

AUDIT REPORT NO. 35 DEETYA INTERNATIONAL SERVICES

Introduction

2.1 The former Department of Employment, Education, Training and Youth Affairs (DEETYA) International Services (DIS) was established in 1993 as a consultancy business. (This Department is now titled Education, Training and Youth Affairs).

2.2 The main services offered by DIS cover:

- project related consultancies;
- study tours of Australia;
- specialist advisory secondments;
- feasibility studies, which promote education and training expertise as part of broader joint venture initiatives with industry for overseas markets;
- an international recruitment service aimed at increasing the number of Australians employed in international organisations; and
- initiatives aimed at increasing Australia's share of international procurement by multinational agencies.¹

2.3 Services to the public provided by agencies in the Australian Public Service (APS) may be delivered under a number of arrangements, ranging from fully commercial to a non-commercial basis. As the Australian National Audit Office (ANAO) noted in its audit report, whatever method is chosen, it should be established, operated, monitored and its overall

1 The Auditor-General's *Audit Report No. 35, 1997-98, DEETYA International Services, Department of Employment Education Training and Youth Affairs*, p. xi.

performance assessed to ensure that quality services are provided to clients in the most cost-effective way to meet government objectives.²

2.4 During the ANAO audit, DIS was operating as a Branch consisting of 13 staff within DEETYA's divisional and corporate planning program. DIS' mission and business plan had been developed in the context of DEETYA's broader international activities. According to its 1996-97 Business Plan, DIS had been operating as a commercial entity.³

2.5 In late 1996 the ANAO conducted a preliminary study of the International Division of DEETYA to examine the Division's functions and operations. The study identified difficulties in developing commercial operations within the APS framework.⁴

Objective of ANAO Audit

The ANAO's objective in examining the operations of DIS was to identify:

- the administrative issues and difficulties being experienced by DEETYA in establishing a commercial entity and its subsequent operation within the APS framework; and
- any lessons learned and better practices from the implementation of commercial arrangements in DIS.⁵

ANAO Audit Findings

2.6 The audit found that most elements of DIS' business were operating well. Satisfactory aspects of the business included the management of service provision where DIS had comprehensive processes in place for the development of proposed services, monitoring delivery and assuring quality. The ANAO stated that this initiative would have contributed

2 *Audit Report No.35*, p. 3.

3 *Audit Report No.35*, pp. 4, 9.

4 *Audit Report No.35*, p. 3.

5 *Audit Report No.35*, p. 5.

significantly to DIS' success in winning tenders, and to overall client satisfaction.⁶

2.7 However, the ANAO also found that DIS had not operated on a fully commercial basis as indicated by its business plan. Although its mission statement and planning documents pointed to a commercial operation, DIS had not clearly defined the level of "commerciality" to be achieved. In the area of community service obligations (CSOs), for example, DIS had neither separated the funding for CSOs to allow a clearer focus on its commercial performance, nor identified tasks which were in the nature of CSOs.

2.8 The lack of a defined business purpose, indicated a requirement for DIS to significantly improve its operations in a number of areas. These included: providing a sound financial planning framework; a comprehensive risk management plan; and a costing methodology to adequately reflect the full cost of production.

2.9 The audit found that because of the shortcomings of its costing methodology, DIS had not been able to identify to any reliable extent the full costs of its operations. It was further observed in the audit report that DIS' true financial position could not be determined because it was not managed on an accrual basis.⁷

2.10 The ANAO made nine recommendations. The recommendations were directed at improving the operations of DIS in areas identified by the ANAO as requiring improvement. These included clarification of DIS's business purpose and identifying CSOs; improving the planning and performance information base; developing an accrual-based financial planning framework; reviewing the costing methodology and establishing a debt management policy. DEETYA agreed with all of the recommendations.⁸

DIS' Current Directions

2.11 Prior to the public hearing, DEETYA provided a Submission to the Committee which indicated that DIS had

6 *Audit Report No.35*, p. xiii.

7 *Audit Report No.35*, p. xiii.

8 *Audit Report No.35*, p. xiv.

refocussed its operations. The Submission noted that during the course of the ANAO's performance audit, DIS had operated as a Branch within the (former) International Division of DEETYA.

2.12 Under the current arrangements, DIS functions as a Unit of seven staff within the Australian Education International Branch which is located in the International, Equity, Youth and Students Division of DEETYA. The Submission further noted that DIS performs its functions in partnership with external stakeholders. These include education and training providers, as well as firms in the private sector involved in bidding for international development projects; International recruitment is a DIS Community Service Obligation.⁹

2.13 According to the Submission, the review initiated by DEETYA was conducted parallel with the ANAO's performance Audit. In response to the findings of both the ANAO audit and the departmental review, DEETYA developed a cost recovery policy and operational framework for the export of its services.

2.14 Under the new operational framework, DEETYA does not aim to make a commercial profit from the export of its skills and services. Its focus is:

*to maximise the achievement of wider corporate policy objectives while minimising risks, recovering costs and containing the call on DEETYA resources...The cost recovery model identifies and clarifies the activities relating to community service obligations and services for which costs are to be recovered.*¹⁰

2.15 The Submission stressed that DIS is currently focussing its activities on supporting government policy objectives rather than competing with the private sector in the area of education and training services.¹¹

9 Submission No. 2, 9 June 1998, p. 1.

10 Submission No. 2, p. 2.

11 Submission No. 2, p. 2.

The Focus of the Hearing

2.16 The Committee focussed on the strategic direction being pursued by DIS and the planning processes which have been put into place to achieve desired outcomes. Therefore, in addition to the ANAO audit, the Committee's examination of DEETYA took into account DIS' current operational framework as described in DEETYA's Submission. The main areas of examination comprised: planning; performance management; managing service provision and accounting and financial management.

P l a n n i n g

2.17 Appropriate planning is essential to the effective operation of any organisation and must be based on a clear definition of an agency's business purpose. The extent to which the business of an organisation will be commercial, must be taken into account in the planning process.

2.18 An essential element of planning in the public sector is the identification of activities which an agency proposes to deliver on a commercial basis and those it proposes to designate as meeting CSOs. If certain activities are identified as CSOs, it is desirable that these should be funded separately to ensure a clear focus on the business objective.¹²

2.19 During the period of the audit, DIS operated as a commercial business. The DIS mission statement which introduced its 1996-97 Business Plan was:

*to promote and expand export opportunities on a commercial basis in the fields of employment services, education and training, particularly where DEETYA has expertise unique to its organisation and services.*¹³

2.20 However, the ANAO audit found that DIS had not clearly defined its business purpose, including identifying any CSOs. Added to this, the ANAO was not provided with documentation which indicated Executive or Ministerial

12 *Audit Report No. 35, p. 9.*

13 *Audit Report No. 35, p. 4.*

approval for DIS' business purpose, particularly as Executive and Ministerial decisions are central to the planning process.¹⁴

2.21 As indicated in the introduction to this chapter, DIS has since refocused its operational framework as a result of an internal review. Under current planning objectives DIS' operations are required to support DEETYA's overall corporate objectives and the Government's broader foreign policy objectives. According to the DEETYA Submission, the departmental review findings were being implemented at the time the ANAO report was being finalised.¹⁵

2.22 The Committee notes that a key finding of the DEETYA internal review was DEETYA's difficulty in justifying export of its expertise on commercial grounds alone. The Committee also observed that the DEETYA review suggested that the:

*preferred operational model was for DEETYA to make its services and intellectual property available internationally on a cost recovery basis within the limits of its core domestic responsibilities.*¹⁶

2.23 Under a cost recovery operational model DEETYA would be freed from a drive for profit and:

*would be in a better position to ensure that its export activities were primarily directed to supporting DEETYA's own corporate objectives, and national policy objectives more generally.*¹⁷

2.24 In its examination of DEETYA's planning process, the Committee noted that DIS was in the process of developing its Business Plan for 1998/99 and that the new plan would reflect the requirements of the DEETYA corporate and business planning process.¹⁸

2.25 At the public hearing, the Committee asked DEETYA to elaborate on DIS' operational direction. In reply, Mr Peter Grant, Deputy Secretary, DEETYA, explained that

14 *Audit Report No. 35*, p. 13.

15 *Submission No. 2*, p. 1.

16 *Submission No. 2*, p. 1.

17 *Submission No. 2*, p. 1.

18 *Submission No. 2*, p. 4.

DIS' previous direction was of a commercial nature and profit oriented, but that direction had not been strategically defined. Mr Grant admitted that experience had demonstrated the limitations and inherent difficulties of DIS' previous approach. He observed that with the benefit of hindsight, DEETYA understood that engaging in international consultancy services should be undertaken "only to the extent that there is clear strategic benefit to Australia and Australians from doing so".¹⁹

2.26 Mr Grant explained that under the present operational direction, DEETYA was pursuing a more strategic approach. However, that did not mean that the Department was ignoring the business side of its operation:

*On the contrary, we are now much more sensitised to the importance of a businesslike approach and to the need to ensure that any export activities are not resourced to the detriment of our primary domestic responsibilities.*²⁰

2.27 Mr Grant indicated to the Committee that an important aspect of the shift in emphasis is that DEETYA itself is doing less international project work. He emphasised that DEETYA will rely more heavily on strategic alliances and partnerships with education and training institutions including the private sector.²¹

2.28 Mr Grant added that in response to the ANAO recommendations, DIS has revised a number of plans and processes including the:

- redefinition of its business purpose;
- clarification of CSO activities;
- revision of business planning processes;
- development of a comprehensive risk management plan;
- revision of debt management policy and procedures;

19 Mr Peter Grant, Department of Employment, Education, Training and Youth Affairs (DEETYA), Transcript of Evidence, 16 June 1998, PA. 28.

20 Mr Grant, Transcript, PA. 29.

21 Mr Grant, Transcript, PA. 29.

- review of costing methodology and pricing strategies; and
- provision of regular quarterly reports to the Secretary of the Department.²²

Performance Management

2.29 Performance management, together with planning, is essential for the effective operation of an organisation. Performance management ensures that an organisation is advancing towards meeting its longer-term objectives through the use of appropriate strategies.²³

2.30 According to the ANAO, DIS has established the basis for a performance management framework. However, the audit found that DIS had not clarified its business purpose and objectives, nor were the strategies and performance indicators identified separately in most instances. As a result, it was difficult to fully assess the overall effectiveness of the process.²⁴

2.31 According to the DEETYA Submission, DIS' performance management system was being revised in response to the ANAO recommendation. The Submission indicates that the revised performance management framework will establish clear linkages between the objectives, strategies and DIS' functional activities. In addition, a set of balanced performance indicators, both quantitative and qualitative, are being formulated against each strategy. The 1998/99 DIS Business Plan will form the basis for the new performance management system.²⁵

2.32 Mr Grant informed the Committee that the new performance management system had been developed in the interest of more effective monitoring and review of DIS' operations. In addition, and in line with the Department's transition to an accrual accounting system, DIS will also be moving to full accrual accounting in 1999-2000. These changes

22 Mr Grant, Transcript, PA. 29.

23 *Audit Report No. 35*, p. 24.

24 *Audit Report No. 35*, p. 30.

25 Submission No. 2, p. 6.

are an indication that DIS' operations have been reviewed and substantially refocused.²⁶

Managing Service Provision

2.33 The management of service provision is important for the operation of all businesses including those operating within the APS. The audit found that DIS has in place comprehensive mechanisms in the area of development and monitoring of service delivery as well as the assurance of the quality of its services.²⁷

2.34 Drawing together an appropriate team is essential in managing service provision. The audit report observed that DIS has satisfactory processes in place to manage the development of tenders for possible projects.

2.35 According to the ANAO, DIS has a number of mechanisms in place to obtain relevant expertise for a particular project. These include approaching departmental staff with appropriate skills for a particular project who have expressed an interest in international work. Other strategies include maintaining a register of curriculum vitae for consultants and DEETYA staff, and contracting suitably qualified consulting firms.²⁸

2.36 However, Mr Grant made the point that DIS is currently staffed by seven officers, half its earlier complement. As a result, staff in the unit are "significantly stretched" in managing their current program workload.²⁹

2.37 DEETYA was asked by the Committee to explain DIS' role if it is subcontracting most of its work which is in turn being subcontracted to others. Mr Grant informed the Committee that by reducing the size of DIS' activities within the Department, there is a need for increased reliance on external expertise and resources. In addition, it is generally believed that in government to government projects, foreign governments place significant importance on the involvement

26 Mr Grant, Transcript, PA. 29.

27 *Audit Report No. 35*, p. 37.

28 *Audit Report No. 35*, p. 38.

29 Transcript, PA. 36.

of the Australian government “not only symbolically but also as some assurance of quality and effective management of the project.”³⁰

2.38 Mr Grant, emphasised that it was the Department’s view that an international market exists for expertise in the field of employment, education and training. There is, however, vigorous competition between, for example, the United Kingdom, Germany and Denmark to win contracts. Despite this competitive environment, DEETYA understands that Australia generally, and the Department specifically, is highly regarded in the international arena for the creativeness of its policy approach and the high quality of its policy solutions.³¹

2.39 The Committee considered DEETYA’s Submission which indicated a refocussing of DIS’ operations based on a cost recovery model and comments made at the public hearing by DEETYA representatives.

2.40 The Committee agrees with the ANAO’s comments that a critical issue for DEETYA into the future is its ability to manage the provision of expertise with only seven staff. It appears to the Committee that DEETYA continues to be unable to clearly define a vision for its international operations, despite its enthusiasm to market its expertise in the international market place.

2.41 The Committee accepts DEETYA’s comments that Australian official involvement in government to government projects provides assurance of quality and effective management of projects. However, the Committee has some reservations about the capacity of a small unit such as DIS contributing in any significant way to the broader Australian foreign policy goals, particularly against vigorous international competitors.

30 Mr Grant, Transcript, PA.35-36.

31 Mr Grant, Transcript PA. 28.

Accounting and Financial Management

2.42 The ANAO report observed that many of the differences between the public and private sectors in the area of accounting and financial management are currently being reduced under reforms to the APS. Limitations in financial management in public sector enterprises have previously arisen from an almost total reliance on annual cash accounting.³²

2.43 Under DEETYA's cash accounting system, DIS is able to estimate its potential administrative costs for specific projects. However, DIS has, as yet, no system to determine the full costs of its operations, which would include, rent, salary on-costs and departmental support services, because it operates within the constraints of the departmental system.³³

2.44 In estimating these costs it has relied on the Department of Finance and Administration (DoFA) formula which estimates full costs by applying a multiplier to direct salary costs. The multiplier covers such things as superannuation, compensation and legal expenses and accommodation expenses. These are additional to the cost of direct salaries.

2.45 Consistently, the audit found that DIS did not apply the DoFA multiplier to all its direct salary costs. In particular, DIS did not include specific allowance in its tenders to cover either the direct salaries or on-costs of its management and administration staff.³⁴

2.46 However, according to the audit report:

*Deficiencies in the costing approach may have led to inappropriate pricing decisions and/or the inability to adjust the cost structure in accordance with commercial requirements. In DIS' case a cash deficit has accumulated since the commencement of commercial operations.*³⁵

32 Audit Report No. 35, p. 43.

33 Audit Report No. 35, p. 44.

34 Audit Report No. 35, pp. 44-45.

35 Audit Report No. 35, p. 45

2.47 The audit demonstrated that from 1993-94 to 1995-96 DIS recorded a cumulative cash deficit of \$1.4 million. The ANAO observed that as DIS did not know whether the costing methodology it had been using took account of the full costs of production:

it could be that the accumulated cash losses are higher than \$1.4m. For example, DIS advised that the deficit recorded for 1995-96 could be understated by \$967 000.³⁶

2.48 The ANAO noted in its report that because of the shortcomings of the costing methodology used by DIS, it had not been able to identify the full costs of operation in a reliable way. As a result, DIS had recorded an accumulated cash deficit which indicated that the business was being subsidised by other DEETYA activities.³⁷

2.49 The Committee questioned DEETYA about DIS' \$1.4 million deficit. Mr Colin Walters, on behalf of DEETYA, replied that this figure predated the accrual accounting system:

and at the moment we are estimating that the operation is more or less breaking even...For example, of the seven staff, one member of staff is occupied full time on the international recruitment service, which does not actually form part of this business...so the \$1.4 million figure is really rather misleading. If it was done on a present day accrual basis, we anticipate it would be a lot less.³⁸

2.50 The Committee sought further information from DEETYA regarding DIS' costing methodology under its current cost recovery operational model. According to advice from DEETYA, under the cost recovery model DIS will be guided by the following parameters that:

- cost recovery is achieved when revenue from an activity meets all associated costs;
- accrual accounting methods be incorporated into cost recovery accounting, through a pilot to be conducted during 1997-98; and

36 Audit Report No. 35, p. 45.

37 Audit Report No. 35, p. 46.

38 Transcript, PA. 36.

- the financial return to work units in DEETYA for the release of staff reflects their full cost.³⁹

2.51 Mr Ian McPhee, ANAO, made the observation that DIS is a very small sector of DEETYA's activities. Its systems and the direction it pursues should be measured accordingly. Mr McPhee stressed, however, that despite the size of its operation the business risks can be substantial. Therefore, a critical issue for DEETYA into the future is its ability to manage the provision of services with only seven staff. Mr McPhee suggested that it is important for the Department to be alert to this, because even with a small staff the risks are likely to be high.⁴⁰

2.52 The Committee was concerned with the audit findings that because DIS operated within the constraints of a departmental cash accounting environment, it had no system or information bases to determine its full cost of operation.⁴¹ The document on costing methodology provided by DEETYA indicates that the direction being taken by the Department, while appropriate, appears to be more in the nature of a statement of principles rather than a costing methodology. Moreover, the document did not identify DIS' Community Service Obligations.⁴²

2.53 The Committee took note of the ANAO's comments that there have been limitations on financial management within the Australian Public Service arising from the total reliance on annual cash accounting of inputs. The Committee recognises that accounting and financial management will change as the Public Service adopts accrual-based output/outcome budgeting and financial management.

2.54 The Committee welcomes the development of a new operational framework for DIS. However, the Committee remains unconvinced that the Department has been successful in setting clear objectives for DIS' proposed new direction.

2.55 The Committee is of the view that if the Department wishes to change DIS' operational culture, clearly defined and

39 Letter from Mr Steve Sedgwick, Secretary, DEETYA, 17 August 1998, Attachment A.

40 Transcript, PA. 42.

41 *Audit Report No. 35*, p. 44.

42 Letter from DEETYA dated 17 August 1998.

well focussed objectives must be formulated and appropriate outcomes determined. The Committee is concerned also that the reduction of DIS' staffing level from thirteen to seven staff could make the achievement of its objectives difficult.

2.56 **Recommendation 1**

The Committee recommends a follow-up audit of the international operations of the Department of Education, Training and Youth Affairs (current title) in order to assess the effectiveness of the cost recovery operational model.

C o n c l u s i o n s

2.57 The Committee considers the ANAO audit of an APS agency operating as a commercial entity was timely and important. The audit highlighted the fundamental requirement upon these agencies to define the level of commerciality they wish to achieve. In particular, the audit demonstrated the importance of establishing soundly based strategic planning to ensure desired outcomes irrespective of the means chosen to provide a particular service.

2.58 The Committee noted that a 1996 preliminary study conducted by the ANAO into the International Division of DEETYA had identified difficulties in developing commercial operations within the APS framework. Despite these findings, DEETYA continued to maintain the operations of DIS as a commercial entity.

2.59 The Committee was concerned that the current audit report tabled in 1998 had also found that DIS was not operating according to commercial principles demanded by its business orientation. The Committee looks forward to improvements in DEETYA's international operations resulting from the implementation of refocussed planning and performance management frameworks.