CHAPTER SIX

CONTRACT MANAGEMENT

> Effective contract management goes beyond holding providers to account for each minute detail of the contract. To get the most from a contract, the contract manager and provider need to foster a relationship supporting the objectives of both parties and which focuses on results to be achieved.[1]

> The Australian National Audit Office (ANAO)
> *Contract Management: Better Practice Guide*

Introduction

6.1 In this chapter, the Committee examines the contract management practices and procedures followed for information technology (IT) outsourcing under the Initiative. It looks at the responsibility for negotiating, drafting and managing the contract at the nuts and bolts level. The Committee then looks more closely at matters that contribute to sound contract management, such as executive and staff commitment to the outsourcing arrangements, the level of expertise and experience needed to effectively manage a new IT outsourcing agreement, and the importance of building a constructive and cooperative relationship between all parties to the contract.

Responsibility for managing the contract

6.2 The Office of Asset Sales and Information Technology Outsourcing (OASITO) was charged with the responsibility for building a legal framework for both the tender process and for the relationship between the agency and the contractor.[2] OASITO's understanding of its role in developing and managing the contract was certain:

> We are merely the midwife; we do not bring up the child.[3]

6.3 In a practical sense, OASITO's responsibility ended with the signing of the contract. The agency then had, in the words of the Australian Taxation Office (ATO), 'carriage of the implementation of a process outcome to which it had contributed rather than managed or controlled'.[4]

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1 Australian National Audit Office (ANAO), *Contract Management: Better Practice Guide*, February 2001, p. 9.

2 Office of Asset Sales and Information Technology Outsourcing (OASITO), submission no. 4.

3 Mr M. Hutchinson, Finance and Public Administration Legislation Committee, *Hansard*, 1 June 1999, p. 280.

4 The Australian Taxation Office (ATO), submission no. 22. Appendix 10 to the report of the Humphry Review, 'Roles and Responsibilities for Agencies, OASITO and the Department of Communications, Information Technology and the Arts (DOCITA) in the IT Outsourcing Initiative', states that: 'OASITO

6.4   OASITO explained that it sought to improve the contract management skills of the agencies through a series of workshops conducted with each group participating in the Initiative. These were designed to improve the level of understanding of specific elements of the tender process, contract development and management.[5]

6.5   In relation specifically to the contract, OASITO assisted agencies define their business and technical requirements in a way that was 'capable of being implemented on a cost effective basis in an arm's length commercial contract'.[6] This process involved, where appropriate, the use of industry and government benchmarks where agencies' business requirements were unclear or internal performance information was not available.[7]

6.6   According to OASITO, a contract management plan was put together in consultation with agencies after the Cluster 3 transaction to assist future groups prepare for managing the outsourcing contract. This guide was prepared and subsequently refined with the objective of setting out common issues encountered in managing IT outsourcing transactions.[8] Thus, the preparation and drafting of the contract evolved as OASITO moved through each transaction.[9]

6.7   The management of IT outsourcing contracts, however, was and remains, primarily a function of the respective agencies. In other words, once a contract is in place, the cluster or agency then decides how to manage the arrangements throughout the life of the contract.[10]

6.8   Mr Edward Killesteyn, Department of Immigration and Multicultural Affairs (DIMA), acknowledged the role taken by OASITO in preparing the agencies for contract management but recognised the importance for agencies to have in place arrangements that catered for their particular needs. He stated:

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retains important strategic interests in post-contract issues that affect the overall success of the Initiative. OASITO will thus liaise closely with agencies after contract signature to ensure that issues affecting the overall success of the Initiative are managed within this broader context.' Mr R Humphry, *Review of the Whole of Government Information Technology Outsourcing Initiative*, Commonwealth of Australia, December 2000, p. 97.

5   ATO, submission no. 22.

6   Richard Humphry, *Review of the Whole of Government Information Technology Outsourcing Initiative*, December 2000, p. 96. Appendix 10.

7   ibid. Again, the consultants, Shaw Pittman, figured prominently in this process. Mr Smith (OASITO) informed the Committee that 'There is a specialist who works on costing and financial modelling and savings model with us. His job is to run across all transactions…he would be responsible for establishing the costing and saving models that we would examine the bids against and to set our cost baselines…he certainly works with agencies to establish their cost baselines…' Finance and Public Administration Legislation Committee, *Hansard*, 1 June 1999, p. 275.

8   OASITO, submission no. 4.

9   See Mr M. Hutchinson, Finance and Public Administration Legislation Committee, *Hansard*, 4 June 1998, p. 419.

10   See Mr M. Hutchinson, Finance and Public Administration Legislation Committee, *Hansard*, 24 November 1997, p. 676.

we had a vested interest in ensuring that the whole process, from specification through to evaluation and negotiation, met our best interests because we were the ones ultimately that had to live with the result. Our role was very strong in all parts of the process.[11]

6.9   Clearly it was in the interests of agencies to ensure that they were not presented with a difficult baby. But the separate roles assigned to OASITO and the clusters created difficulties for some agencies. The tension between a number of agencies and OASITO, evident during the tendering process, carried over into the contracting stage.[12] Thus, at times during the process of finalising the contract, agencies and OASITO came into conflict. Mr John Broome, former head of the National Crime Authority (NCA), told the Committee:

> If there are lessons to be learned from this, it is that while governments have every right to expect that contracts will be entered into quickly and effectively and that there should be no unreasonable delays in giving effect to government policy, nonetheless there are questions about the adequacy and effectiveness of the contractual arrangements, which ought not to be lost sight of. Some predetermined date for a press conference is not a reason to sign an unsatisfactory contract.[13]

6.10   Changes made to the implementation of the Initiative, with responsibility now devolved to agency heads, will remove this source of friction for agencies involved in settling the contractual arrangements. Nonetheless, there are still lessons to be learned from the process to date.

Negotiation

6.11   Even though a rigorous tender process may succeed in selecting the best provider of goods and services from the range of bidders that tendered, agencies still need to take measures to ensure that the arrangements finally agreed to will produce the best possible outcome.

6.12   The first phase of contract management—the negotiation phase—follows the selection process and commences from the time the provider is confirmed as the successful tenderer. During this period, parties to the contract work together to establish a framework within which the contract can be managed wisely. Agencies that have been through this process stress the importance of this stage in contract management and emphasise the need to specify exact requirements at this time.

6.13   As noted earlier, under the cluster model, agencies were heavily involved in finalising the contract. The Australian Customs Service (Customs), an experienced contract negotiator, although not part of the Initiative, suggests that the contract and

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11   Mr E. Killesteyn, Committee, *Hansard*, 15 March 2001, p. 217.

12   For a description of the nature and intensity of this tension, see this report, Chapter 3, pp. 18–21.

13   Mr. J. Broome, Committee, *Hansard*, 17 May 2001, p. 400.

supporting documentation need to clearly outline the roles and responsibilities of those involved in providing advice and taking decisions.[14] It should contain clear specification of performance and service levels and detail how these will be measured.[15]

6.14   According to Mr Peter Moran, Assistant Secretary, IT Group, Department of Health and Aged Care (DHAC), his department had 'a major involvement in the negotiation of the request for tender and considerable responsibility, and almost autonomy, in terms of conducting negotiations with initially three and then ultimately one tender.[16] He told the Committee that the department has 'a very precise set of contractual obligations with its provider, IBM GSA, in terms of the things that they will do'. These arrangements include Schedule 1, the statement of work, and Schedule 3 which describes the sanctions in a financial sense that the department will apply.[17] Mr Yarra from OASITO explained that a huge amount of effort was expended 'to prescribe to the nth degree precisely what the agencies want'.[18]

6.15   Although agencies are aware of the need to specify in detail their requirements and ensure that intended outcomes are clearly articulated in the agreement, a number of witnesses have mentioned problems encountered once a contract is finalised. For example, one ESP submitted that there was enormous underestimation by agencies of IT activity and volume levels which impacted on costs and resulted in it making some less-than-optimal decisions.[19]

6.16   Mr Richard Humphry commented on some of the uncertainties and difficulties that arose after the contract was signed and of the additional costs incurred as a result of 'having to patch up the contract and the arrangements afterwards'. According to him, a lot of work went on 'in actually settling down some of those earlier contracts, and there was a cost associated with that'.[20] In the main, he found in his Review that insufficient attention had on occasion be given to understanding an agency's business, resulting in a large number of issues needing resolution which added considerably to the risks of implementation.[21]

6.17   He told the Committee that the tendering process and contract management had:

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14   Australian Customs Service (Customs), submission no. 21.

15   Customs, submission no. 21, and submission to the Humphry Review.

16   Mr P. Moran, Committee, *Hansard*, 9 March, 2001, p. 134 and p. 119.

17   ibid., p. 124.

18   Mr D. Yarra, Finance and Public Administration Legislation Committee, *Hansard*, 4 June 1998, p . 420.

19   Information supplied to the Committee.

20   Mr R. Humphry, Committee, *Hansard*, 7 February, 2001, pp. 56–7.

21   Richard Humphry, *Review of the Whole of Government Information Technical Outsourcing Initiative,* Commonwealth of Australia, December 2000, p. 10.

taken a lot of additional staff time, and that there were issues that had not been anticipated that had been thrown up which required reclarification of the contract. Part of this was due to inexperience. There were expectations arising from the contract in some agencies which were not the same as those which the service provider was going to provide. It needed the process of both sides becoming aware of what expectations were on either side.[22]

6.18   In the following section, the Committee looks at contracts for IT outsourcing in general terms, the environment in which they were negotiated and why some problems arose despite the attention given to specifying contractual arrangements.

The Services Agreement

6.19   The Services Agreement, comprising the contract and a number of schedules, sets out the terms on which the contractor will provide the IT infrastructure and services, the terms on which the contractor enters into the Agreement, and the contractor's commitments with respect to industry development. According to OASITO, the Agreement was designed to assist agencies manage risks associated with outsourcing IT services. It allowed flexibility for agencies to define and obtain new services to meet their changing business requirements and it also provided a solid basis of:

• standards of technical requirements and services levels;

• pricing certainty for the majority of services for a five year period;

• transparency of pricing and costs;

• security and privacy protections; and

• obligations for contractor compliance with Commonwealth administrative and accountability processes such as the Archives Act and processes undertaken by the Auditor-General, and the Commonwealth Ombudsman.[23]

6.20   The Statement of Work is central to the Services Agreement. It describes in great detail the services to be provided by the contractor, including a general description of the work to be performed, hours of operation, contractor's responsibilities and specific tasks. The Health Group included in this document a statement of intent and business needs in order to convey a high-level understanding of the purpose of the requirements for particular services.

6.21   Clearly, agencies have the primary role in developing this detailed statement of work that defines exactly the technical requirements the provider is to fulfil. But a more difficult task for the agencies is to specify the levels of service and how they will

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22   Richard Humphry, Committee, *Hansard*, 7 February, 2001, p. 61. See also Richard Humphry, *Review of the Whole of Government Information Technical Outsourcing Initiative,* Commonwealth of Australia, December 2000, pp. 10–11.

23   OASITO, submission no. 4.

be assessed. The Services Agreement includes a Services Level Agreement which sets down the expected service level and how it will be measured. For example, the DHAC services level agreement stipulates:

> The Contractor must provide the Services so as to achieve or exceed the Service Levels set forth in this Service Level Schedule. Service Credits as indicated shall be payable by the Contractor to Health in the event that the Contractor fails to meet the Service Levels.
>
> The Service Levels and their measurements set forth in this Service Levels Schedule are intended to measure whether the Contractor is meeting the performance levels that are necessary to satisfy Health's business requirements. Service Levels may be added, deleted or modified by the Parties during the Term, in accordance with the Services Agreement, in order to achieve an accurate and consistent measurement of the Contractor's performance of the Services.[24]

6.22   Without doubt, there is much scope for disagreement and misunderstanding between the provider and the agency in determining the levels of service and how they should be measured. This is particularly so since the quality of service level is a subjective issue and both parties have very different priorities.

6.23   In entering a business deal, the private sector and Commonwealth agencies bring different interests to the negotiation table. The Auditor-General noted that private sector service providers are in business primarily to make a profit and to increase shareholder value. Commonwealth organisations, as recipients of these services, enter into contracts primarily seeking the best value for money. This situation, where the client is seeking a high quality service and cost effectiveness while the vendor is juggling the demands of delivering this level of service and maximising its profits, creates a difficult environment for negotiation. Although the two different approaches generate friction, they are not necessarily mutually exclusive.

6.24   IT outsourcing also brings with it major changes. For agencies there are significant adjustments to be made in moving from a government provider of IT to an ESP. Likewise, service providers must adapt quickly to a new environment and gain an understanding of the agency's business.[25] The Canberra Business Council (CBC) noted that there were a number of implementation risks which needed to be understood and managed including a formalisation of new commercial relationships between the IT Service Provider and the Public Sector Customer. It stressed that these relationships need to be agreed and understood by both parties.[26]

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24   Schedule 3, Service Levels and Service Credits, Services Agreement for Information Technology and Telecommunications (IT&T) Services and Industry Development, Department of Health and Aged Care (DHAC), paras 1.1.1.2 and 1.1.1.3.

25   See for example, ScreenSound Australia, submission no. 11.

26   Canberra Business Council (CBC), submission no. 15.

6.25   Moreover, IT outsourcing is concerned not only with technology issues but also with a range of matters and contractual arrangements which must be tailored to each individual organisation.[27] According to IT Newcom Sourcing Consultants, the transactions are large, both in dollar terms and their impact on the organisations, and they are often vigorously negotiated. In addition, it noted that there are many complexities associated with the contracts that need to be managed. These relationships between parties, therefore, must be managed differently to other business processes. It submitted:

> if an organisation does not have clear objectives for outsourcing an IT function then it will be difficult for the organisation to put in place an effective outsourcing arrangement. Outsourcing arrangements without clear objectives are difficult to manage because there is typically a mis-match of objectives between the Customer and the Vendor which only becomes apparent after the contract is signed—too late for most organisations.[28]

6.26   Even though experience shows that establishing, identifying and articulating contract requirements at the time of agreement can save considerable time, cost and effort later in the contract, nonetheless, misapprehension and disputes still arise.[29]

6.27   The Committee notes that the negotiation stage is the last opportunity for agencies to make sure that the arrangements are appropriate. It understands that the onus falls heavily on agencies at this time to determine the level of service and to ensure that this information is specified in the contract. It also appreciates that the relationship between the parties comes under particular strain during the negotiation period.

6.28   The Committee believes, however, that potential risks created in entering a business arrangement can be managed and the opportunities for mutual benefit enhanced through the development of an effective operational framework during this negotiation phase.[30] In recognising the different expectations of both parties to the contract, it is important for agencies to take care to ensure that their interests and those of the Commonwealth are protected while the priorities of the contractor are acknowledged and given serious consideration.[31]

6.29   The ATO believes that its current arrangements with Electronic Data Systems Australia (EDS) would represent 'one of the most successful information technology

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27   IT Newcom Sourcing Consultants, submission no. 18.

28   ibid.

29   See for example, Auditor-General's foreword to ANAO's *Contract Management: Better Practice Guide,* February 2001.

30   See also Auditor-General's foreword to ANAO's *Contract Management: Better Practice Guide,* February 2001.

31   For example the Australian Information Industry Association (AIIA) suggested that contract details and negotiations need to have a substantially greater commercial focus. AIIA, Committee, *Hansard*, 17 May, 2001, p. 432.

and telecommunications (IT&T) outsourcing arrangements in the Commonwealth'. Based on its experience, the ATO suggests that preparation for outsourcing requires agencies to:

- clearly define roles and responsibility during the transition;[32]

- establish a contract management office early in the process;

- identify, define and obtain organisational endorsement for the contract management methodology;

- develop and test engagement protocols, practices and procedures before handover;

- develop a service delivery model and a service delivery plan; and

- develop a detailed risk management plan, including a contingency and escalation methodology.[33]

6.30   Thus, while working through the negotiation stage of the contracting process, it is important for both the contractor and the supplier to develop a thorough understanding of each other's expectations, the level of services to be provided and the management environment in which they operate. They should establish priorities in ensuring the reliable delivery of these services and identify and evaluate the areas of substantial risk or any circumstance that is likely to impact on the ability of the agency to achieve its objectives. They should design an appropriate risk management plan looking at both preventative measures to minimise the risk of shortcomings in service delivery as well as corrective and control measures to deal with any failures.

6.31   As mentioned in the previous chapter, agencies and vendors should have developed a sound understanding of each other's objectives, strengths and weaknesses during the tendering process. The negotiation phase is an opportunity to build on this relationship and to establish a common understanding of the contract and its requirements to ensure the reliable delivery of goods and services. But particular aspects of the contract, especially determining the level of service, are difficult areas for both parties to reach agreement and, as noted, can lead to misunderstandings. The Committee appreciates that contractors need time to agree to and understand the level of service required by the agency and determine how service delivery will be monitored.

6.32   The Committee emphasises the importance of agencies not only specifying clearly and accurately their requirements in the contract but also using the negotiation period to reach a common understanding with the contractor of the responsibilities and obligations of each party. They should also use this time to look ahead to anticipate potential problems and work out ways to deal with change. During this period,

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32   Customs, submission no. 21.

33   ATO, submission no. 22.

agencies may need to call on specialists in contract drafting and negotiation as well as IT experts.

Need for experts

6.33   As was the case during the tendering process, the negotiation stage also draws on specialised knowledge and experience. OASITO relied heavily on the expertise of overseas consultants, such as Shaw Pittmann Potts and Trowbridge (Shaw Pittman), during this period. OASITO's Mr Hutchinson told the Finance and Public Administration Legislation Committee:

> Shaw Pittman's strategic advice focuses very heavily at the end of a project on negotiating tactics to maximise the value of the contract with the Commonwealth. They have expert negotiators in IT outsourcing.[34]

6.34   The people from Shaw Pittman not only advised on negotiating positions with potential vendors but, on occasion, conducted negotiations on behalf of OASITO with such vendors.[35]

6.35   As with the evaluation teams, the Committee accepts that overall, there is a need for the negotiation team to consist of people skilled in contract interpretation and negotiation, relationship building and technical knowledge to ensure that the agency's interests, and therefore the Commonwealth's interests, are protected.[36]

Allow for changes

6.36   In preparing a contract, OASITO recognised the need for agencies to take into account the possibility that changes, outside the agency's control, could result in a reorganisation of the agency. It stated that any IT outsourcing contract put in place 'must be able to accommodate changes in departmental structures, the creation of departments, the abolition of departments, and the reallocation of responsibilities between and among departments'. Mr Hutchinson continued:

> There will always have to be scope to add agencies or components of agencies, subtract agencies or components of agencies, if and when the Government changes its structure.[37]

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34   Mr Hutchinson explained that Shaw Pittman is a law firm but was 'not engaged as legal counsel, but rather as strategic advisers…their role is to focus on the business case, the business parameters and the tax…they negotiate the clarification and the detail and the improvements in terms of the substance of the transaction.' Finance and Public Administration Legislation Committee, *Hansard*, 17 February 1999, p. 321.

35   Finance and Public Administration Legislation Committee, *Hansard*, 1 June 1999, p. 272.

36   See for example Customs, submission no. 21.

37   See Mr M. Hutchinson, Finance and Public Administration Legislation Committee, *Hansard*, 24 November 1997, p. 685.

6.37   Customs is aware of the potential difficulty in dealing with major changes in administrative arrangements if this leads to different service providers being grouped together in one agency or functions previously the responsibility of one provider being split between a number of agencies.

6.38   It had this experience with the loss of excise functions to the ATO and certain industry assistance functions to the Department of Industry Science and Resources (DISR). It maintains that a climate of cooperation between the relevant agencies is a pre-requisite to ensuring government approved changes are quickly put into effect. Some of the specific aspects which require careful thought are:

- contractual requirements and the possible loss of negotiating leverage with suppliers when changes are initiated by a government agency—particularly if major contract variations are required; and

- assessment of the implications of volume changes (these may impact on economies of scale).[38]

Transition period

6.39   When finalising the details of the Services Agreement, all parties to the agreement should be looking to put in place a strategy for the smooth transition from the old system to the new arrangements. The contract, even with clear identification and articulation of contract requirements, needs to be appropriately managed for the arrangement to work for the benefit of all parties involved.

6.40   Mr Brendan Welsh, Managing Director of IT Newcom Sourcing Consultants, was aware of the pitfalls in contract management and added a cautionary note, that while an agency can have a great outsourcing contract, if it 'has not got the wherewithal and the desire to manage it or make sure it delivers business benefits, it will not happen'.[39]

Management structure

6.41   The contractual relationship between the agencies and the contractor provides a framework for direct management by individual agencies.[40] Before committing itself to an agreement, an agency must give consideration to the management structures it will put in place to monitor and assess the performance of the provider and the benefits and costs of the project.

6.42   Cluster 3 was the first of the Government's IT outsourcing arrangements under the Initiative and included the Department of Immigration and Multicultural Affairs (DIMA) which, it submitted, has considerable experience in the management

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38   Customs, submission no. 21.

39   Mr. B. Welsh, IT Newcom Sourcing Consultants, Committee, *Hansard*, 9 March 2001, p. 210.

40   OASITO, submission no. 4.

of large outsourcing contracts.[41] Cluster 3 set up the following arrangements to manage the contract.

6.43   The cluster agreement with the external provider, CSC, commenced on 1 July 1998 for a five-year term. The agency chief executives established a Cluster Management Committee (CMC) comprising senior executives responsible for all operational issues. It meets on a monthly basis and 'plays a major role in managing contractual obligations specified in the IT Agreement'.[42]

6.44   The CMC, however, delegates the day to day responsibility for managing the Agreement to the Contract Management Office (CMO) which comprises 6 officers. It monitors CSC's performance against agreed service levels. According to DIMA:

> Monthly performance reporting, together with regular independent audits on key aspects of service delivery, are the key control mechanisms used in ensuring services are being provided in accordance with the contract, and the appropriate charges and service credits are being applied.[43]

6.45   With the changed arrangements for the Government's IT outsourcing Initiative, management structures will have to be designed to suit the particular requirements of an agency or composition of agencies. Mr Michael Reardon, (Consultant, Timbelle Pty. Ltd) at the request of Mr Humphry, prepared a paper on principles for effective IT outsourcing as a useful and practical guide to outsourcing issues. He stated succinctly:

> The organisation outsourcing must take responsibility for this project. Although it must include the service provider within the project management arrangements the project itself cannot be left to them.[44]

6.46   He recommended that a project manager of suitable status within the client organisation should manage the implementation of the outsourcing arrangements. This manager should report to a steering committee of senior management to oversee the project and resolve issues arising.[45] A team comprising both vendor and client staff should assist in managing the details of the transition.

6.47   The agencies that have participated in the Initiative to date, such as those in Cluster 3, provide working models for other agencies that are yet to outsource. Agencies will be able to examine and assess the experiences of others and the management structures they have put in place in order to develop for themselves a framework that would best suit their particular circumstances. The Committee

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41   DIMA, submission no. 6.

42   ibid.

43   ibid.

44   Richard Humphry, *Review of the Whole of Government Information Technical Outsourcing Initiative*, Commonwealth of Australia, December 2000, p. 86. Appendix 8.

45   ibid.

believes that the experience of these agencies is a valuable resource and one that the Government should be seeking to maximise. The Committee refers to recommendation 6 in the report of the Humphry Review that it is essential for a separate service organisation, acting as a central repository of skill and knowledge, to be established. The Review noted that such a group could draw on OASITO's experience.

6.48   The Committee goes further to suggest that a special coordinating and advisory body be established that also taps into the experience of agencies, liaises with these agencies and is not only a service organisation but an active centre of education and training for IT outsourcing.

6.49   The Committee believes that the Government should look again at its proposal to establish a body, which will reside in the Department of Finance and Admistration (DOFA), to advise agencies, at their request and on a fee for service basis, in managing the transition of IT functions to the private sector.

Time for adjustment

6.50   A number of organisations identified the transition as a period particularly prone to failures. Mr Mike Jones, from the Public Service and Merit Protection Commission (PSMPC), told the Committee:

> You go through a bit of a rocky period early in pretty much any new contractual arrangement. Particularly with something of this scope and particularly when you are a small agency. I think things obviously dipped a bit in the first few months. We have discussed those issues closely with the provider along the way, and I think the service we are getting now is better than it was six months ago. I think it can still improve a little yet, but it is going in the right direction. It certainly looks a lot better than it did six months ago.[46]

6.51   Mr Raymond Comer, Executive Manager, Corporate Services, Civil Aviation and Safety Authority (CASA), explained that although they had also experienced problems during the initial transition stage, their ESP, Ipex, has grown into its contract.[47]

6.52   The Department of Transport and Regional Services (DTRS) also experienced 'some degree of technical difficulties' during the teething stage. The department and the contractor, Advantra, expected the implementation stage to take six months when it took 12 months.[48] Ms Roseanne Kava from the department told the Committee that

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46   Mr M. Jones, Public Service and Merit Protection Commission (PSMPC), Committee, *Hansard*, 17 May 2001, p. 482. PSMPC belongs to Group 8. Their ESP is Ipex.

47   Mr R. Comer, Civil Aviation and Safety Authority (CASA), Committee, *Hansard*, 9 March 2001, p. 197. CASA is also in Group 8.

48   Mr C. Simpson, Department of Transport and Regional Services (DTRS), Committee, *Hansard*, 9 March 2001, pp. 177–8. This department belonged to Group 5.

one clear thing that it would probably do differently would be to have a longer transition period. She explained:

> We had a fairly short transition period of 10 weeks, which was very ambitious, as I understand it, the provider was very confident that they could meet that; but, on reflection, I think that was overly ambitious. We would in future look at a longer transition period.[49]

6.53   Even the ATO, which claims to have had a most successful transition to an outside IT provider, explained that they had some early problems with some components of service delivery. It maintained that EDS generally met expected operational service levels from the handover date of 24 June 1999 and that there had been a continuous improvement in service delivery and in refinement of processes over the course of the operation of the ATO Services Agreement.[50]

6.54   Mr McDiarmid from the CBC, looked at transition problems from the business side. He explained:

> some of the primes did not quite understand the culture and some of the systems work that had been developed, and because there was this absolute focus on speed and cost savings within time frames that seem to be a little unrealistic, there were real problems for the prime deliverers as to what was expected, and I think the agencies have felt probably that they have not got what they were expecting to get for those reasons.[51]

6.55   Along similar lines, the Sausage Group argued that the aim to move accountability from the agency to the outsourcer as quickly as possible was driving the transition processes.[52]

6.56   Considering the size and complexity of the IT outsourcing program, the Committee believes that adequate time should have been allowed for the provider and the agency to adjust to the new relationship. The unrealistic timeframes that dominated the Initiative are to be avoided in the devolved environment. Again, the experiences of agencies that have been through this process provide a valuable source of information and knowledge for other agencies.

Hidden costs

6.57   Allowances should also be made for possible increased or unexpected expenses. ScreenSound Australia told the Committee that it can take time for any contractor to gain a level of understanding of the client's business that enables an

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49   Ms R. Kava, DTRS, Committee, *Hansard*, 9 March 2001, p. 191.

50   ATO, submission no. 22.

51   Mr R. MacDiarmid, Chairperson, Outsourcing Commission, CBC, Committee, *Hansard*, 16 March 2001, pp. 345–6.

52   The Sausage Group, submission no. 7.

increasing return of long term value. ScreenSound noted that this was especially so for the Archive, which has 'complex, whole-of-organisation IT requirements with substantial specialist needs relating to managing very large volumes of audiovisual material'.[53]

6.58   ScreenSound told the Committee the costs of supporting and administering the contract had been higher than was hoped and that it was looking forward to a reduction in costs in year two of the contract.[54] Nonetheless, it stated that its experience of the outsourced arrangements to date had been generally positive. Negotiations to outsource its IT services were conducted over an extended period with the three-year contract signed in June 2000. ScreenSound's most important short-term requirements of a good transition of desktop support services and upgrades had been well managed, although it maintains that this was achieved at a higher cost than if sourced in-house.[55]

6.59   In particular, the cost of accessing adequate in-house and external expertise in contract management can be significant and have a major impact on savings. DHAC told the Committee that 'on the basis of our current costs of contract management, there are no direct savings'.[56] Under the Initiative, a much needed, accurate estimation of the impact of contract management costs on savings does not appear to have been performed. While DOFA estimated DHAC's contract management costs at $700 000 per year, a total of $3.7 million over the life of the contract, DHAC's estimation of such costs amounted to approximately $8.9 million.[57]

6.60   The costs incurred in engaging Shaw Pittman provides a stark example of the level of expense involved in setting up a contract. By mid 1999, OASITO had paid Shaw Pittman almost $9.5 million for strategic and commercial advice on the Government's IT infrastructure outsourcing program.[58] Mr Hutchinson informed the Legislation Committee:

> They are expensive compared to Australian professional fee rates in broadly comparable areas, but this firm and these are the people who have been assessed objectively as the best in the world and these are the fee rates that people pay for the best in the world. The fact of the matter is that, in professional fee structures—whether it be legal, accounting other strategic IT advice—Australia domestically is a low fee environment, and when we go across international borders we find ourselves faced with high fee

53   ScreenSound Australia, submission no. 11.

54   ibid.

55   ibid.

56   Community Affairs Legislation Committee, *Hansard,* 19 February 2001, p. 123.

57   ibid., p.122.

58   Finance and Public Administration Legislation Committee, *Hansard*, 1 June 1999, p. 274.

environments. If we have to buy in an international market, we have to face that difference.[59]

6.61   OASITO also engaged a range of other consultants such as Minter Ellison for legal advice and Flexible Resources for specialist advice on the industry development aspect of IT outsourcing. See the figure below for an indication of the range of advice sought from external consultants by OASITO.

Figure 3:   OASITO's expenditure on Consultants for the Initiative

	1996-97 ($m)	1997-98 ($m)	1998-99 ($m)	1999-2000 ($m)	YTD Dec 2000 ($m)	Total ($m)
Strategic						
Shaw Pittman	0.478	5.498	4.232	6.209	2.885	19.302
ID						
Felixible Resource	0	0.275	0.209	0.188	0.083	0.755
Cutler and Co.	0	0.162	0.199	0.045	0	0.406
Allen Consulting	0	0.137	0.072	0.073	0.025	0.307
Financial						
Pricewaterhouse Coopers	0.120	0	0.488	0.507	0.070	1.185
Acumen Alliance	0	0	0.151	0.145	0.346	0.642
Walter and Turnbull	0	0.049	0.375	0.193	0.110	0.727
D & T Consulting	0	0	0	0	0.022	0.022
BDO Nelson	0	0	0	0	0.011	0.011
Deloitte's	0	0.780	0.006	0	0.002	0.788
Legal						
Minter Ellison	0	1.370	0	0	0	1.370
Blake Dawson Waldron	0	0	1.838	2.049	0.914	4.801
Probity						
Stephen Marks & Co.	0	0.102	0.102	0.2	0.047	0.451
Telecommunications						
Telsyte	0	0	0.107	0.119	0.050	0.276

59   ibid., p. 277.

Miscellaneous contractors						
National Computer and Advisory Authority		0.006				0.006
Clauden Pty Ltd		0.099				0.099
Layris Pty Ltd		0.101				0.101
Planning Support Inc		0.217				0.217
Reineke		0.028				0.028
Defence			0.006	0.010		0.016
Laurie Mackechnie & Associates			0.014			0.014
Corpsec			0.001			0.001
Australian Corporate Reporting			0.004	0.004		0.008
Coolong Consulting				0.052		0.052
Gartner Group Pacific				0.043		0.043
Spectra					0.005	0.005
Sentinel	0	0	0	0	0.021	0.021
T4 Protective Security	0	0	0	0	0.027	0.027
Total	0.598	8.824	7.804	9.837	4.618	31.681

Source: OASITO, question on notice, Finance and Public Administration Legislation Committee, Additional Estimates 2000-2001.

Agency commitment

6.62   Clearly, IT outsourcing arrangements are complex and difficult. To work well, they require a lot of time, effort and commitment from the organisation. A lack of support from the executive for outsourcing arrangements can undermine the success of contract arrangements.[60]

6.63   Mr Welsh from IT Newcom Sourcing Consultants pointed out:

> what we see typically at the initial phases of an outsourcing relationship of a similar type in the whole of government outsourcing initiative is difficulties

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60   IT Newcom Sourcing Consultants, submission no. 18.

during the transition phase. There is a whole lot of change going on during that phase and it requires incredible commitment of both organisations to make the relationship work. If that commitment is not there during the initial phases of the transition period, it is very difficult to remedy the relationship.[61]

6.64   He stated bluntly that it is absolutely critical to meeting the business objectives of an outsourcing arrangement that there be senior executive buy-in to the process.[62]

6.65   The lack of strong commitment observed so far in the Initiative may in large part be due to the central control exerted over the tendering process. Certainly, Mr Humphry believed that because agencies felt that they did not have control over the transaction they did not 'buy into the process'.[63] He explained that the considerable disagreement among agencies and OASITO as to what constitutes outsourcing and which outsourcing model best meets agency needs contributed 'significantly to the lack of willingness of agencies to accept fully the Initiative.'[64] He found that:

> There has been a general lack of buy-in by senior management and an unwillingness to accept that the Initiative is the most appropriate approach to IT outsourcing. This lack of buy-in is by far the most significant risk factor for implementation management. The lack of acceptance by agencies has presented the Initiative with difficulties at every stage.[65]

6.66   In responding to the Humphry Review, the Minister for Finance and Administration took particular notice of this finding.[66]

6.67   Although this matter should in part be resolved by the decision to devolve responsibility for implementing IT to the agencies, the Committee is nonetheless concerned that the whole-of-government approach to IT outsourcing may exert undue pressure on an agency head to adopt a proposal to which he/she is not fully committed. Incentives and support may prove more fruitful than using the heavy stick of budget cuts in expectation of savings.

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61   Mr B. Welsh, Committee, *Hansard*, 9 March 2001, pp. 207-8.

62   Mr B. Welsh, IT Newcom Sourcing Consultants, Committee, *Hansard*, 9 March 2001, p. 210. CSC reinforced this point and stated that total commitment of both parties to the concept of outsourcing was 'a pre-requisite for success in any outsourcing engagement'. CSC, submission to the Humphry Review.

63   Mr R. Humphry, Committee, *Hansard*, 7 February, p. 61. See also Dr P. Boxall, Finance and Public Administration Legislation Committee, *Hansard*, 20 February 2001, p. 302.

64   Richard Humphry, *Review of the Whole of Government Information Technical Outsourcing Initiative,* Commonwealth of Australia, December 2000, pp. 10–11.

65   ibid., p. 10.

66   Media Statement, the Hon John Fahey, Minister for Finance and Administration, 'Review of the Implementation of the Whole of Government Information Technology Outsourcing Initiative', No. 01/01, 12 January 2001.

Staff during transition

6.68   The Committee understands that the move to outsource IT has a significant effect on staff and is an area that requires serious consideration. It believes that the transition to an external service provider brings with it a major cultural change that needs to be managed competently and with sensitivity.

6.69   It recognises that effective workforce planning is an integral part of making the transition to outsourced IT infrastructure a success. As the ATO wrote in its submission, 'outsourcing is not concerned solely with an organisation's IT&T infrastructure. Outsourcing is also an important human resource management issue that brings with it consequential organisational and cultural change'.[67]

Impact on the quality and effectiveness of the IT workforce

6.70   Before an agency decides to outsource, it needs to consider what effect IT outsourcing will have on the quality and effectiveness of its IT workforce. As the Humphry Review and subsequent government response has shown, this aspect of workforce planning is a major factor in deciding whether IT outsourcing should proceed.

6.71   The Humphry Review addressed the effect of IT outsourcing on the quality and suitability of an agency's IT workforce in the context of Group 9 (the science agencies). The Review noted 'the difficulties in separating scientific and operational IT requirements and the potential loss of staff who have a mix of IT and scientific skills'.[68] This was a central motive for recommendation 9 of the Review that states 'Group 9 should not proceed until the Chief Executives of each agency are satisfied that the implementation risks have been adequately addressed'.[69] The Government agreed to this recommendation in recognition that the distinct nature of these agencies and their workforce would be endangered if outsourcing were to go ahead under the Initiative.

6.72   Despite the reprieve granted to the Group 9 agencies, evidence presented to this inquiry continued to raise the issue of the close relationship between the scientific research conducted in Group 9 agencies and IT, a relationship that has resulted in a specialised in-house IT workforce. IT personnel in such agencies frequently have scientific qualifications and understand the specialised scientific needs of research staff.[70] This combination of skills is a necessary driver of research and development.

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67   ATO, submission no. 22.

68   Richard Humphry, *Review of the Whole of Government Information Technical Outsourcing Initiative,* Commonwealth of Australia, December 2000, p. 39.

69   ibid., p. 19.

70   Australian Nuclear Science and Technology Organisation (ANSTO) Combined Unions, submission no. 12 and Commonwealth Scientific and Industrial Research Organisation (CSIRO) Staff Association, submission no. 14.

6.73   The Australian Nuclear Science and Technology Organisation (ANSTO) Combined Union submission further noted that working in the nuclear industry requires an awareness and commitment to such an industry that outsourcing may jeopardise.[71]

6.74   Although the science agencies are currently not scheduled to undergo outsourcing under the Initiative, it should be kept in mind that the outsourcing of such agencies remains a possibility to be considered by agency heads if a business case can be made. The impact of IT outsourcing on the quality of the IT workforce needs to be taken into account by such a business case and in any re-evaluation of the merit of IT outsourcing for science agencies.

6.75   While the interweaving of IT skills with an agency's core business has been largely raised in the context of the research and knowledge-based agencies, the relationship between IT services and an agency's core business needs to be considered in all evaluations of the merits of IT outsourcing.

Management of the transition for IT personnel

6.76   Clearly the outsourcing of an agency's IT infrastructure means that a number of its IT personnel are no longer required by that agency. Correspondingly, more IT positions will be created in private sector IT organisations. According to OASITO, this shift should be a positive one. Indeed, one of the stated benefits of the decision to outsource IT infrastructure 'is to improve the potential for staff career development in an environment where IT&T is the core business'.[72] To manage the transition to IT outsourcing for IT staff in such a productive fashion requires careful and effective planning.

6.77   Agencies encounter a range of workforce management problems prior to outsourcing. Submissions to the inquiry noted that in preparing to outsource, IT departments and their staff are left in hiatus. Delays with the original implementation schedule of the Initiative further extended these periods of uncertainty. The very prospect of IT outsourcing gives rise to the danger that experienced and skilled staff will start to leave the agency and the agency itself will place on hold any development of IT infrastructure and staff training.

6.78   For example, the Committee was told that in anticipation of IT outsourcing two of ANSTO's most experienced IT managers departed. The combination of skills required for such positions is very unusual and ANSTO was unable to replace one of the managers.[73] Similarly, faced with the possibility of IT outsourcing, one

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71   ANSTO Combined Unions, submission no. 12.

72   OASITO, submission no. 4.

73   ANSTO Combined Unions, submission no. 12.

Commonwealth Scientific and Industrial Research Organisation (CSIRO) laboratory lost three out of four IT staff.[74]

6.79   This environment of uncertainty makes it difficult for agencies to fill such vacancies as they cannot offer staff permanent positions. IT staff recruited during this period of confusion are faced with short contracts. Moreover, because limited term positions are offered, the field of highly qualified persons prepared to apply is likely to be small.

6.80   Staff departures and the recruitment of replacements on short-term contracts means that there is considerable insecurity and disruption among IT personnel in the approach to IT outsourcing. The Community and Public Sector Union's (CPSU's) submission observed that this higher level of turnover erodes an agency's corporate knowledge and skills base.[75] This renders the agency less able to manage the transition to an ESP. Business observed the same problem. CSC noted that because of the long drawn out process in reaching a decision on the preferred outsourcer, there is a tendency to lose key staff and IT&T contractors 'possessing unique knowledge about the agency's business and IT processes, practices and support knowledge'. It maintained:

> Agency staff and contractors are placed in a position of uncertainty about their future role with either the agency or potential ESP. Many use the opportunity afforded by the lengthy decision making process to seek other opportunities and thus their essential skills, knowledge and expertise are lost to the agency and the ESP.[76]

6.81   For staff that remain with an agency in the approach to IT outsourcing, the suspension of IT development may present disadvantages. The CPSU remarked that in the period approaching outsourcing staff face difficulties updating their training and developing their skills because an agency usually lacks the funds, skills and leadership for this to be possible.[77] Yet it is precisely at this time that agency staff need to be well equipped with skills in order to enter the private sector.

6.82   The prospect of IT outsourcing gives rise to such IT workforce issues even though outsourcing does not have to eventuate for its impact to be felt. This was the case with agencies in Group 9 that suffered IT staffing difficulties in the lead up to their proposed outsourcing even though the outsourcing project was abandoned. For example, the ANSTO Combined Union, even after the Humphry Review recommendations were accepted, expressed serious concerns about outsourcing and its effect on staffing. It noted that while the central management and control of IT outsourcing has been discontinued under the Initiative, the debate still continues in

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74   CSIRO Staff Association, submission no. 14.

75   The Community and Public Sector Union (CPSU), submission no. 10.

76   CSC, submission to the Humphry Review.

77   CPSU, Committee, *Hansard*, 15 March 2001, p. 242.

one form or another, seriously affecting staff morale.[78] To have such a drawn out debate causes instability and places staff attempting to plan their futures in an unreasonably difficult position.

6.83   The Committee accepts that while some sense of insecurity in the lead up to outsourcing may be inevitable, it is necessary to develop strategies to reassure staff and help them adjust to the possibility of IT outsourcing. It is also important to avoid a lengthy period in which staff are left in limbo about whether outsourcing is going to occur. Such a period seriously affects staff spirits and stability, whether outsourcing proceeds or not.[79]

Approaches to managing the transition

6.84   OASITO presented the agencies with two approaches to managing the transition to IT outsourcing for IT staff—the phased approach and the clean break approach. Only one approach could be used by any one group of agencies.

6.85   In its *Human Resources Management Kit for the Commonwealth's IT Infrastructure Outsourcing Initiative,*[80] OASITO states that the Government's preferred approach is the phased approach.

6.86   According to the Initiative's phased approach, the contractor is required to meet its additional staffing requirements initially from within the pool of in-scope staff. In-scope staff must resign in order to accept a job with the vendor. The agency is expected to assist discussions between their staff and the contractor and negotiate with the contractor about employment opportunities.

6.87   The advantage of the phased approach is that it allows for greater continuity of staff between the outsourcing agency and the contractor and a smoother transfer of skills and knowledge. It also minimises the need for redundancy payments, in particular for those people who receive a job with a new provider, and thus reduces cost. However, it may be a very complex process both in terms of negotiations between the agency and the contractor, as well as administratively.

6.88   The clean break approach allows for in-scope employees, in accordance with the prevailing redundancy provisions, to accept voluntary redundancy if offered and pursue employment with the contractor or any other employer if they choose.

6.89   The advantage of the clean break approach is that it is an administratively simpler and shorter process. Consequently, fewer resources need to be dedicated to the management of the employment transition process. Another advantage that DHAC

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78   ANSTO Combined Unions, submission no. 12.

79   Association of Profession Engineers, Scientists and Managers of Australia (APESMA), submission no. 16.

80   OASITO, *Human Resources Management Kit for the Commonwealth's IT Infrastructure Outsourcing Initiative,* 1998, p. 2 of 9. http://www.oasito.gov.au/ITOInfoSheets/HROver.html

noted was that it avoided the risk of losing staff before the transition.[81] Disadvantages include the high cost of redundancy payments and less continuity in staffing between agency and the contractor, which in turn may affect the continuity of services.

6.90   According to the Requests for Tender (RFTs), which include a schedule outlining the Employment Transition Framework, all groups under the Initiative adopted the clean break approach. As a result substantial numbers of IT staff left Commonwealth employment via redundancy.

6.91   Although there are less formal avenues for staff taking up positions with the new service provider under the clean break approach, agencies anticipated that most staff who accepted redundancies would transfer to the new contractor. However, the CPSU submission observed that the take up of staff by contractors was variable.[82]

6.92   For example, at the Health Insurance Commission (HIC) 135 staff were made redundant and 116 of these staff accepted offers of employment with the outsourcer.[83] This represents a re-employment rate by the contractor of 86 per cent. On the other hand, ATO stated that there were 483 staff in-scope. Two hundred and sixty–seven left the ATO of which 129 staff were employed by EDS. This represents a re-employment by the contractor rate of only about 48 per cent.[84]

6.93   One IT provider maintained that the rigid application of 'clean break' requirements for the employment of former Commonwealth employees and contractors affected the company's domain knowledge by creating an inability for it to recruit and retain sufficient ex-Commonwealth staff to ensure a smooth transition.[85]

6.94   While the clean break approach would clearly seem to be the agencies' preference, greater consideration needs to be given to ensuring that an effective number of IT staff make the transition from the agency to the ESP. As the Customs submission asserted, such staff continuity is a major factor in making a smooth transition to IT outsourcing. While Customs adopted a clean break approach, its provider, EDS, offered positions to all staff in-scope, ensuring that staff continuity was high.[86]

6.95   In instances where the level of transfer is considerably lower than expected, the likelihood of a loss of corporate knowledge, technical skills and expertise skill increases substantially. Lower levels of staffing continuity between the agency and the contractor means that the contractor's initial understanding of the agency's requirements is lessened.

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81   Community Affairs Legislation Committee, *Hansard*, 2 May 2000, p.182.

82   CPSU, submission no. 10.

83   DHAC, answer to question on notice, 17 May 2001.

84   ATO, submission no. 22.

85   Information supplied to the Committee.

86   Customs, submission no. 21.

6.96   Experience under the Initiative indicates that it should not be assumed that agency IT staff will choose to transfer to the contractor. The ANSTO Combined Unions and the CSIRO Staff Association stated clearly that their respective IT staff were unlikely to transfer to the contractor, opting to pursue other opportunities in the wider IT market. The result for ANSTO and CSIRO, should that happen, would be a significant loss of intellectual capital and scientific knowledge.[87]

6.97   The Committee understands that whichever approach to employment transition arrangements is adopted, it must be recognised that the costs of preparing for and implementing the employment transition are substantial. These costs need to be estimated in advance, recorded in retrospect and factored into any calculation of estimated savings. To the Committee's knowledge, OASITO did not factor in employment transition costs into its method of estimating savings. The Committee notes that staff transition arrangements are yet another hidden cost.

Private sector conditions

6.98   While it is generally held that IT personnel, when working in the private sector may enjoy greater benefits such as higher rates of pay and the advantages of working in an IT focused company, there is the possibility that conditions might fall below that of the public sector.

6.99   The CPSU submission suggested that there needs to be some safeguard to prevent public sector IT workers being employed under worse conditions and wages in the private sector. According to the CPSU, the creation of a reasonable floor under wages and conditions would ensure that reductions in wages and conditions are not used to underwrite lower bids. It is suggested that the simplest means of doing this is through legislation, such as the United Kingdom's Transfer of Undertakings (Public Employment) Regulations 1982 (TUPE).[88]

6.100   An agency might find value in seeking expert guidance on how to help staff adjust to a new working environment. DHAC retained an organisation called DBM Australia which provided the department with a range of advice on how to handle sensitively the sorts of changes that people were going through. Mr Moran from the department told the Committee that there was a specific team set up known as the 'change management team'.[89]

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87   ANSTO Combined Unions, submission no. 12 and CSIRO Staff Association, submission no. 14.

88   CPSU, submission no. 10.

89   Mr P. Moran, Committee, *Hansard*, 9 March, 2001, p. 131.

Preparing the organisation for change

6.101   There is a tendency in the outsourcing process to have a strong focus on the functions and staff being outsourced and less on communicating with, and educating, the wider organisation in regard to the major change they are going to experience.[90]

6.102   Without doubt, the move to an external IT provider brings disruptions and uncertainties to the organisation. The ATO submitted that outsourcing may bring with it:

- a new, often more disciplined, way of delivering IT;

- a loss of informal internal staff networks developed over many years;

- an initial reduction in service delivery;

- a loss of corporate IT history and experience in some areas;

- a loss of knowledge in regard to business/IT alignment;

- the consumption of large amounts of emotional energy;

- an increase in user expectations; and

- reduced productivity due to staff uncertainty leading up to the handover of responsibilities.[91]

6.103   An understanding of the possible effects of outsourcing on day-to-day operations must be conveyed not only to staff immediately affected but also to the wider organisational community. According to the ATO, the outsourcing of its IT&T infrastructure impacted on every member of staff to varying degrees. Drawing on the experience of other organisations that had outsourced their IT&T, the ATO developed and implemented a multi-faceted organisational strategy that included:

- an education program and large human resource management effort for those staff designated as in-scope;

- an education program tailored for the wider organisation; and

- staff movement between functions designated as in-scope and out-of-scope.[92]

6.104   Customs also submitted that consideration needs to be given to the impact of new arrangements on regional or remote areas where outsourcers frequently do not have staff.[93]

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90   ATO, submission no. 22.

91   ibid.

92   ibid.

93   Customs, submission no. 21.

6.105   The Committee believes that preparing staff throughout the agency for the changes ahead, especially in regard to anticipating and resolving problems with service delivery and possible raised expectations, is a sensible approach to managing the transfer to an external service provider and is also a means of involving staff in the change over.

Contract management

6.106   In addition to putting in place a managerial structure to supervise and administer the contractual arrangements, agencies must consider the level of expertise needed within that structure to ensure effective management of the contract. The Canberra Business Council suggested that there is a tendency for agencies to under-estimate the resources required to manage the contract effectively once the tender is let. The Council maintains that inadequate expertise to manage the contract, particularly in responding to changing circumstances, presents risks to both the agency and the service provider. It suggested:

> the effective management of the contractual relationship by both parties to the contract is probably the most significant mechanism for ensuring appropriate delivery of outcomes and outputs. It is therefore mandatory that the representatives of both parties have the required capability and capacities to manage contracts effectively. If this condition is not met the success of the initiative is clearly at risk. [94]

6.107   As noted on a number of occasions in this report, IT outsourcing is not a straightforward commercial transaction merely involving the purchasing and installation of a commodity or range of commodities. The contract itself is a complicated and highly technical document. The contractor is expected to provide the skills, qualifications and experience necessary to perform and manage the information technology and telecommunications services required by an agency in an efficient, cost-effective and controlled manner consistent over a significant number of years.

6.108   The service provider is expected to support the agency's business and delivery requirements, be responsive to the changing business needs and strategic direction of the agency, provide improved services at lower cost, fulfil industry development commitments, and protect and maintain the security of the agency's data. Moreover, large sums of money and resources are involved and for some agencies a failure in service delivery may have a serious impact on core business.

Skilled staff

6.109   Mr Killesteyn, DIMA, told the Committee that to manage the contract effectively, agencies require staff with an understanding of IT as well as the ability to manage contracts.[95]

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94   CBC, submission to the Humphry Review.

95   Mr E. Killesteyn, DIMA, Committee, *Hansard*, 15 March 2001, pp. 223–4.

6.110   Customs agreed. In looking at contract management, it argued that there is a need for staff skilled in contract interpretation, negotiation, relationship building, and technical knowledge to ensure that agency interests are safeguarded.[96]

6.111   Taking note of these views, the Committee accepts that IT outsourcing projects rely on a range of skills to frame and manage a contract. Specialists with relevant knowledge in procurement processes, contract law, financial management, human resource management as well as IT are needed throughout the project to ensure effective, efficient and proper management of the arrangement.

Knowledge of agency business

6.112   Agencies have engaged external consultants to provide or complement the level of knowledge and skill they required during the tendering and contract negotiation process. But agencies also need to consider building or maintaining a level of in-house expertise to ensure effective management for the life of the contract.

6.113   Customs drew attention to the importance of maintaining continuity in contract management. It stated 'Continuity in the tender preparation and contract process is important for effective contract management'. It asserted that there must be mechanisms to ensure that critical staff are not lost when responsibilities are handed over to a service provider. The contract management group needs to include staff who are fully familiar with the nuances of the contract and the negotiations that went behind it.[97]

6.114   Dr Lacity and Dr Willcocks identified a range of factors which they believe contribute to problems in outsourcing which included failure to keep adequate in-house management capability.[98] The Auditor-General also noted:

> It is important…that agencies ensure that they not only have the skills that are necessary to manage the contracts concerned or to manage the tender process and put proper contracts in place but, more particularly, have the knowledge and understanding of the agency's functions and its requirements to achieve its particular outputs and outcomes and the knowledge and understanding essential to be able to get the performance from the IT outsourcing that is warranted and justified.[99]

6.115   DHAC informed the Committee that it has retained in the department a small technical team who are ex-Health people who have a role in working with its provider, IBM GSA. The members of this team are there to advise and, on some occasions, to

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96   Customs, submission no. 21. See also, Mr B. Welsh, IT Newcom Sourcing Consultants, Committee, *Hansard*, 9 March 2001, p. 206. He pointed out that any good outsourcing transaction requires a focus on all three aspects: legal, financial and operational management type issues.

97   Customs, submission no. 21.

98   Lacity and Willcocks as referred to in CSPU, submission no. 10.

99   Mr. P. Barrett, Auditor-General, Committee, *Hansard*, 5 December 2000, p. 2.

monitor service delivery but 'not in the sense of doing their work for them, it is an advisory role given their long familiarity with the systems'.[100]

6.116   Adequate in-house experience may also encourage innovation in IT. Outsourcing should provide an excellent opportunity to trial IT initiatives such as government-industry staff exchanges, reforms aimed at making individual outsourcing contracts more commercial in nature, and encouraging greater interaction between outsourcing agencies and Small to Medium Enterprise (SME) service providers.[101]

6.117   Dr Willcocks in his research, however, found that there is a 'massive lack of innovation' as a result of IT outsourcing. He suggested that knowledge of the business is needed to spur innovation but that suppliers often do not have the required level of knowledge to do so. In his opinion:

> they get so buried in the operational problems and issues on a day-to-day basis that thinking more strategically out of the box by the supplier is quite a difficult thing to do.[102]

6.118   Besides, he questioned whether the supplier should have the responsibility for innovation. For him:

> the core capabilities of an in-house operation of a business or government agency is to control the agenda in terms of innovation and what they want to do as a business or agency.[103]

6.119   Dr Willcocks suggested that agencies run an in-house team, including business people, as well as IT, and that if experts are needed within that group the agency brings them into that team. He stated 'it needs to be a multidisciplinary team business, with IT people involved and external suppliers involved as resources to work on the team if you are going to do application development well'.[104] He maintains that responsibility to innovate should lie with the in-house operation and that this should be seen as core capability.

6.120   The Committee agrees that adequate in-house knowledge of both IT and the agency's core business places the agency in a much stronger position not only to monitor and assess performance but also to move forward with advances in the field.

6.121   The Committee believes that in order to contract out an agency's IT infrastructure successfully, there needs to be staff with the knowledge and experience of, as well as commitment to, the agency's core business. Only then can adequate judgements as to which IT infrastructure arrangements would best suit the agency be

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100   Mr. P. Moran, Committee, *Hansard*, 8 March, p. 126.

101   Information Industries Development Board (IIDB), submission no. 8.

102   Dr Leslie Willcocks, Committee, *Hansard*, 17 May 2001, p. 511.

103   ibid.

104   ibid., p. 512.

made in the tendering out process. A key means of maintaining and cultivating corporate memory of the agency's core business is ensuring that experienced and skilled senior agency staff are retained.[105] Corporate memory can then also be maintained and disseminated by documentation, training and debriefings.

Summary—workplace and staffing matters

6.122   Workforce planning is an integral part of core strategic objectives of the IT Initiative. It is a central factor in maintaining continuity during the transition to IT outsourcing, in estimating savings and in ensuring that the standard of the services provided by the ESP is high. Workforce problems identified by agencies may have important flow-on effects such as long delays implementing outsourcing and impact on savings estimates and outcomes.

6.123   OASITO has presented the Committee with little information regarding the success or failure of its workforce planning strategies. Reliable data needs to be collected and further research done on the flow of IT staff between agencies and contractors and the impact of the Initiative on the IT skills and corporate knowledge an agency has access to. Further consideration needs to be given to ways of incorporating the impact of the loss of staff with unique corporate knowledge, skills and experience into any evaluation of the merits of IT outsourcing.

6.124   Similarly, the Committee has not received adequate information to evaluate the financial consequences of workforce issues surrounding the Initiative. Data on the cost of redundancies, the financial cost to agencies of staff losses and the cost of contract management should be collected and examined. This information should be factored into any estimation of savings under the Initiative.

6.125   The Committee recognises that subjecting staff to prolonged periods of uncertainty about whether outsourcing will proceed or not is unreasonable. Regardless of the final decision, such periods lead to lower staff morale and the loss of valuable staff to the detriment of the agency. Furthermore, such a situation does not create a climate conducive to a smooth transition should the decision be taken to outsource.

Building a partnership

6.126   The Committee has already touched on the complexities and difficulties involved in negotiating the contractual arrangements and in making the transition from government supplier to external provider. Indirectly, the report has on many occasions referred to the relationship between the agencies and the provider. It has noted that, although both parties are aware of the need to work together cooperatively and constructively, misunderstandings and disappointments undermine this relationship.

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105   Joint Committee of Public Account and Audit, *Contract Management in the Australian Public Service,* October 2000, p. 95.

6.127   The Sausage Group identified the commercial interests of the agencies and the provider as a major source of friction between them. In its opinion, government process forces cost minimisation through service minimisation that undermines relationship management. It concluded:

> We see most outsourcing arrangements in relationship difficulties, for the low level of contingency denies flexibility by the supplier to meet changing demands or remedy shortfalls.[106]

It also looked at the relationship in broader terms, submitting:

> We observe great angst by the Agencies in outsourcing about their professed loss of control and their difficulties with the outsourcers who rail against inappropriate constraints to business…the outsourcer has no strategic engagement with the Agency, denying a partnering approach, and the Commonwealth management tends to reflect the mores of the past rather than embracing the future. Management needs to be elevated from a contractual, commodity based management within the lower echelons of the IT departments to a higher business engagement. Agencies will not gain the benefits of partnering if they hold the Outsourcer at arms length from the business.[107]

6.128   Overall, the Sausage Group was critical of the approach taken to date by the Commonwealth which it maintained:

> provides a business risk where relationships are onerous, outcomes are subject to onerous contractual relationships, punitive arrangements are sought without corresponding incentives and an adversarial relationship is initiated at the earliest opportunity. To be successful in any business relationship it is necessary to understand the imperatives, needs and business constraints of each other. These have been ignored to date in the quest for cost savings.[108]

6.129   IT Newcom Sourcing Consultants also highlighted some difficulties in the relationship between the agency and the vendor. They focused not so much on conflicts created by the different commercial interests of the parties but the tension generated when a perceived imbalance develops in the relationship:

> unless adequate resources are devoted to establishing and maintaining the customer/vendor relationship, difficulties can arise in the outsourcing arrangement. Where the relationship is handled in an ad-hoc, trial and error manner, disputes can arise as customer needs change, or due to insufficient clarification of important details. Disputes cannot be resolved, hampering the performance of the service agreement, resulting in an inability to

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106   The Sausage Group, submission no. 7.

107   ibid.

108   ibid.

maximise potential benefits associated with outsourcing. Without adequate relationship management, the customer can lose control of the outsourcing relationship, and the customer may fail to achieve the business outcomes desired. Inadequate customer/vendor relationship management can also result in delays in dealings with the vendor, reducing the customer's benefit from the agreement. [109]

6.130 Dr Lacity and Dr Willcocks also identified power asymeteries developing in favour of vendors and loss of agency control of IT destiny as a factor that they believe contribute to problems in outsourcing. [110]

6.131 Taking an agency's point of view, Customs agreed that adjustments are needed in moving from a government provider of IT to a service provider, and that business areas need to move quickly to build up the expertise required to deal with service providers which inevitably have a heavy profit focus. [111] But in looking specifically at what business should do, Customs stated:

> there needs to be a mechanism whereby service providers gain a quick but comprehensive understanding of the business of agencies, government processes and requirements, the role of regulators and of the Auditor-General. They also need to understand that these can change quickly in response to evolving business needs, legislative changes or variations in Government requirements. [112]

6.132 Mr Richard Humphry also looked carefully at the relationship between the contractor and vendor and commented on the complexity of the IT outsourcing process. As noted earlier, he emphasised that IT outsourcing is not about buying a bag of barley but rather involves a complex relationship that may last for years. He stressed that before the parties get around to negotiating the contractual arrangements, they need to establish whether or not the partnership is compatible. For him, it was a 'very significant and most important issue'. [113]

6.133 Clearly, both sides to the contract need to make adjustments to the changed environment. The aim is to develop a partnership arrangement whereby parties can address problems as they arise and deal with them rather than waiting and then deciding on a different tack the next time. [114] Put simply, both partners should work together as associates with shared goals.

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109   IT Newcom Sourcing Consultants, submission no. 18.

110   Lacity and Willcocks as referred to in CPSU, submission no. 10.

111   Customs, submission no. 21.

112   ibid.

113   Mr R. Humphry, Committee, *Hansard*, 7 February, 2001, p. 52.

114   Mr P. Barrett, Committee, *Hansard*, 17 May 2001, p. 474.

6.134   A number of contributors to the inquiry take up this matter and stress that a successful outsourcing arrangement is based on a relationship not just a contract.[115] Compaq submitted that managing and delivering a successful outsourcing contract is a tough proposition both for the client and the outsource vendor. It stated:

> It will work more successfully in the long term if it is a partnership based relationship rather than a vendor-customer relationship, the former requires a degree of trust that each partner is working for mutual success. This is difficult to obtain in an environment where the client is seeking cost savings while the vendor is endeavouring to deliver a quality service while maximising return on investment. Any imbalance—usually caused by a realisation that the contracted service and/or the cost of delivering it does not meet the expectation of the other party—will cause major friction. A truism that tends to apply is that the service level delivered will adjust to a level where the cost of delivery allows for a base margin return in the outsource vendor's business. If the contracted price and service level is inconsistent with this return, then the relationship tends to be difficult and customer satisfaction low.[116]

6.135   The Information Industries Development Board (IIDB) considers that building stronger relations between the Commonwealth Government and industry suppliers is an integral step toward achieving an efficient, innovative and equitable operation of the Commonwealth's outsourcing initiative and promoting the most competitive outsourcing system.[117]

6.136   A number of agencies recognised the importance of establishing a sound and cooperative working relationship with their provider. Ms Kava told the Committee that DTRS had concentrated on developing a sound relationship with the outsourcer to make the contract work effectively. She stated 'We are interested in forging a partnership to our mutual benefit so that we do receive good service and meet out objectives in terms of having this arrangement in place.[118]

6.137   The ATO seems to be one agency that has established a mutually beneficial partnership with its external provider, EDS. It told the Committee:

> The relationship between the ATO and EDS is that of an alliance, with both parties appreciating that mutual benefit is derived from working as a

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115   OASITO, submission no. 4. See also Customs, submission no. 21, ATO, submission no. 22.

116   Compaq submission to the Humphry Review. See also CSC submission to Humphry Review. CSC expressed identical sentiments: 'implementation risk is reduced if the agency and the ESP have a business relationship based on trust and partnership and aiming for a 'win-win' outcome. To facilitate this, an agreed set of governing principles and processes, with clearly defined roles and responsibilities aligned to common objectives is imperative. Where a strong partnering ethos exists, substantial savings flow as duplicate processes, monitoring, checking etc, are reduced. Effort can be aimed at achieving objectives rather than less productive pursuits.'

117   IIDB, submission to the Humphry Review.

118   Ms. R. Kava, Committee, *Hansard*, 9 March 2001, p. 188.

collaborative team to deliver the IT&T infrastructure services that the ATO requires. The ATO and EDS have worked together to establish a relationship that continues to strengthen and to which both parties have maintained a high level of commitment. The ATO/EDS alliance is outcome focused and cost conscious.[119]

6.138   The Committee accepts that both parties to an IT outsourcing agreement have to make significant adjustments in becoming partners in a new business. Each brings its own special interests and assumptions to the relationship and there are significant cultural changes to deal with. Initially, the agency has entered the arrangement with any number of expectations—cost savings, improved levels of service delivery, access to latest technology. On the other hand, the vendor while endeavouring to meet the agency's objectives must also satisfy its own requirements to make a reasonable financial return on its investment. These different approaches can draw the parties into misunderstandings and disagreement leading to an adversarial rather than a cooperative relationship. But in the view of a number of witnesses this situation can be avoided.

6.139   According to some agencies, they have succeeded in building a genuine partnership with their provider. They set the standard for what can be achieved and indeed, for what both agency and business should be working toward. Evidence presented to the Committee by the private sector also demonstrates that business is keen to establish a partnership with agencies to ensure a 'win win' situation.

6.140   This chapter has looked at many aspects of contract management. Individually, whether it is drawing up specifications for the statement of work or determining and agreeing on levels of service, managing staff during the transition or engaging consultants, each phase is complex and presents difficulties. The Committee understands that agencies need time to formulate their IT strategy—that it is an undertaking that requires care and planning. The Committee also accepts that once the decision is taken to outsource IT, both parties to the arrangement must work together to make it a success.

6.141   The Committee believes that the Government has a vital role in assisting agencies to outsource their IT. It is disappointed, however, that the Government does not seem to appreciate that in this post-Humphry Review period, agencies need not only encouragement to outsource their IT, but support and guidance to prepare for and manage their IT outsourcing program.

6.142   At this point the Committee returns to a dominant theme running through this report—the importance of having a central body of experience and expertise that will help agencies through the potential minefield of IT outsourcing while allowing them the level of autonomy which they require to exercise their legislated responsibilities. The Government's current proposal for a unit in DOFA falls far short of meeting the needs of agencies.

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119   ATO, submission no. 22.

Recommendation No. 13

The Committee recommends that the Government consider establishing a centre of IT outsourcing expertise in the Department of Communications, Information Technology and the Arts (DOCITA) concerned with the technological and industry development side of IT outsourcing but not necessarily the tendering and contracting process. The Committee proposes that the role of a service unit in DOCITA would be far different from the OASITO model and be more consultative and helpful than the service unit now established in DOFA. It would have broader horizons on IT and would establish and form the hub of a network between IT outsourcing units in Commonwealth agencies. Further, it would assume an education and training role in IT outsourcing with its focus on IT planning for the future.