forma contract, for our standard pro forma RFT, request for tender, for use in an exercise they were about to undertake. They also ask for advice as to our procedures and our policies. It has happened quite frequently, to my own knowledge.

**Senator GIBSON**—Could you give us a note about the sorts of advice you have been asked for by other Commonwealth agencies in recent years?

**Dr McCawley**—Yes, we can. Again, I come back to the point that our contracts tend to be in developing countries, which changes the nature of the relationship. Nevertheless, we can certainly provide information.

**Mrs Fettell**—We even had a request the other day from a private sector firm for our form.

**Mr McCulloch**—That is quite common.

**Mrs Fettell**—We put out the draft contract with our request for tender in the tender stage anyway, and we put them on the Internet just as a matter of course, but we had a specific request the other day from a private sector contractor for our suite of contracts. That was just something easier for him.

**CHAIRMAN**—They think you are getting better, or some of them.

**Mr COX**—You say in your submission that your contracts always include access either for AusAID, a nominee of AusAID, the Auditor-General or a delegate of the Auditor-General to conduct an audit of the project financial records held by the contractors and the contractors' financial management systems and procedures. What are the criteria for deciding whether it is AusAID, a nominee of AusAID or the Auditor-General that has that access?

**Mr McCulloch**—Going back to our audit procedures, our own internal audit section on an annual basis will draw up a plan, after consultation with various areas, of priority contractors or other entities to be audited. These days audit section engages private auditors through a period contract system, so they are on call over a number of years. We found this was beneficial because the auditors who were contracted developed expertise on what is required and the approach. Audit section would decide after consultations, or they would have a core program of who is to be audited. From time to time, if a particular desk area, for example, had a concern about a contractor, they could go and request some sort of audit to be done on that particular contractor.

**Dr McCawley**—We have an annual plan. The annual plan comes to the audit committee. The annual plan is prepared by the internal audit section consulting around the agency, and we do that I guess on the basis of sniffing around. We see which areas have problems. The Philippines desk area or someone might say, 'I am a little bit concerned about the way this firm has been running in that area. I wouldn't mind you doing an audit.' We pick all of those up and then look at them. Then the audit staff sift through. The audit staff consult with the relevant branch head, who is not here today, and on the basis of that a proposal comes to the audit committee.

**Mr COX**—Is there any reluctance amongst your contractors to have those clauses in their contracts?

**Dr McCawley**—I think they have accepted them.

**Mr McCulloch**—We have not received any complaints about having those clauses in the contracts.

**Mrs Fettell**—The contractors have accepted that it is a part of doing business with AusAID.

**Dr McCawley**—It is part of the game; they know that. They are not enthusiastic. When we let them know that we are going to audit them it is not an enthusiastic response, but it is accepted.

**CHAIRMAN**—They do not come to you at tender stage and say, 'You have this item in the contract specification and it is going to cost you another \$1 million because you might come and look at my books.'

**Mrs Fettell**—No, they do not say that sort of thing at all. They might think that. This is not a problem that we have encountered.

**Dr McCawley**—They all know they are up for audit and they must expect in any particular four or five-year period that they will get audited; they know that.

**Mr COX**—How often would the Auditor-General go and have a look?

**Dr McCawley**—I do not think the Auditor-General himself has a look, although he does of course have access to our reports by virtue of access to our audit committee. One of the questions that we often ask on the audit committee is this: are we satisfied with our audit process? The representative of the ANAO sits in on that discussion. We have a discussion around the table and I, as chairperson, will turn to him and say, 'We are keen to hear comments from you. Are you satisfied that this process meets what you would regard as acceptable standards?'

**Mr COX**—Can you give us a copy of the clauses that relate to auditors and AusAID access for the purposes of audit and also check whether the Auditor himself has ever delved into your contractors' performance?

**CHAIRMAN**—It would be good to hear.

**Mr COX**—He might have had a look but not reported it to the parliament.

**CHAIRMAN**—To the best of my corporate knowledge, he has never gone in and looked at contractor records with respect to these contracts, but we know he would like the right to do so, if it became necessary.

**Mr COX**—Regarding the excellent statistics you have given, do you keep statistics on the number of contracts that are won by Australian companies for multilateral agencies?

**Dr McCawley**—No, we do not keep them. We could try to get them. There are a large number of international agencies. The main ones would be the World Bank, the ADB and several UN agencies. We do not keep them, but an indication could be obtained. I was Australia's representative at the ADB for four years and the ADB maintains fairly good statistics on that. I presume the World Bank does as well. Several of the main UN agencies would. There are a long number of UN agencies that are not that important in terms of the amounts of the contracts that are let, but we could attempt to get some information for you if you want it.

**Mr COX**—Yes, thank you. Do you take an active role in assisting Australian companies to get contracts with those organisations?

**Dr McCawley**—In a sense, yes. We hold regular what we call access AusAID seminars around Australia. They are held pretty frequently. There is going to be another one in Melbourne. Our staff – Carolyn Brennan and others – are going down. It is often the case – but not always – that in this context we draw attention to opportunities in the World Bank and the ADB. It so happens that I brought with me the latest publication I have received from the ADB – this is a monthly publication – about opportunities. We often draw the presence of these and access to them to the notice of Australian contractors and we encourage them to contact our representatives at the ADB or the World Bank. Australia is quite active. The answer is: not always, but frequently. We do not take the additional step, although we have on one or two occasions in the past. We see it as the main job of AusAID to facilitate the direct contact between Australian firms and the banks. You could say that we are friendly – we do what we can – but we tend to hand them over to Austrade when they start saying they would like to have a delegation to go to the banks and so on.

**Mr COX**—Do you think that other countries take a more active role than Australia does in pursuing such commercial opportunities?

**Dr McCawley**—No, I do not think so. It is hard to judge. In my experience, there are always complaints from different countries. Business firms in Australia tend to say that the Canadians, the French and the Germans are better looked after. If you talk to the Canadians, the Canadians will tell you that the Australians are better looked after. You tend to get a bit of cherry picking around the place. I think that on the whole Australia and Austrade work quite hard at it. What I have perceived over a number of years is that there are opportunities that we could be working on. An important part of the problem is that a lot of our skills – not all – are locked up in the public sector. It will be a big challenge in the years to come for Australia to somehow spring some of those skills loose. This is changing as public sector agencies become more flexible. When you think of the sorts of skills in Australia – agriculture, management of ports, marine, railways, electric power supply, universities and health facilities – many are in the public sector. Some of them are becoming more flexible. I had a dramatic illustration four or five years ago of these problems. I was talking to someone from the Victorian electric power industry – a middle level manager – who said, 'I am not allowed to make international telephone calls without getting a clearance.' If they see something in this book and want to inquire and they are not allowed to make international telephone calls, that is clearly a barrier to trade. Some of the problems are our own.

**Mrs Fettell**—Of course, experience gained by Australian contractors on AusAID projects puts them in very good stead for winning jobs with other agencies.

**CHAIRMAN**—Yes, but we would make the point to you that experience generally of suppliers and contractors of Australian goods and services to the Commonwealth government is invaluable as a reference to winning contracts for the supply of similar goods and services overseas. Thank you for your submission. We will appreciate receiving the additional information. Is it the wish of the committee that the document entitled *Business Participation: Australia's Aid Program 1998-99* and presented by AusAID be taken as evidence and included in the committee's records as exhibit No. 16? There being no objection, it is so ordered.

**Proceedings suspended from 12.03 p.m. to 1.08 p.m.**

**CHALKER, Mr Graham John, Federal Affairs Adviser, Australian Business**

**WESTON, Air Vice Marshal Brian George, Executive Director, Defence Industries, Australian Business**

**CHAIRMAN**—I welcome representatives from Australian Business to today's hearing. We have received your written submission and now invite you to make a brief opening statement.

**Mr Chalker**—Thank you, Mr Chairman. Australian Business welcomes the opportunity to provide comment on this important issue of contract management in the Australia Public Service. Australian Business is an independent broad based business improvement and membership organisation with a history of more than 110 years. I guess a lot of people are a bit confused about who and what we are with the name. We were formerly the Chamber of Manufactures of New South Wales. Two years ago we changed that name. We have now got over 5,000 member companies, eight regional offices and two affiliate offices in Newcastle and Wollongong.

Government procurement continues to be an area of considerable interest to a large number of our members. To confirm the significance of that, last year Australian Business established a defence industries unit in our Canberra office. My colleague Brian Weston will say a few words about the sort of work that they do and some of the things that they have achieved over the last year.

We are generally supportive of the government's desire to make a greater use of commercial tendering in contracts but we feel that there are some problems in the way the policy is being put into practice. The concerns we get are predominantly from our smaller members. They feel they are often disadvantaged when contracts are bundled together and by the attitude of the government purchasers, which makes it difficult for small business people to overcome and win contracts. There seems to be a mindset in a lot of government areas that large contracts that favour large suppliers over smaller ones will give them a better outcome whereas, in fact, a lot of times small business can provide a cost-effective service.

We would like to see a great deal of improvement in the areas of uniformity of contract procedures and documentations, which often work against our smaller members. We have had a number of complaints particularly about the provision of consultancy services, and one really irksome feature for these people is the short time frames in which they are often asked to prepare bids. They often complain that they are asked to submit tenders for projects when they really have little or no chance of success. They contend that they are often being asked just to make up the numbers.

I recently got a letter from one of our members who was asked to tender for a government agency contract. He thought that he could perform the consultancy services more than adequately but found that, when he asked for documentation administration papers for the contract, it was out of all proportion to the size of the consultancy. He turned his printer off after 50 pages of an electronic copy had come through for him. He said that the time taken to fill out all those requirements, to specify referees and so on just would not have made the job worth while. The description of the project itself in those 50 pages took about six lines, in fact.

Members have also made complaints about the fact that, in the bidding process, they often find that information is passed on to winning bidders to facilitate their work on the assignment. They are concerned that their intellectual property, which they have developed, then goes to the other firm. They would like to see a greater transparency and equity in the letting of contracts for consultancy services, and that would benefit both suppliers and departments. Delays in payment of contracts are still a great problem for many of our firms. When I requested some input for this inquiry, we had many complaints from both large and small firms. We continue to receive complaints about the length of time it routinely takes to pay an invoice. Particularly for small firms, waiting for periods of around two months for payment can be a common occurrence and it creates significant difficulties for both small and large suppliers. With the greater use of e-commerce, we think that some of those things could well be overcome. I will pass over now to Brian Weston to make a few comments about the defence unit.

**Air Vice Marshal Weston**—The Department of Defence is a very large organisation and some of our members, both large and small, can find it difficult and confusing to do business with. My role is to assist them to understand the department, to represent their issues with the department, to advise them as a free consultancy service, essentially, of Australian Business and to assist them in assessing what course of action they should take. We understand that Defence signs one contract every 30 seconds every 40-hour week with industry. Defence is obviously a major buyer, and therefore we and our members are concerned that Australian Business and industry have a very good relationship with Defence and that that money is spent in Australia. So we are very positive and we support the Department of Defence doing business with Australian industry.

However, the department is rather process driven. Our members tend to report that often the process is confused with the outcome. Whilst we acknowledge that there must always be probity and a clear process in

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government departments that are spending the taxpayers' dollar, it is also very important that some commonsense towards the required outcome is kept in view. We often find that Defence contracts rarely specify an outcome. They go into excessive detail and specify not only what the contractor must do, but how that contractor must do it. They would say that an item has to be cleaned with a certain product so many times a day to a certain standard, rather than simply to specify that a certain workplace item or equipment must be presented in a clean condition.

I guess that is a practice that has grown up over the years, and it probably makes it a little easier later on for the department to correct a contractor who is not doing the right thing. But, on the other hand, it also puts a very excessive cost overhead on business trying to respond to such contracts, and it does not allow contractors to use new ways of doing business or alternative methods and innovation to do the job perhaps more efficiently and to achieve the outcome at less cost to Defence. We think that the outcome, not the process, should be the focus.

Defence contracts are tending to become draconian, as one member described it – and this is particularly so for smaller companies – as they require very large financial guarantees and indemnities in terms and conditions that may be a standard contract but one drawn up more appropriately for a large company than for a smaller company. We think that some of those terms need to be modified to bear in mind that there are a large number of smaller firms out there for which guarantees and indemnities in terms and conditions need to be more appropriate to the company.

In summary, doing business with Defence is very important for Australian Business. It does however require a long-term commitment from their members – we have explained that to them – and there are some costs up-front. But we do conclude that it is important to keep doing business with Defence. The department should aspire to always reduce that business risk because, in the end, it ultimately comes back to lower costs for Defence.

**CHAIRMAN**—In your submission, one of the things you called for that I have noted particularly is that governments at all levels should attempt to standardise general terms and conditions for contracts. Would you like to tell us why?

**Mr Chalker**—This came from a supplier who supplies to Defence and also to state governments and government agencies. He finds that he often gets very similar contracts for similar goods, but the terms and conditions are such that he often has to bring on board a legal person to go through them because they are slightly different. He believes that, if he could have similar general conditions in there, it would save him and probably the department a lot of time and effort if, where the variations occur, they are put perhaps in an attachment to it.

**CHAIRMAN**—With all due respect, this inquiry is not about purchasing pencils and paper; we are talking about contracts and contract management in the public sector. Surely the business that complained to you does not find identical terms of contracts with all the private sector people that it deals with.

**Mr Chalker**—No, not necessarily.

**CHAIRMAN**—Not necessarily; absolutely!

**Mr Chalker**—We are talking about the way to make things more efficient. He believes – and I think there is some reason for this as well – that time could be saved if there was some uniformity from contract to contract when similar products or services are being supplied. The department could save itself some trouble as well.

**CHAIRMAN**—Surely we ultimately get to best practice by allowing freedom of enterprise. If we were to say to the government, 'We think that some bureaucrats should sit down and write the world's most perfect set of terms and conditions of contract and everyone shall use these terms and conditions of contract,' we would be going back about 30 years, wouldn't we?

**Mr Chalker**—I do not think, necessarily, that the whole of the contract has to be standardised, but there are certain conditions in the terms of indemnities and methods of payment and so on that could be. As an organisation, we use a standard contract when we are purchasing a product, but there are variations in that. We allow those variations, and we identify them.

**CHAIRMAN**—Are your terms and conditions of contract the same as those of your competitive employee organisations?

**Mr Chalker**—I cannot say yes or no because I do not know. We are ISO 9000 quality assured, and we use some of the recommended things that they have come up with. We go through the ISO procedures. I think that the standards organisations supply some of the broad framework that we use.

**CHAIRMAN**—In your submission, under the heading 'Expressions of interest', you said:

Consideration should be given to making greater use of Expressions of Interest before formal tenders are called. This would allow non-complying tenderers to be eliminated before they go to the time and effort of completing a formal tender.

I am a little confused by all that.

**Mr Chalker**—Again, people have said to us that they have put in what they believe to be compliant tenders for a particular project and have found that, over a period of time, tenderers who did not comply with the terms of reference in fact got the jobs. What has sometimes happened in the process is that the purchasing officer has decided that maybe there is another solution to a particular problem, but other people who have tendered have not realised that there was that flexibility in the process. We are saying that, perhaps when departments ask for expressions of interest, they should be prepared to say, ‘We will take something that may be not necessarily compliant,’ or they should at least ask for an expression of interest in the first instance.

**CHAIRMAN**—I do not understand exactly how the expression of interest satisfies that issue.

**Mr Chalker**—Perhaps there should be an earlier round in some of these that allows for people to come in with some broader solutions rather than looking for a very technical requirement.

**CHAIRMAN**—One of the things we said we were interested in was whether or not the Auditor-General should, in all Commonwealth contracts, have right of entry if necessary because of concern about probity or fraud or whether or not the Commonwealth has paid too much or that the contract value is overexpended. Should the Auditor-General have the right, as part of the contract terms and conditions, to examine contractor books and to enter contractor premises where Commonwealth property resides which has been paid for? What would your members views be of such provisions?

**Mr Chalker**—I know that, in a number of government contracts that I have been involved, there certainly is a requirement for an independent audit to be undertaken. I would have thought that that requirement would be in most contracts. I do not know whether they have thought through exactly whether the Audit Office would come in or not.

**Air Vice Marshal Weston**—From the defence industry side, my perspective is that a carte blanche requirement is excessive. There are other mechanisms to ensure that the Commonwealth gets good value for money, and in the contract there could well be requirements for essentially open-book examination, which many contractors are willing to do rather than to provide the Auditor-General with unlimited access to a contractor’s premises. We argue that there are probably other avenues to ensure that the government gets good value for money rather than to allow total access.

**CHAIRMAN**—We are really talking about exceptions; we are not talking about a general rule. I can tell you that the ANAO is not funded to examine every contract that is let by the Commonwealth government, nor is it likely to be and nor are we likely to recommend that it be, but under exceptional circumstances.

**Mr COX**—Fraud.

**CHAIRMAN**—Yes, and where there is reason to believe that the contract cost control mechanisms have failed and that the Commonwealth is advancing more money than is of real earned value. In terms of the contract, the Auditor-General should hold that right, as a right of last resort, to protect the Commonwealth’s interests.

**Air Vice Marshal Weston**—With respect, we would still encourage other avenues to be used. The industry believes that an intelligent customer and an appropriately qualified contractor should be able to have a contract which does not have to resort to such a draconian measure by the Auditor-General.

**Mr COX**—Such as?

**Air Vice Marshal Weston**—It is essentially a matter of privacy, commercial-in-confidence. It could destroy that contractor’s business by the exposure of intellectual property that that contractor has developed and values highly. Competitors could get such an advantage from an Auditor-General’s report that that contractor could no longer be viable.

**CHAIRMAN**—AusAID representatives were the last respondents to our inquiry this morning. One hundred per cent of their contracts require, if necessary, an external audit and/or Auditor-General access to premises and records. They constantly tender, they administer thousands of contracts and they have a contract budget running at \$2 billion under contract at any one time. They say the contractors that work for them are quite happy to sign the contracts.

**Air Vice Marshal Weston**—I do not speak for that part of the industry but I would note that there is probably not the degree of intellectual property in providing those sorts of goods and services that AusAID would seek, compared with the intellectual property technology that is available in a Defence contract.

**Mr COX**—But where Defence contracts were examined by the Auditor-General, the Auditor-General would not be reporting on the technology. He would be reporting on the contractual arrangements, whether the

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money that had been paid had been paid in accordance with costs incurred and whether there had actually been fraud.

**Air Vice Marshal Weston**—The department is very strong on developing schedules that are paid on earned values. There are already mechanisms in place in Defence contracting. Indeed, they have a directorate in the contracting branch that looks at developing proper models for earned value contracting, so I think there are other avenues that show that there is a degree of maturity at that level of contracting but there are reservations that that would be an excessive use of the Auditor-General's powers.

**Mr COX**—One of our difficulties with Defence is that quite often they say that the trail vanishes off somewhere into the contractor's activities and, because of the legislative limitation and contractual limitation, the Auditor-General cannot get at it. There is a real issue of accountability and transparency there that is not being dealt with by Defence's present arrangements. I would say, from the experience of this committee to date, that it is the inadequacies of Defence's processes that are probably informing the committee's growing view that there is a need for this kind of accountability and kind of access.

**Air Vice Marshal Weston**—I have just read the Inspector General's report into the two amphibious landing platforms, which was covered by a report by the Chief of Navy. I think that was a good report. That has exposed a number of issues in Defence and possibly with the contractor. The salient point from the contractor's point of view was that the initial contract was a relatively small contract but it grew by a very significant margin. One of the major difficulties was that that contractor was not assessed for a \$430 million contract; it was assessed initially for something like a \$35 million contract, and the problems came out of that contractor having to embark on a project that he had not envisaged in the first place. That is my brief synopsis of the Inspector General's report. There is no mention in there of that, other than the broad management difficulties that a relatively small contractor had when his work, from being a relatively small operation, grew very large into a very large operation.

From talking to other industries, I know Defence does spend an enormous amount of time devising its contracts. Contract negotiations take a lot of time before a contract is solved, and the cost of business is quite significant for business to do business with Defence. I just think this is another disincentive that does not encourage Australian industry and business to do business with Defence. One of the points that come up continually in the defence industry is that business does business in the defence sector with each other relatively expeditiously with not excessive overheads but, when the contract is with the Commonwealth, it becomes a far more difficult process with very significant costs involved. This would be just another business risk; a business risk requires a premium and the premium will have to be paid by Defence.

**CHAIRMAN**—The Institution of Engineers, the Master Builders Association and the Royal Australian Institute of Architects have all decried what they say is a loss of technical expertise across Commonwealth departments which, according to them, should be used for contract management. Do you have any comment on that?

**Mr Chalker**—I think we would agree with that. When we talked to this committee a year or so ago in the purchasing environment, we instanced in perhaps more simple purchasing areas that certainly our members had spoken to us about loss of expertise in purchasing because of devolution of purchasing authorities. They found that it was very difficult to do business with the lots of bits and pieces, whereas in the past they always did business with more of a central area in each department. So I guess I have heard of what the Institution of Engineers are saying and I would think that at a broad level that sounds quite plausible.

**CHAIRMAN**—You are talking about different issues here. We are not talking about devolution of responsibility; we are talking about technical expertise to manage contracts. Don't confuse the two.

**Mr Chalker**—I would have thought there were some similarities, though. We find that our members who are in much smaller and simpler areas do find, particularly in consulting services, that they are dealing with people who do not have the expertise to manage the contracts that they are dealing with.

**CHAIRMAN**—But do they find their experience with the Commonwealth a different thing than dealing with a multiplicity of public sector companies?

**Mr Chalker**—I am not saying it is necessarily totally different. But a lot of these people do a lot of work with government and they believe it could be done better and could be made more efficient both for them and the user of their services.

**CHAIRMAN**—Efficiency might be just one thing. We might say it was horribly efficient to have a central department to do all the purchasing – but it was not. That tends to produce the same sorts of outcomes and be risk averse and all the rest of it. There are 20 or so Australian government departments. The issue is why they should be identical when there might be 20 or so companies in an industry group doing the same kind of work in the private sector environment or, indeed, working for the public sector. Each of them will have a different

set of terms and conditions of contracts that they use with people that work for them. They will have different terms of payment, different procedures and different levels of technical expertise. So why should all the departments be similar?

**Mr Chalker**—What they are suggesting to us is that different departments have different requirements but that, within each department, some central area of expertise would be advantageous.

**CHAIRMAN**—Such as?

**Mr Chalker**—I understand that Centrelink has an area of some expertise in contract management, and the Department of Foreign Affairs and Trade seems to have as well. Other departments that our people deal with do not have that central area of expertise. They are suggesting that some sort of improvement could come about through bringing an area into each department that has a fairly large use of contractors.

**Ms GILLARD**—I want to ask you about some of the comments you made in your submission about the tender process. In one section you say that your members are frustrated when they meet tender deadlines only to see a slippage in the evaluation period and date of decision. Can you give us some concrete examples of where that has happened?

**Mr Chalker**—I have not got them in front of me, but I can probably go back to the members and ask for some of those.

**Ms GILLARD**—Is that a common occurrence?

**Mr Chalker**—It seems to be quite common. The tight time frame seems to frustrate them and that they are asked to do things in short times frames only to find that the period often seems to blow out at the other end.

**Ms GILLARD**—Do you have a view about why that happens? Why the tight time frames at the start?

**Mr Chalker**—I think the requirements are often not properly thought through. Perhaps someone, internally, recognises a requirement, but it takes time to get approval from more senior levels.

**Ms GILLARD**—You make the comment that some of your members believe that they have been asked to tender to make up the numbers. Can you tell us what people mean by that or give us any examples of that?

**Mr Chalker**—I put some confidential information to the committee on one member's experience which suggested that he felt was evidence of that. He had received a phone call and been asked to apply for a bid – this one is in the confidential information – only to find that the group of them who felt they were very expert in the area they were being asked to tender for were not even called in to discuss the bid with the department. The people who got the bid in the end appeared to be known to the committee – this was his position. That was one example. There was a similar sort of occurrence to the one I mentioned in the introductory remarks where someone received a phone call and was asked to put in a bid only to find that the requirements were quite onerous. They were key performance indicators within a corporate plan, and he felt it was quite obvious that the only people who could fulfil the task were the people who had done the corporate plan for this organisation.

**Ms GILLARD**—In your introductory remarks you cited an example where someone turned their printer off to stop the 50-page email from continuing to print, as only a few lines of it were actually project description. What was the balance of the material?

**Mr Chalker**—It was things like requirements for referees and the usual terms and conditions of contracts, which he felt were not needed in this particular case, and a whole stack of stuff about the previous task, which was the corporate business plan.

**Ms GILLARD**—There is obviously a balancing issue here. We have also heard from groups this morning who have said that there is not enough specification at the front end, and that causes costs and inefficiencies in the tendering and contracting processes.

**Mr Chalker**—In this particular one he had got the call, 'Can you tender for this project?' When he asked for some information on it, they referred him to the web site. The information was on the web site – a great use of modern technology – but the only way he could access it was to load the whole document down. It was 50 pages long and, as a small contractor, he said he had used up enough of his ink by that stage.

**Ms GILLARD**—Have your members in part come to the conclusion that they would like to see a standard contract or standard set of central conditions because they are finding the contract material that they are given is not plain English drafted, not accessible and that it is only capable of comprehension with the assistance of lawyers? Is that part of the problem?

**Mr Chalker**—That is part of the problem. There are small changes in each contract which necessitate them working their way through every contract, page by page; whereas, if certain parts of it were uniform, they



would know that they had already satisfied those criteria or that they were happy with that part of the contract, and then they could go on to the specific requirements that they needed for this one.

**Mr COX**—You have made a suggestion in your submission that payment ought to be faster. The Commonwealth pays reasonably quickly up to the 30 days standard that it has set for itself as its terms of trading. What do you see as the need for payment faster than that?

**Mr Chalker**—There might be a requirement of departments to do that, but in actuality our members are not receiving that money in that sort of time frame.

**Mr COX**—Have you got any stats on that?

**Mr Chalker**—No. I can only go by anecdote. When I sent out to members for comment, back came the comments – as I mention in there – of some small contractor working with the department of industry or the CSIRO who was waiting two months. Another in a similar position was a larger contractor with an AusAID budget. That is where the comments in there come from that they often find the invoice will get left. Personally, I have worked as a contractor to government and found similar sorts of problems. So maybe the statistics will show you that everyone does, but we have also got people who are not being paid.

**Mr COX**—Unless the situation has deteriorated dramatically since Labor left office, the statistics certainly showed then that an overwhelming proportion of people got paid within the 30 days, provided the invoice was correct. It was certainly close to the 30 days – but that is a cash management issue for the Commonwealth as much as it is for the contractor – and there are avenues for people specifying shorter times as part of a commercial negotiation if that suits both parties and has a benefit to both parties.

**Mr Chalker**—I am saying that just going by comments that we get from our members, and it continues. Certainly, the Commonwealth does pay in most cases, and that is one advantage over the private sector where it does not always happen.

**CHAIRMAN**—What do you mean ‘in most cases’?

**Mr COX**—In 99 per cent of cases, probably.

**CHAIRMAN**—I am concerned about that. It is a pretty loose statement, with respect.

**Mr Chalker**—Perhaps it was a little loose.

**CHAIRMAN**—I am not aware of any. This committee is not aware that the Commonwealth does not pay its bills. I am sure the Auditor would be investigating such circumstances very quickly.

**Mr Chalker**—When I worked with the department of health more than a year or two ago, I waited 15 months for one payment just through people changing offices and changing requirements, and so on. Certainly I got paid in the end, but it did take time. It was a small contract and it took a lot of chasing up.

**CHAIRMAN**—It was ‘in most cases’ that bothered me. That has tightened it up a bit.

**Mr COX**—Do you think that Defence generally have excessive specification in a contract or do you think they do it when they want to ensure a particular outcome?

**Air Vice Marshal Weston**—It is a two-edged sword. If you are attempting to tie down the particular product or service you want and get categorically that product, you specify precisely what you want and you will ultimately get it. But that is a very time consuming practice for those writing the contract and for those responding to the contract. As well, times change. So, if you specified a 286 computer 10 years ago and your contract comes in five years later, you will get a 286 and not a Pentium I. So what we see in defence industry is that there is a sensible approach to this. An over-rigid approach to specification acts neither in Defence’s interest nor the contractor’s interest. Yet clearly there is a concern by Defence that they want to control at the end what they get. We would argue that they should devote their resources to trying to specify the outcome, the service, the capability that they want very carefully rather than resorting to excessive detail. That will require a good relationship between Defence and industry, but after all both are being asked to subscribe to the concept of partnership and certainly in the spirit of partnership you should be able to achieve that sort of thing.

**Mr COX**—I have heard stories of, for example, Defence specifying office chairs in 24 pages of detail so there was only one chair that would comply. I have had personal experience of Defence overspecifying a contract to a ridiculous degree so that only one tenderer could possibly get it, which I then threatened to refer to the inspector-general and they redid the spec. Have you had any experiences like that?

**Air Vice Marshal Weston**—There are two points that come out of that. One is that if Defence wants a product that is on the market we would encourage Defence to go sole source and negotiate with that supplier to deliver that product, and not try and bring other players in to compete when in fact they believe that they have a product that suits their purposes. They would be putting costs onto other competitors who are coming in under false expectation. What they should be trying to do is negotiate what they want with the sole source

supplier. And we believe that Defence is acknowledging quite often that sole source is the way to go. It is cheaper for Defence and it stops industry wearing unnecessary costs.

The second is phased acquisition. If Defence is moving towards a certain capability, and this tends to be in the larger contracts, then they can go through the acquisition by phases, such as a funded study, project design and project development, which may have a series of competitors which is gradually whittled down until ultimately they will sign a contract with one supplier to get a capability. They will have spent money up-front to get a better product at the end. We would encourage that they spent money up-front. Industry knows that they are not wasting money. They are being encouraged to invest their own money with Defence's money in money up-front to get a better product, and ultimately in the competitive environment Defence is more informed because it has been watching these phased acquisitions develop over time. We would think that Defence probably gets a better product at the end with less contract risk.

**Mr COX**—Even though in the subsequent phases it reduces the number of people who are effective competitors.

**Air Vice Marshal Weston**—Ultimately you have to commit to a certain supplier. If you have not got the market intelligence, the technical expertise or whatever it is, Defence should spend money to develop that to the point where it finally decides it has sufficient competence to evaluate contenders and make a decision.

**CHAIRMAN**—Thank you very much for your submission and answering our questions. We will send you a copy of our report when we have completed it and tabled it.

[1.54 p.m.]

**PECK, Mr Michael Laurence, Chief Executive Officer, Royal Australian Institute of Architects**

**CHAIRMAN**—Welcome. We have received your submission, which we have absorbed with interest. Do you have a brief opening statement you would like to make? I emphasise ‘brief’.

**Mr Peck**—Yes. As I said to one of the secretaries this morning, I could go on for hours on this subject, but I won’t.

**CHAIRMAN**—Good! We will ask you questions instead.

**Mr Peck**—This is about procurement in the construction industry. We have used this opportunity to draw attention to what we think is a major dysfunction in the procurement of public sector works, not only at the Commonwealth but also at the state and local government level. During this year we will be promoting a complete review of the whole procurement methodology that has been adopted in Australia, and we will be promoting the same sort of thing that has been happening with the UK government following the Latham and Egan report on the construction industry in that country, which is focused on quality rather than on cheapness.

**CHAIRMAN**—Thank you, Michael. I have to say to you that what this inquiry is not about is the simple issue of purchasing; this inquiry is about contract management. Contract management, of course, involves initially deciding that you want a contract for something, writing a specification, purchasing it if you want to make it that simple, managing the contract and completing the works. It considers the whole or through life costs of everything involved. You said a lot of things in your submission, but one of the things that first flagged itself to us was that you talked about corporate knowledge. You said:

Successive Governments, both State and Federal, have caused significant de-skilling of Government departments and agencies through policies of cutbacks, privatisation and outsourcing. The loss of corporate knowledge has had a profound effect on the nature of the relationship between architects and their government clients.

I will cite the example of Victoria, and we went through this with the MBA this morning, which used to build all of their own buildings. Most of what a state government builds is schools anyway. That is the majority of what they build, not that it is all by any means, but the government instrumentalities used to build them, and we had the Commonwealth Department of Housing and Construction that built Commonwealth buildings all over the country. Victoria, in the early to mid-1980s, went from that system to hiring private sector architects, your people, to design the buildings, to supervise their construction and award school council contracts, where the government provided the money but the school council itself took responsibility for getting the building built and what they wanted built. And you are telling me that that is bad?

**Mr Peck**—Yes. The problem we are finding is – and it relates to the whole question of the procurement of professional services and, to use the jargon of the free market, the informational symmetry that exists between the consumer and the provider – because of the deskilling of the public sector, the procurement processes that are being adopted are driven generally by managers who are used to procuring paper clips and widgets. They understand that you can look at a product and decide whether that is a sound product and look at the price and decide whether that is a good price. But when you are buying professional services, you are buying knowledge and skill, and you have to be equally skilful to be able to transact to make sure you are getting the right outcome. That is a fundamental plank of free market operation: both parties to the deal are equally informed and able to communicate efficiently.

What is happening in public sector procurement now is that these managers, without any skills in the area of infrastructure and building procurement, are trying to apply methodologies that have worked in the procurement of desks, cars or capital equipment of that sort, and it is not working. What we say about that is that when this move to deskill the public sector first was flagged, our organisation and many other organisations said, ‘This is a good thing,’ and encouraged governments to do so, because there was a naive expectation that all this work would come to the private sector and we would be better off. The reality is, and I think the UK government has recognised this, that you cannot have a good infrastructure or building project unless you have a skilled client.

The research that we did in those early days leading up to the current situation is that we looked at a number of government sectors in the Western world and how they procure, and we found that the best arrangement is to have about 70 per cent of the work contracted out and 30 per cent done in-house. This maintains the skill and the career paths for professionals in the public sector, who can effectively interact with the private sector and get the best deal for the public purse.

You get situations – and it is particularly bad at local government level – where there are managers driving quite significant building projects who have no idea how the building industry operates. They are forcing consultants to underdocument and they are forcing contractors to enter into quite draconian contractual

arrangements on the basis of very poor documentation. You will hear, no doubt, from the Master Builders and all of us in the construction industry that the result is that buildings today – according to recent CSIRO research – are costing up to 11 per cent more to build and taking 11 per cent longer, because the contractors are forced to work on the basis of inadequate documentation. I am not arguing for a return to the old days of public works and that sort of thing because that was too bureaucratic and too heavy, and we are all aware of the waste that was involved in those old arrangements. But the pendulum has gone too far. What we need to do is get balance back into this. That is why we believe we need a strategic look at the whole procurement methodology. Procurement based on draconian adversarial contractual arrangements forces everyone into defensive positions and they try to optimise their position. So, instead of getting on with building the project with confidence and cooperation, you are fighting one another all the way through it. That is why we are arguing for a major review of procurement in the construction industry.

**CHAIR**—You said that many of the qualified architects avoid or are unwilling to take on public projects. Can you quantify that?

**Mr Peck**—I can qualify it but not quantify it. The situation is that, if you are running a successful architectural practice at the moment and you are getting most of your work from the private sector, there is no way you will touch public sector work. If you speak to the private sector major clients like Bankers Trust you will find that the first thing they want to get is the best team. When they have got the best team together and have defined what their objectives are they will then negotiate the contract, the deal – how much money; what level of expertise; which personnel will be working on it. The cost of the service falls out of a complete understanding by both parties as to what is to be delivered and how much it will cost, and then they sign it off.

In the public sector – because of, I think, a misunderstanding of the probity requirements – they believe that what they have to do is state out in front, ‘This is what we want. We will maximise it for competition. Anyone can have a go at it and the cheapest price wins it.’ The problem with that is that they do not have the skill to define the scope of works. This is where it falls down. That is why the engineer or any operator in the construction industry who can make money and continue their practice or their business on a relationship of trust with their clients and with reasonable cash flow for the work that has to be done will work in that sector. They will only delve into the public sector if they have to. Each public sector job is going to be right on the verge of a loss, or a loss leader.

**CHAIR**—If, as you say, the public sector increasingly is not detailing their requirements adequately, how do they supervise the construction?

**Mr Peck**—That is the point; they cannot. With respect, being in the construction industry you know that the level of knowledge of the lay client in terms of the technical performance of buildings, and particularly the life cycle performance of buildings, is very poor. We on our side of the industry know all the issues, so there is a symmetry. They write a one-line specification saying, ‘We want a 500-bed teaching hospital’ and they think that specification is sufficient. But we know that you do not have a specification for that building until you have properly designed it, you have researched all the medical procedures that have got to go on, looked at the latest advances in medical procedures and have specifically designed the building. From the contracting side, you do not know what you are going to have to build until you have a clear set of working drawings and specification. It is that lead-up to the commitment of the contractor that determines the life cycle costs of the building, the initial capital costs of the building and the construction time. So it sets the potential performance of that asset and it is in this area that there is not sufficient work and knowledge being applied from the public client sector.

**CHAIR**—We are told by MBA that increasingly Commonwealth building contracts going out for tender are not including bills of quantities. Is that your experience?

**Mr Peck**—Yes, there has been a move away from bills of quantities because they are expensive. This prevailing free economic competition philosophy that pervades all purchasing in Australia at the moment says, ‘If we can load it off onto the provider, we will be better off. We give them all that responsibility, or we get the cheapest price and we will be better off.’ That is very simplistic thinking.

**Mr COX**—I would like to ask you a very specific question. Was the Department of Foreign Affairs and Trade a skilled buyer?

**Mr Peck**—I really do not know the procurement methodology they used there. I think they used the Commonwealth architect to design that building; I am not sure.

**Mr COX**—Do you think it was any good?

**Mr Peck**—I have driven past the building and I cannot tell you whether it is a good building or a bad building. Architectural design is not about simply aesthetics. It is about how the building functions and how much it costs to own and operate over its life cycle. That is what design is really about. The fact that it turns

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out to be an aesthetically pleasing icon like this building or like Sydney Opera House is a consequence of the process, but the fundamental about good design in architecture is a building that is going to be a worthwhile asset for the public sector purse. That is the way we see it.

**Mr COX**—They sold it to the Motor Trades Association for a fraction of what they paid for it. I do not know whether it is a good building architecturally or not. I have not been inside it. But I can tell you that I tried like hell to stop it being built.

**Mr Peck**—Gareth's gazebo, wasn't it?

**Mr COX**—Yes.

**Ms GILLARD**—On your model of holding 30 per cent of the expertise in-house and 70 per cent externally: if you were to try and retain in-house expertise, how would the Commonwealth retain the best and create career paths for them, given that you would be dealing with relatively small numbers? Do you have a view on that?

**Mr Peck**—I have. If you are doing 30 per cent in-house, that would be a fair volume of work. An architectural practice of 30 people in size can attract some really talented people to it. The Melbourne City Council is a very good example of a public sector agency developing for itself an incredibly high reputation in urban design and attracting people who want to succeed in that profession to work for that organisation. I think that in the last 10 years they have won over 30 urban design prizes for good design and for delivering projects on time, on budget and all that sort of thing. That is a public sector agency which has retained its in-house skills. It still contracts out most of its work, but there are a core of people in there that really know their business and they can guide the city council in its dealings with the outside world.

**Ms GILLARD**—To replicate that model in the Commonwealth you would have one centralised area, would you?

**Mr Peck**—I do not know.

**Ms GILLARD**—Because once you start devolving out to the departments and agencies you do get below that critical mass.

**Mr Peck**—That is right. One would have to look at it afresh, and in my view one would have to research what is being done, particularly in the UK and the United States, to see how their public sector procurements are going. In this paper I refer to qualification based selection, particularly relating to the selection of architects, engineers and other professionals in the industry, and that is based on the Brooks legislation in the United States. The interesting thing about my reference to that is that it has been picked up in the UK and applied to the procurement of all sections in the construction industry, not just to the professional side but to contract as well. So what they are trying to do there is to put teams together of contractors, subcontractors, designers and so forth that have been specifically selected for the needs of the project.

This methodology came out of the North Sea oilfields. You will remember that in the seventies there was a tremendous decline in the price of oil – there was a real crisis – and they had to build their oil rigs at about 40 per cent of what they had been paying before. So those old methodologies were not working, and they introduced a new system. By putting the right teams together, they have achieved huge efficiencies. It is interesting to note in the construction industry that NatBACC, the National Building and Construction Council, which was set up by the federal government to look at reform in the construction industry, paid consultants to review various procurement methods in the construction industry. The consultants' final summary was that they looked at all these different procurement methods – 'alliancing', traditional head contractor and all those sorts of things – and they came to the conclusion that it was not the methodology that was so important; it was the team. If you had the right people, you got the best result. Chairman, with your indulgence I will table a paper which I have just given to a construction industry conference in Hong Kong, which touches on some of the points that I have mentioned today and points to some of the solutions that we see.

**CHAIRMAN**—On page 2 of your submission, it says:

In spite of the existence of standard forms of Client Architect Agreements, such as the RAIA Conditions of Engagement or the Australian Standard AS4122 (Int.), many agencies have produced agreements that contain unworkable, unfair, and often uninsurable provisions.

Such as?

**Mr Peck**—I do not know whether you have come across the term, but 'fitness for purpose' is one of their favourites that they resort to. If they cannot define precisely what they want, to use the example I used before, they will say, 'We want a 500-bed teaching hospital that will be fit for its purpose.'

**CHAIRMAN**—You are having me on?

**Mr Peck**—No, I am not. I am not having you on; that is a standard phrasing. The thrust of it is that sort of approach. In fact, we have just concluded a long negotiation with Standards Australia to avoid that sort of provision in AS4122, the consultant's agreement, because those catch-all phrases do not save anyone. All they do is make money for the lawyers whilst we fight out in court years later what the hell it meant.

The other one that I would refer to, the one we are constantly having a go at the Commonwealth about, is copyright. Australia is a signatory to the Universal Declaration of Human Rights, which establishes copyright principles, and yet, whenever the Commonwealth builds, they try to take copyright away from the people that are providing the service to them. That is unfair. They do not need it under the licensing provisions in the Copyright Act now. They can have all the intellectual property they need for the purpose for which they need it but they do not need to take copyright. They ask us to sign warranties and guarantees which the insurance industry will not cover. The industry says, 'If you have a professional indemnity insurance policy with us and you sign a warranty or a guarantee that exceeds your professional obligation at law, forget your professional indemnity insurance.'

**Mr COX**—What precisely is the Commonwealth trying to get you to sign up to?

**Mr Peck**—That the architect will ensure that all safety measures on the site are adhered to – all provisions in regard to workplace safety. That is a typical one. You are frowning because you might know something about the construction industry and you know that is a nonsense. But this goes back to what I was saying before about the level of skill and knowledge of the procurers at the lower levels in the procurement chain. They do not understand that and they write it into these agreements, and we are seeing a plethora of these agreements particularly at local government level.

**CHAIRMAN** – We cannot handle your problems with local government.

**Mr Peck**—All right.

**Mr COX**—So they want you to indemnify them against planning risks with local government?

**Mr Peck**—It is a philosophy of risk shedding and they get legal advice – 'How do we shed our risk?' 'This is how you shed your risk.' I do not know if you have heard of the Abrahamson principle of risk allocation in construction law, but under that arrangement his principle is that risk is allocated to the party most able to manage it and where that cannot be defined the parties agree how they will share the risk. It is pretty simple, pretty straightforward and it really works. But what is happening in public sector procurement is that because of the deskilling they just say, 'We have to avoid risk so we will shove it all on to them.' That does not work.

**CHAIRMAN**—Are you aware of Commonwealth agencies specifying unlimited liability?

**Mr Peck**—I do not know about 'unlimited' but they ask for covers that are just totally ridiculous. One of our subsidiaries is an insurance broking company and so we sell professional indemnity insurance in the construction industry. Going back over 25 years, the average claim against an architect is \$350,000. The cover that we are being asked to provide on some projects is in excess of \$10 million. That is just an enormous cost and, of course, the insurance industry are not going to tell you about that; they are perfectly happy with that. The clients say, 'We have to be very risk averse and therefore we'll just up this amount.' The insurance industry take the money and we pay for it.

**CHAIRMAN**— The client pays for it.

**Mr Peck**—That is a good point. You can always pass a cost like that on to a client in a market that has a little bit of fat in it but you cannot pass it on in the market that we are in – no way.

**CHAIRMAN**—If all of the architects tendering to design a particular building, a particular complex or whatever are faced with the same specification, they go out and get competitive prices for insurance. If you do not, you are mad – and you are telling me that does not go into your price consideration. Come on!

**Mr Peck**—I will tell you a story about SOCOG. SOCOG had to move the showgrounds from their current position in Sydney out to the new location, Homebush. They decided that they would divide the project up into five sets of buildings and they would get three consultancy teams to compete for each one. So they prequalified these consultancy teams – architects, engineers, landscape architects and everyone – and they said, 'Okay, you're to tender on this project,' so three of them were to tender on each one.

This is how the pricing worked. The architects got bids from each of the subconsultants, because it all had to be in one bid, and they put it together. Then they looked at it – and I had 14 of them write to me to set down this methodology, so I can confirm this is how it was done – and looked at the price and they said, 'That's not going to win it so what will we do?' They went out and got bids from other subconsultants with whom they had never worked – and therefore they did not know what their performance would be – just on the basis of price, then they put all that together and they said, 'Well, we had better cut 10 per cent off to make it competitive,' and they put that price in. So it has nothing to do with the amount of insurance cover they were

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expected to provide, the amount of service they were expected to provide and the length of time the job was going to take. It all has to do with buying the job and then, when they get the job, they have the enormous problem of delivering the service that they are expected to provide. That is not smart procurement because you have people who are struggling right from day one to try to provide the service you need.

**CHAIRMAN** – Without effective competition how does anyone ever get started in an industry? How do we ever get new players?

**Mr Peck**—Under the qualification based selection system, we propose two methods of competition for procurement, and I can only talk about architectural services and consultancy services. They are qualification based selection and architectural competitions. For example, the Federation Square competition held in Melbourne was won by a small firm of architects from London, because the competition was exposed to the world, 177 firms competed in the design and they won it. They had never done anything like it before but that is how they were introduced into the bigger game. Qualification based selection is about analysing the resources and capabilities of a firm to perform what you want. I have just run a system like this for our own strategic facilities plan and it really works because it makes you focus on what really is being offered. If you have a firm that maybe has not done the type of project before that you are talking about but happens to have had join them someone who has done some recent research in the field that your project is in, it will often put them ahead in terms of qualification than a firm that might have done a whole lot of them before but not very successfully. So it requires a higher level of intellectual application to the role of purchasing, and that is what I think is really needed on the public sector side now.

**CHAIRMAN** – Thank you very much for that, Michael. As always, we will send you a copy of our report after we have finished receiving evidence, talking to people and writing it. Is it the wish of the committee that the document entitled ‘Qualification based selection of architects’, presented by the Royal Australian Institute of Architects, be taken as evidence and included in the committee’s records as exhibit No. 17? There being no objection, it is so ordered.

**Proceedings suspended from 2.24 p.m. to 2.34 p.m.**

**GRILLS, Mr Peter, Councillor, Canberra Business Council**

**LEAYR, Ms Helen Maree, Executive Director, Canberra Business Council**

**CHAIRMAN**—Thank you for your submission. Do you have a brief opening statement before we ask you questions?

**Ms Leayr**—Yes, and I will be very brief. I welcome the opportunity to participate in this inquiry into contract management. As you will appreciate, the members of the Canberra Business Council are keenly interested in the government's outsourcing and general procurement program and its success. The Business Council is committed to the success of Commonwealth government outsourcing and has worked with the government over a number of years to ensure a positive outcome for both the public and the private sector. We believe that that outcome will come about through the development of sustainable strategic partnerships. The Business Council recognises the specific nature of this particular inquiry into the contract management skill level of the Public Service. While the Business Council, in its submissions to government, usually focuses on broader issues, including industry development and a range of activities, we welcome the ability to participate in this particular activity.

The one comment I would like to make on contract management – and what I think is a key component of the success of Commonwealth government outsourcing in relation to contract management – is the importance of maintaining confidence in the system in the process. That confidence will ensure success for both government and the private sector. If the government does not have confidence in the ability of the Public Service to review tenders and to prepare appropriate tender specification, a particular agency or department may not have confidence in the process or be sure that they are getting the right outcome from that process – likewise, if the business community does not have confidence in the process and the ability of the Public Service to deliver the right outcome for both government and the private sector. For example, if the business community believes that the government is only interested in the cheapest solution or does not have faith in a value for money approach, the business community may not present the government with the best solution. It may very well just present the cheapest solution. I cite those examples just to try to emphasise what we believe to be the importance of a system that stands up in its own right and that people who are participating in can have confidence in.

Government business is changing in a range of ways, and an essential component of ensuring that that change is managed is to make sure contract management skills across the Public Service are extensively and regularly updated, and I know that this process is part thereof. The Business Council is not in the business of supplying to government – we are an industry association, an economic development organisation – but we can draw on the information received from our members. That is where Peter Grills as a councillor and a member of our outsourcing committee at the Business Council comes in. In that instance, we draw on his expertise. On matters that the Business Council cannot provide a response to today, we will be happy to go and ask our members or seek the input of some broader business community to provide you with those solutions.

**CHAIRMAN**—Your submission, along with some others, has tended to focus more on the specifications and purposing function than on the whole of the contract management scene. That involves a lot more than just deciding who is going to do it and what you are going to have done in the first place. It also then makes sure that, when it is finished, you have what it is that you wanted, both parties are happy, whoever winds up being the contractor is not broke and the Commonwealth – in our case – has a satisfactory outcome. Do your members believe that technical and professional expertise in the public sector has wound down to the extent that it causes them difficulty, both at the tendering and specification stage and in managing the contract?

**Ms Leayr**—I will defer to Peter, who I know considers this a very important issue.

**Mr Grills**—I see those two steps overlapping a lot. If you do not get the tender and the procurement process right, if you do not start off on the right basis, managing the contract afterwards becomes a heck of a lot harder. The skill sets and the understanding are important right across. If you do not have people who understand the technical side and what you are trying to achieve involved in the up-front, you are unlikely to have it in the administration down the track. So they do overlap. We have got concerns that, in a number of areas, technical expertise is not as robust as it was in the past and that is impacting on the tender specification and the relationship during the management of the contract. If you can go to someone with a problem halfway through an administration and talk to someone who understands the problem, the technology and the profession, you are much more likely to come up with a good solution than if you talk to someone who is looking at a legal document and interpreting it from the point of view, 'Clause 23A says this and you must do.' Yes, you have to have the framework and, yes, you have to deliver your contract, but unless you have that technical understanding of how you do that I do not think you will get as good an outcome. There are signs that, at least in some areas, departments have shrunk to a point where there is not always that expertise.

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**Ms Leayr**—The comment has been made at the Business Council that government tendering and contract management really need to become core competencies of a senior level of the bureaucracy and that they really have become part of government's core business.

**CHAIRMAN**—You are not suggesting, are you, that we go back to the days when government did things for itself?

**Mr Grills**—No.

**Ms Leayr**—No.

**CHAIRMAN**—You are not suggesting we go back to having a Department of Housing and Construction again that builds houses and buildings for the Commonwealth and designs them?

**Ms Leayr**—The point I am making is that we are getting away from that and that the core competency of the government is actually in managing the relationship with somebody else who is delivering the service, the good or the outcome and that the government's core business is actually to ensure that the outcome is produced, because that is what the government has chosen to achieve.

**CHAIRMAN**—In a practical sense, how would we, as a group of parliamentarians, recommend to the bureaucracy that they do a better job of keeping the skill level? How do we go about doing that?

**Ms Leayr**—We have been wrestling with this.

**Mr Grills**—We have been talking about that. To respond a little more to your comment there, in my observation, in the earlier stages – particular outsourcing – of the general contract, there was an assumption that, if we were going to contract this out, it would mean we would not have to worry about it anymore. There was a tendency not to pre-plan to have a contract management expertise retained to continue the contract administration. I think that lesson has been learned or is being learned. I am not expert enough to say it has been, but there is a recognition now that that is so. Things are changing, and it is important, from the business's point of view, to make the point that it is not simply that the government now does this and the private sector does that. If you are going to provide a service, it has to be managed. That is an important thing.

I do not know the answer to your question, but I will make one comment. Traditionally, the expertise of government was perceived to be policy. The people who rose to the top of the public sector tree were policy experts. I am not decrying the importance of policy, but I could not agree with Helen more that I think the way the public sector has changed in the last few years and that issues like contract management and the understanding of project management are becoming increasingly important in the skill set that is needed in very senior administrators. I do not know whether it is in the design of performance contracts or in selection criteria or whatever the appropriate words are, but those sorts of skills ought to be given a higher priority vis-à-vis policy. I think that would help a lot. There is no doubt that you have to write the policy submissions to government but, in implementing them, the other sorts of things are important too.

**Senator GIBSON**—This morning the Institution of Engineers appeared. I do not know whether you have seen their recent publication, but recommendation 3 says:

Government agencies should employ the following model to ensure they have access to the appropriate level of technical expertise –

and I will add 'and managerial expertise' –  
in the most cost-effective manner.

1. Examine the good or service to be procured to determine the level of technical expertise required to be an informed buyer.

2. Evaluate the relevant existing level of in-house and external expertise available

3. Undertake a cost benefit analysis of in-house versus contracted-in expertise at each stage of the contracting process.

4. Obtain and where appropriate, retain the required expertise.

I guess we are concerned about making sure that managers of government agencies go through that process. Of course, we recognise that lots of agencies will go through this process only occasionally, and therefore it is impossible to hold and retain the relevant expertise – hence it would seem sensible to get it from somewhere else – whereas others are doing it all the time. AusAID appeared before the committee this morning, and they are letting contracts all the time. Would you care to comment on what the Institution of Engineers have suggested to us?

**Mr Grills**—I think the problem that you just touched on is the really hard one. If the occasional big contract is managed by an agency, and then they do nothing for a period of years, how do you retain that? You will wash my mouth out, but perhaps there is a role again for something like the old Purchasing Australia: professional public servants who manage or advise on procurement processes to varying agencies. I am not convinced that the private sector can manage government tendering contracts well on behalf of government.

The private sector does not have the same understanding of the purchasing requirements of government that it does of its own requirements. For example, sometimes I have seen agencies bring in someone to manage the tender process. I am not convinced that the private sector is the best place to do that on behalf of government, because government requirements are different.

**CHAIRMAN**—How are they different?

**Mr Grills**—Let me give you an example that has been touched on in one of your questions: accountability. Understanding the requirements of government privacy and assessing whether or not the contract adequately deals with that is very difficult for the private sector because it does not live with it all the time. My experience of lots of quite senior and competent private sector people is that they do not understand how government really works. If I could give one of my slightly tongue-in-cheek responses, I still meet very senior businessmen who think that ministers reply to their own correspondence rather than giving it to the department to be drafted. So they do not understand some of those fundamentals.

**Mr COX**—Some of them do, and that is when you know you really have a problem!

**Mr Grills**—It is about the depth of understanding of the Public Service and how it works, because the private sector clearly works very differently, even in big bureaucracies.

**Ms Leayr**—One of the points you raised, which Peter picked up on, was the need for that expertise to be regularly maintained. Part of the solution to that is to encourage the agencies to realise how important that is in the performance measures that exist within a government structure. We need to ensure that contract management is seen as a high priority right across the government, and that it is not something that is towards the bottom of the lists of a particular agency or department's produceables.

**CHAIRMAN**—How does your council see that function with respect to the private sector? Surely every private sector company goes through the same thing that a government department goes through? They may not build buildings very frequently, but do they keep a resident architect on board for the building they build once every five years? The chances are that they do not. Do they keep in-house the IT expertise to allow them to design a new system or systems and to implement the system, including hardware and software? How are these departments so different from the private sector with respect to contract management, which includes the contract specification letting in the first place? You do not always have to have competitive tendering in order to get the best value for money, do you?

**Mr Grills**—No, you do not. I guess that is an example of where the private sector does not face anywhere near either the same degree of scrutiny or the same ground rules. The concept of open and effective competition applies very differently in the private sector. The purpose of your private sector procurement is to add value for the shareholders. You would never get people approaching a company in the same way they do government and saying, 'I have a right to supply to government, and if I didn't win this tender I am entitled to know why and to challenge the reasons why.' So there is that sort of approach to assessing the tender and to measuring the issues. It is quite different from the private sector.

**CHAIRMAN**—Governments do from time to time let contract management contracts where the final price is open-ended. They do from time to time have limited tender lists that, whatever the technical area the contractor is concerned with, are limited to invitation, to those who are pre-qualified. So everything is not open to free and competitive tendering, is it?

**Ms Leayr**—No. But I think the point that Peter is making is valid: that, regardless of the process, the other end's scrutiny is slightly different and, whether it was a selection out of a dozen pre-qualified tenderers, the other 11 will have a different view of the outcome and their ability to scrutinise the various aspects of that decision than they perhaps would have had if they had participated in a tender to a major private sector company.

**CHAIRMAN**—So the scrutiny of a government department is different from the scrutiny of the shareholders or a board of directors.

**Ms Leayr**—I think it is.

**Mr Grills**—I am aware of situations. I am trying to think of one where I will not put my foot in it, because these days alliances change. Let me be totally hypothetical: if Packer owned half of Ansett, you would not imagine that any Packer company would let a travel tender and have Qantas win it. They would simply say, 'This is corporate business and, irrespective of the price of Ansett, we will go with Ansett.' You cannot do that in government, and you should not do it in government. There are different considerations. So you can simply overrule on the grounds of corporate alliances or those sorts of issues.

**Mr COX**—What did you do before this job, Peter?

**Mr Grills**—I was a public servant. It shows, does it?

**CHAIRMAN**—We guessed. In what area did you work?

**Mr Grills**—Admin services.

**CHAIRMAN**—In your submission you said that:

The Canberra Business Council's experience has shown that some agencies have in practice been unable to develop adequate performance measures.

Can you tell us some examples to expand on what you are talking about?

**Mr Grills**—Yes. Can I put my hand up and say that I did not write that submission, so I am talking on behalf of someone who did.

**Ms Leayr**—The Business Council, in many respects, is a worse bureaucracy – if I could use that word – than a number of other organisations.

**Mr Grills**—We are all volunteers. The case study there is still live, and I would prefer not to specifically identify it. It relates to some performance indicators that really were not measurable. They did not have something that said, 'Yes, you're in or you're out.' It was very subjective, and the company felt that the perspective of whoever was assessing their performance could say, 'You are in,' and they could not argue about it.

**CHAIRMAN**—This is something like the Royal Australian Institute of Architects just told us – that clauses for a design of a building might include such things as fit for purpose statements.

**Mr Grills**—What is fit for the purpose depends on the view of the person. I can give you an example that I am aware of – it is not mentioned in there – that was based on the assumption of high volume turnover. It said 'All product will be delivered within five days of order' and if less than 95 per cent of that was achieved a percentage penalty would apply to each five per cent thereafter. That is fine if you order 200, but the lawyers of the company said, 'What if you only order two?' You were immediately 50 per cent out and that brought in a very huge penalty, far outweighing the value of the order. Because it was predicated on a percentage, you could find yourself with a very real problem. That is one that I have seen just recently. The agency said, 'We wouldn't do that, we understand what you are saying,' but that is what the letter of the specification said.

**Senator GIBSON**—In order to address the apparent difficulty of finding experienced, competent and qualified contract managers, the Institute of Engineers suggested in their submission that an institute of contract administrators ought to be formed so that people were identified as experienced and practising contract administrators. They saw that as a sort of a subset of their current moves to set up a list of practising engineers. With regard to contract administration, they thought a subset of that would be those who are in contracts on a continuing basis, in conjunction with architects and others. Have you any comment on that?

**Mr Grills**—I think it is probably a little narrow in the sense that I am not sure that the skill set for contract management is enormously different from the skill set for project management. I know there are organisations of project management and it would probably be more appropriate to try to grow that than have a separate body.

**Senator GIBSON**—Good point.

**CHAIRMAN**—The Master Builders, the Institute of Architects and the Institution of Engineers have all said today and in their submissions that as a generality they believe that the Commonwealth is devolving risk management to the private sector – that is, putting most of the risk on the contractor and accepting little or no risk themselves, including such things as indemnity clauses with unlimited liability or extremely high liquidated damages. I note that you have made the point that contracts should allow scope for both parties to share the rewards if a goal is reached. Can you comment on that?

**Ms Leayr**—Before you get to the technical side of it, the Business Council has been involved in running a number of what we call 'outsourcing roundtables'. We have run four. Minister Fahey has been a guest speaker, and he has attracted a great deal interest from the business community. At our most recent one last September, this issue was raised as being extremely significant. The points made were from the private sector's point of view. Imagine a person who participates in a very large organisation saying, 'We can factor risk into the price if we know where the risk is going to be shared between the two organisations. If the government wants to transfer the risk entirely, then the price will reflect that.'

But the difficulty was that there was no real indication at an early stage exactly where the government was trying to place the risk and that there did not appear to be a recognition by those who were preparing the tender specification exactly what risk was there and where it needed to be placed. I guess we discussed at this forum how we as a private sector organisation go about working with key members of government to explore an understanding of the risk and risk transfer. If you want to transfer the risk entirely, you sell it; you actually sell the whole asset. If you want to have something delivered regularly then you might be sharing the risk. The

other extreme is that you keep the risk entirely in-house. So I just make that comment, that there was a great deal of discussion by the private sector and it was seen as a major concern. Perhaps Peter can elaborate on specific examples of that.

**Mr Grills**—The underlying principle that was mentioned somewhere in the papers that risk should be borne by the person or party that can best manage it is I think the most sensible principle. What I think is important, though, is the point that Helen made, and that is that in the private sector risk equals reward: the more the risk, the greater the reward. So if risk is being transferred as part of a particular contract I think that has to be formally recognised in the evaluation and analysis of the bids. What I think did happen, and it was quite observable and perhaps understandable, is that in regard to some contracts, particularly in some areas that had been highly controversial and caused a lot of angst, when that was contracted out the view was, ‘Phew, we have got rid of that,’ not recognising that there is a price to pay for absorbing that. So I think that there needs to be understanding of the link between risk and reward and then saying, ‘Okay, that’s fine. You are taking over that. That is a high risk. Yes, we will allow the appropriate margins, and so forth.’ That is the way that I would like to see things happening.

**Ms Leayr**—And underlying all of that there needs to be a recognition that if a government is going to be the prime customer there is always going to be, however small, an element of risk. If you are a customer at a milk shop, there is an element of risk whether that milk is going to be exactly what you believe you are purchasing. So risk is a very important issue that needs to be effectively communicated to those that evaluate a tender, and so forth.

**CHAIRMAN**—If you just look at the issue of liquidated damages as an example of risk, let us say for time of completion of a contract, regardless of what it is for – I do not care whether it is for IT, a building, a piece of defence hardware or a defence system – I would be willing to bet that liquidated damages for late delivery on Commonwealth contracts are much higher than they are with a contractor doing a similar project for the private sector. Would that be reasonable?

**Mr Grills**—I would not like to speak authoritatively, but I think you are right.

**CHAIRMAN**—I do not know definitively but I suspect so. Yet I would also suspect that the Commonwealth has rarely, if ever, invoked liquidated damages clauses.

**Mr Grills**—Yes. That horrific debate that wasted an enormous amount of energy without a great deal of outcome between the IT industry and the government on limitation of liability was exactly around that point, that the government was not prepared to accept a limit, but it never ever pushed the point and the industry wanted limits, and it went round and round and I do not think it really achieved a great deal. I can certainly think of a couple of anecdotal cases to support your view. With the DOFA payroll you had one of the country’s biggest payroll managers withdrawing from a contract because it could not accept the risk. That highlighted to the Business Council that there are still different perceptions, that the expectations of government and the expectations of the private sector are different in that area.

**CHAIRMAN**—I must admit that, coming from another country with a different business ethos, liquidated damages surprised me and frightened the life out of me. I could never understand why there was such a proliferation of contracts in Australia containing pre-estimated, liquidated and ascertained damages for some event, generally the delivery of whatever, without a corresponding benefit to the contractor for early delivery.

**Senator GIBSON**—I agree.

**Mr Grills**—You would not get an argument from me on that. To me the concept of reward for doing better, along with things like, for example, the sharing of savings, does not seem to get the same degree of attention or recognition as being penalised if you get it wrong.

**CHAIRMAN**—Does it get any recognition in Commonwealth contracts in your experience?

**Mr Grills**—I am aware of some where there has been some sharing of saving. I am aware of some where there has been some reward for productivity improvement, but I certainly do not think it is anywhere near what it could be or what the focus on the negative is.

**CHAIRMAN**—Even if it were there, would the agencies have the technical and practical expertise to be able to evaluate properly performance against the standard that had been set in the contract?

**Mr Grills**—In some areas.

**CHAIRMAN**—It is about value judgments.

**Mr Grills**—Where there are cases where there is an obvious benefit to government for doing something better, then there may be, but there is a lot of grey and I would hate to try to make some of those judgments on either side.

**CHAIRMAN**—You have no idea how we could suggest that people could do things better?

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**Mr Grills**—I certainly think there is scope for a more clear and up-front building in of rewards and recognition from both sides. As I said before, I came out of government and, whilst I do not want to give any specific examples that I was directly involved in, I can remember achieving savings and being told, ‘Sorry, due to budgetary considerations all of that saving goes,’ and feeling, ‘God, we busted our gut for that and got nowhere.’ I think a more long-term perspective of ‘Let us keep encouraging this all the time’ would have had a better long-term impact.

**Mr COX**—One of the questions that we are asking everybody is: how does your organisation feel about the Auditor-General having access to a private contractor’s books and premises if there is a serious allegation of malfeasance or fraud in relation to the operation of the contract?

**Mr Grills**—I guess my concern is as much about the confidentiality of the information as opposed to the access. If government funds and taxpayers’ money are involved, there has to be accountability, and I do not think the private sector has a concern about that. Where you feel concerned, however, is that material that could be quite damaging or beneficial to your competitors might become public as a result of such an investigation. That is where I would have a concern because the same issues do not apply in the pure government sector. Again, without taking sides, there has been a fair amount of coverage of such an issue in the local situation at the moment – over the Bruce Stadium – where there is enormous pressure once an auditor has gained access for that information to be made available. So I think there are two separate steps. There is the accountability and the scrutiny, but the recognition that information that is perhaps politically sensitive may also be of direct commercial value to the organisation is one that needs to be made. Protecting your own competitive position can be extremely important to a private sector organisation. I am not aware of any cases in recent times with the Commonwealth Auditor General where that has been an issue. I think there is a recognition of that, but I think that principle is important.

**Mr COX**—I would imagine that the Auditor-General would be capable of handling that in a reasonably sensitive way.

**Mr Grills**—Yes, that goes to my last comment that I agree, but it is an issue that I think is important. The actual accountability I have no problem with. There is a related issue to that when you are talking about accountability in perhaps a slightly broader sense, that needs to be recognised when you are dealing with the private sector. That is the assumption that sometimes the supplier, the private sector company, has the records, the systems and the ability to provide the response that an equivalent government organisation will have. It does not always have it because it is not relevant, issues like privacy or the ability to respond to an FOI request, those sorts of issues not of – I will not say fringe accountability – pure financial accountability. When they were introduced in the public sector, there was a long period of ramp-up, of developing systems procedures to manage them, and then you hear of proposals that that accountability should be extended to the private sector. I think there has to be recognition that many big companies do not keep the sorts of records that would fit that automatically, so if that is going to become part of the accountability framework it needs to be spelt out up-front so that people know what they are letting themselves in for and can prepare for it in time.

**Ms Leayr**—And so that the cost of preparing for that is recognised.

**CHAIRMAN**—Let us take a large government contract. It is always difficult to measure precisely the completed value of a contract. It is very difficult, if not impossible, to accurately, exactly and precisely measure where you are in terms of contract completion. If the auditor has concerns that the particular department’s or agency’s own internal accounting systems are not keeping track of earned value properly, why shouldn’t the auditor have the right to test the case through the contractor’s records as long as the contractor has been told that the auditor has the right of access?

**Mr Grills**—I am not sure that we would have a problem with that.

**CHAIRMAN**—That is what we want to hear. The auditor has said:

In the ANAO’s experience, we have found that, almost without exception, the relevant issues of principle can be explored in an audit report without the need to disclose the precise information that could be regarded as commercial-in-confidence. In this way, the Parliament can be confident it is informed of the substance of the issues which impact on public administration.

**Ms Leayr**—To some extent the success of that statement relies on the private sector organisation being aware up-front that (1) the Auditor-General has that power and (2) what kinds of information need to be kept to ensure that the auditor can justify that and be able to sign for it.

**CHAIRMAN**—In our report on the Collins class submarines, this committee did recommend that the auditor, as a matter of right, be given access to every Commonwealth contract and that it would not be up to the departments’ discretion when they write contracts whether or not the auditor can have access to the books but that in fact he does have access to the books.

**Ms Leayr**—The Business Council is quite comfortable with the scrutiny of a government when there is a relationship between government and the private sector. The only area that is of concern is the one that you have picked up on and on which you have made the point that the confidentiality does not need to be breached, that the business's coemptive edge or corporate knowledge or corporate secrets do not need to be disclosed. If the private sector is confident of that, I do not think there is any problem with the level of scrutiny.

**CHAIRMAN**—You would be aware that parliaments, not just ours but others – this is an issue that the Australasian Council of Public Accounts Committees will discuss in Canberra next February – have concern about this use of commercial-in-confidence in order to bury what would have been scrutinised by parliaments in other times on behalf of the Australian public and they are no longer able to do so because of perhaps overuse of the clause.

**Ms Leayr**—Peter has raised a very good point that at the ACT level at the moment this is an enormous issue because we have an ACT government –

**Mr Grills**—It is the fear of misuse. The private sector, justifiably I think, is always worried about what will happen.

**Ms Leayr**—It is the unknown.

**Mr Grills**—I share your view. There is genuine commercial-in-confidence and there is misuse of commercial-in-confidence. I cannot justify misuse of commercial-in-confidence, but I do think there are sometimes issues of genuine commercial-in-confidence that are not appreciated or understood by people who have a need or desire to get particular information. It is a balancing act. As long as you have a competent, fair, unbiased Auditor-General, the system can work well. But you can understand the fear of the private sector who do not necessarily have that same degree of scrutiny normally suddenly being exposed to it and thinking, 'Oh my God, what do I do?' Whilst I personally have a better understanding of that, on behalf of our members I would have to say that some of them would have a perhaps overdeveloped fear of that simply because it is different.

**CHAIRMAN**—But parliaments do have a responsibility, do they not, to try and keep the executive accountable. If the executive has a mechanism whereby they can bury their accountability, they are self-encouraged to use it.

**Ms Leayr**—To clarify the Business Council's point on this and the private sector view, it comes back to that point I made in my brief opening comments about confidence. If the rules are there and they are clear and there is not this fear of the unknown, of uncertainty, then I think the private sector can work within them and will do so, and will factor in the processes that it needs to work within those. I think that is the bottom line.

**CHAIRMAN**—Thank you very much for your submission and for talking to us. As always, when we write the report, we will make sure that we send you a copy.

**Ms Leayr**—Thank you.

[3.20 p.m.]

**LAURIE, Mr William Andrew, Office Managing Partner, PricewaterhouseCoopers**

**McWILLIAM, Mr Andrew David, Consulting Director, PricewaterhouseCoopers, c/- Business Catalyst International Pty Ltd**

**NARRACOTT, Ms Michelle Elaine, Partner, PricewaterhouseCoopers Legal**

**CHAIRMAN**—I now welcome representatives from PricewaterhouseCoopers to today's hearing. We have received your submission. Would you like to make a brief opening statement?

**Mr Laurie**—We would appreciate that. Very many thanks for the opportunity to discuss our submission and to respond to any questions that you may have. I would like to just refresh your mind slightly that, in our submission, we addressed a number of the committee's terms of reference, including contract specification matters, management accountability, performance monitoring, risk allocation and corporate memory. By way of introduction I would simply say that, in our view, contracts which work best are those that are well managed. It seems a fairly simplistic statement but it covers a multitude of sins.

Based on our experience, good contract management embodies a number of features – and I will briefly run through what we see as the features of good project management. The first important issue is that contracts are developed to accurately reflect the outputs and outcomes sought. In this regard, we believe the establishment of sensible, useful and reviewable key performance indicators is of fundamental importance. A second important feature of good contract management is a formalised, regular communication environment between the customer and the contractor. This environment on larger contracts should be tuned towards building the relationship between the parties, where ideally the parties see themselves in an alliance with common objectives for the production of the agreed outputs. The alliance should aim to build understanding and trust, and this is facilitated by a consistency in personnel from both sides of the contract. The third issue of importance to us is the management of risk. Risk management starts well before contract management. Sound contracts are based on careful, up-front risk assessment as part of the tendering and subsequent contract negotiation phases. Good contract management recognises that risk needs to be negotiated and allocated between both parties in order to provide the basis for a sound relationship as well as a sound price. The fourth point is the growing need for specialist and trained contract managers, perhaps under the control of a position which could be described as a 'chief resource officer' or – what we would say – a CRO, with ranking and responsibilities not dissimilar to a CFO or chief financial officer. As the pace of outsourcing grows and the Commonwealth continues to be a major buyer of other goods and services, the need for expertise in contract management is similarly growing. It seems to us that there may be some merit in focusing responsibility for contracting policies, contract management and education and training at a single point within an organisation.

In regard to accountability, we see it as essential that the Auditor-General has equal access to contractors' books and records in the manner to which the Auditor-General is accustomed already in the public sector. We would add, however, that it is useful to contractors for them to have a clear view of the Auditor-General's mandate and focus, as they enter into contracts. Finally, the devolution of responsibility under the FMA and CAC acts heightens the accountability of the CEO and adds a further dimension to the need for parliamentary scrutiny. In some respects, the move towards outsourcing adds a helpful level of transparency to various processes of government, which become visible through the contract terms and the performance indicators associated with the contract. Where these functions were not previously outsourced, there was no particular need to have similar levels of documentation. So, as a general statement, contracts which realistically define outputs and are accompanied by appropriate performance indicators play an important role in public accountability. My colleagues will be keen to answer your questions and elaborate on our submission as we proceed.

**CHAIRMAN**—Thank you for your statement on Auditor-General access to contractors' books. This committee has been pursuing this issue for a long time and recently as part of our report on the Collins class submarines made a very definitive recommendation, on which we are still awaiting an answer from government. I am interested particularly in this issue of risk and risk sharing. You said the two parties ought to get together and decide how to share the risk. But realistically a very large part of the time the purchaser of goods and/or services, in this case being a Commonwealth agency, is going to specify in the contract who takes the risk. They will do so in their terms and conditions of contract. Today the Master Builders Association, The Institution of Engineers and the Institute of Architects have all said that, in their view, with increasing outsourcing the Commonwealth has become more risk averse, not less risk averse; that contract specifications are attempting to transfer all the risk to the private sector, or the majority of it in general, not in absolute terms. That was their view. Do you have a view on those issues?

**Mr Laurie**—I have a view, and I am sure my colleagues would elaborate by posing their own views. My view is that before the tendering process starts an important responsibility of a contracting agency is to do a thorough risk assessment so that when the tenders go out to interested parties there is a strong view coming from the contracting party as to where the risks are likely to be incurred. Of course, the contracting party will not know where all the risks are because they will not have received the response and they will not have the views of the organisations responding to the tender, who will have their own perceptions of risk. So there are going to be two streams of risk assessment happening concurrently. It seems to me that the really important thing, therefore, is to have an environment in which the risks can be identified and negotiated so that there is a balance between both parties. The present arrangement where, for example, under certain contractual terms liability is fully in the hands of the contractor is not a terribly good starting point and it can be a deterrent to small and other businesses, who see the words on the paper and say, 'I'm not going to accept that risk,' and disappear. Yet those who are larger and have dealt more often understand that this is a negotiable issue. I think an important reason as to why the private sector might take a view that the Commonwealth is pushing risk in the direction of the private sector is perhaps a lack of confidence that the public sector may have in being able to effectively negotiate the position. Perhaps that points to staff turnover and lack of training. So I think if we have a well-trained, professional contracting environment in the Commonwealth then their ability to assess, identify and negotiate risk will be much more effective.

**CHAIRMAN**—Do we?

**Mr Laurie**—It is patchy.

**Senator GIBSON**—How do we improve it?

**Mr Laurie**—Michelle would have some views on that.

**Ms Narracott**—I have some fairly strong views on how to improve the quality of contract management. I guess I see the absolute essential in getting any government system in place, including contract management, is embedding that system in the staff and any contractors that are used to provide that service. The only way I believe that you can do that is to have very clear instructions and education on the contract process.

As for the question of risk aversion and the intransigence of government contract managers, I believe that is the result of not fully comprehending standard form agreements and, for example, the indemnity clause – 'What does that indemnity clause actually mean?' To me education is critical. I have anecdotal evidence of one area of government operations and the way that they have approached this whole issue of contract management. I should mention that I see contract management as being two streams and I feel we are very much focused on procurement.

Probably there is another growing and probably more legally exposed area, which is contracts relating to the Commonwealth's commercial activities. My experience is in that commercial area and with contracts there, where there is high legal exposure. What is critical in that type of training is to ensure that it is compulsory for those staff who are involved, that there is some form of accreditation within the agency so you do not get your wings to be a contract negotiator or to be involved in contract preparation unless you actually understand what the basic principles of contracting are. That does not mean we are going to turn our contract managers into lawyers; that is the last thing anyone wants. What we are trying to do is keep legalese out of the equation, so certainly – just briefly on that contract education side – I think it is critical that it be compulsory for people involved in contract management within the agency, that it be coordinated centrally through the notion of a CRO and that there be an ongoing education campaign. The level of training would actually be built in as a performance indicator in the CEO's performance agreement. Essentially, I think we need professional contract managers. The other option of course is to buy in but I think that with outsourcing it is always critical to have a contact or several contacts if possible within the agency who are managing it.

**Senator GIBSON**—I think what you are describing suits large agencies where they are doing contracting all the time, so you need a core of professional managers to handle that work. But what about the smaller agencies that do occasional work? How should they cope with that? This morning we had the Master Builders Association and the Institution of Engineers saying there was a deficiency in contract management expertise in lots of agencies and suggesting, in the document that I have here, that agencies go through a process of asking themselves if they have the expertise, and if they do not have it they should go and get it. Would you care to comment on that?

**Ms Narracott**—I would query whether any of our agencies, small or large, could say that contract management is not a major item in their management, whether it is the procurement of basic services or the provision of services to others. I would like to turn it on its head and say that it is an essential service or activity being carried on by all agencies. To me one response is to elevate contract management on the agenda. At the moment it is down there, with the contract purchasing officers, but it needs to be a lot higher on the government's agenda.

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**Mr Laurie**—There is a little history there. We used to have centralised administrative arrangements through DAS. We do not have DAS any more and there seems to be a vacuum that was formed in those organisations that were not regularly out in the contracting market. To pick up Michelle's point, I do not know the extent to which organisations have picked up the importance of this function now that it is not available centrally. It may be that this is a focus that the CEOs really ought to be looking at. I know Andrew has some views on knowledge management issues.

**Mr McWilliam**—I suppose that we have moved on from Purchasing Australia and the National Procurement Board, as it then was, with FMA and the like.

**CHAIRMAN**—I would remind you that this is not a purchasing inquiry. We did that last year.

**Mr McWilliam**—You did look at things like accredited purchasing units, and a number of agencies have still gone down the route of having virtually high level skills when you reach complex procurement thresholds of \$100,000, if you like, so that expertise is still there in a number of agencies. With a small agency, the ability still exists for it to go to a larger one and buy it under a service level agreement or a memorandum of understanding. That is still there and under FMA, as I understand it, that will always be the case, but it requires a level of cooperation between the agency CEOs who want to do it.

**Senator GIBSON**—One of the suggestions that the Institution of Engineers made was that there ought to be an institute of contract administration – I think the last witnesses then said that perhaps that should be wider and project management oriented – in other words, some sort of recognition of expertise and continuing experience in that particular area.

**Mr McWilliam**—I think there is potential for doing that. I speak from experience of an exercise of electronic purchasing arrangements in the Commonwealth. We looked at the whole spectrum of activity of the life cycle. Some expert advice to the working group suggested that there was the possibility of having contract management embedded, if you like, in an Internet or intranet that people can access, so it obviates the real need to have detailed knowledge. Our friends at Australian Government Solicitor's were able to tell us that you can get some standard terms and conditions of contract which probably fit purchase of goods and some services – not battleships and the like – which people can buy and use. In terms of getting the Institute of Project Management to expand, that is the way to go, rather than splitting it out yet again. The Institution of Engineers will probably go down that route as well.

**CHAIR**—Ms Narracott, you said some lovely euphemistic type words about elevating the role of contract management, project management – whatever people call them – and making sure that everyone is trained competently. How do we go about writing such a recommendation?

**Ms Narracott**—There are, I believe, five specific mechanisms that could immediately be made the subject of recommendations which would improve accountability for contract management. The aim of these mechanisms is to elevate contract management in the government's current framework. The first of those, I would suggest to the committee, is to recognise the importance of proper contract management in both its forms – procurement and management of commercial activities – and recognition of it within all of the corporate governance work that the committee has already valuably done over the past two years.

On the way to elevate contract management on the governance agenda within Commonwealth agencies, I see two key ways. The DOFA report of operations under the CAC Act – the guidelines that they issue – could quite specifically include contract management performance reporting. On a previous occasion I have raised with the committee issues of just how specific that report of operations is and I see the opportunity where parliament identifies issues that are of such critical public importance – probity issues like contracting and tendering and environmental management – and we put those into the report of operations each year. The second way to get it elevated is to include contract management performance measures for government agencies, for their boards. One of the critical recommendations of the committee, I believe, in the GBE sector is the need for performance agreements between boards and ministers, CEOs and boards – that whole area of performance indicators.

The types of indicators I would be recommending are things such as the level of disputation arising over the contract management process and the costs to the Commonwealth of litigation. Going back a step, there is the cost to the Commonwealth of involving lawyers. I believe that the involvement of lawyers in contract management is actually a sign that our contract management system is not best practice.

**Mr Laurie**—Despite the interest of the PWC.

**CHAIRMAN**—I did not really expect you to answer the question. But keep going.

**Ms Narracott**—The final indicator, and a critical one, that I guess we have experienced in the Commonwealth sector is the frustration of extended negotiation times, so what are the time frames agencies are achieving? I have seen seven-month negotiation periods for a \$5,000 agreement.

**Mr COX**—Obviously there were significant principles at stake.

**Ms Narracott**—That is between government agencies.

**Mr COX**—The secretary's car park.

**Ms Narracott**—Should I keep going, Mr Chairman?

**CHAIRMAN**—Absolutely. I do not know whether we need anyone else.

**Ms GILLARD**—Contract out the production of the report.

**CHAIRMAN**—We would need to talk about the terms and conditions of contract.

**Ms Narracott**—The third point is one that has been very close to my heart as the member of a large statutory authority, and that is the need for consistency of ministerial contract approval processes. Sometimes we forget that aspect of contract management; that historically contract approval has been kept for ministers, so a lot of your older enabling legislation will say that ministerial approval of contracts is required. Contract management was always specified in the old enabling legislation, but that has dropped off a lot now.

**Mr COX**—Buck-passing. They hand the risk to the minister and when it goes wrong they say, 'But, Minister, you approved it.'

**Ms Narracott**—That is right, whereas the CAC Act suggests movement down to the CEO and the board. The way the CAC Act has been doing that is through the reporting of significant events under section 15 and section 16, keeping the minister informed. Still, though, within the Commonwealth we have lack of consistency. Some agencies are required to get ministerial approval for contracts and some are not. There is a good opportunity for the committee to establish what will be the contract approval process, and I would suggest the CAC, or pushing down to the CEO level.

The fourth point is really a bit of a follow-on to this issue of keeping the minister informed. Under the CAC Act when reporting to the minister each minister has the opportunity to develop guidelines. With all respect, I would suggest that that is not actually occurring. It is difficult to say that, but at a minimum there is no best practice sharing of what a set of ministerial guidelines should look like for reporting. I would say that most agencies do not have a set of guidelines in place that have been precipitated by the CAC Act. They are probably relying on old systems.

**Senator GIBSON**—Have you seen some good ones?

**Ms Narracott**—No.

**Mr Laurie**—It is the same as the chief executive instructions. They are now separate between agencies and departments and lack consistency. So at both those levels you have a problem.

**CHAIRMAN**—Without going into great detail, if I understand you correctly, you are really suggesting that we use our powers of persuasion with respect to annual reports in order to move the agenda on.

**Ms Narracott**—Yes.

**Mr COX**—On the subject of elevating the role of contract management I suppose it is fair to say that, when government did everything for itself, a reasonably high level of intellectual resources were devoted to that process. The Chairman of the Public Service Board was the most important or the second or third most important person around, depending on whether or not you happened to be the Secretary to Prime Minister and Cabinet or the Secretary to the Treasury. Since most of those functions have been pushed out to the private sector, a vacuum has been created that has not yet been filled for management of those things. While there is such a preoccupation with devolution of responsibility to agencies, that vacuum is not likely to be filled in any coherent way.

**Mr Laurie**—Perhaps it needs some enthusiastic pushing to see that the vacuum disappears. The vacuum is becoming important and a risk to the Commonwealth. If we look at each of the departments at the moment, for example, all their back office functions will be outsourced progressively, we understand, over the next couple of years. That means very substantial contractual arrangements will have to be put in place that will have to manage risk across a variety of functions. As I understand it, those are going to be done on an individual, department by department basis. It is a critical issue that those contracts, let alone others, are done properly. So the time is now to start making some changes, to start elevating the positions and responsibilities as we suggested to a level – why not? – the same as CFO. These are important issues that can put the Commonwealth and the performance at risk.

**Mr McWilliam**—The other thing I would say is that in getting the contract management elevated we need also to tie it back to service level agreements and to the outcomes. So you start getting strategic management flowing through and realised in the contract management. So you have that continuum between outcomes,

outputs, service level agreement performance indicators and down to individual contracts with contractors. That way, if you can cover that continuum off, then you can start injecting skills at the appropriate point.

**Ms GILLARD**—You are not suggesting in the contracting out of those back office functions that the contracts would necessarily end up the same; you are just saying a high level of accountability and presumably some best practice sharing between agencies as that process is gone through?

**Mr Laurie**—I think that would be really helpful in where we are at the moment. In the endowment of resources we have in contract management, I think you have to share. As I understand it, each of the back office outsourcings will be different, so that it is not just the same model that will be applied. Each agency is going to look at what, why and how and therefore each will be charged with that responsibility of getting the contract up and having it managed. Some are going to find it a very challenging exercise and, if the contract is not successfully concluded in terms of, as Andrew says, appropriate performance indicators that you could start building a relationship around between the contractor and the organisation letting the contract, you do not really have a basis for sound contract environment. I do think there are going to be organisations that will need to borrow people and their skills from others who have been there before.

**Senator GIBSON**—Perhaps something that we can recommend and be strong about is that whoever does gain expertise in setting these commercial contracts in place early up makes sure the other agencies are aware of that and borrow that expertise in following through. By doing so, the risk would be lower.

**Mr Laurie**—There certainly are some examples of that happening.

**Senator GIBSON**—Are there?

**Mr Laurie**—In DOFA there is a particular contract that is just in the ending stages of selection and I understand the official responsibility for that will soon be going off to another department to do different but similar things.

**Senator GIBSON**—That is good.

**CHAIRMAN**—We also believe there is a huge level of disparity in terms of expertise of these things across agencies. Some do some things very well, some do other things very well, and nobody does everything the best.

**Mr COX**—Is that DOFA contract in the IT area?

**CHAIRMAN**—That is true in the private sector, isn't it? That is true in life.

**Mr Laurie**—Yes.

**CHAIRMAN**—I daresay none of the three of you is equally competent at anything.

**Mr McWilliam**—Fair comment, Mr Chairman.

**CHAIRMAN**—One of you is going to be best at each kind of issue that we pick. We are going to have to go.

Resolved (on motion by **Mr Cox**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

**CHAIRMAN**—I declare this public hearing closed.

**Committee adjourned at 3.50 p.m.**



