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PARLIAMENT OF TASMANIA

**AUDITOR-GENERAL
SPECIAL REPORT NO 29**

**COMPETITIVE TENDERING AND
CONTRACTING BY GOVERNMENT
DEPARTMENTS**

No 1 of 1999 – August 1999

*Presented to both Houses of Parliament in accordance with the provisions of Section 57 OF THE
Financial Management and Audit Act 1990*

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**Tasmanian Audit Office
GPO Box 851
Hobart
TASMANIA 7001**

**Phone: (03) 6233 4030, Fax (03) 6233 2957
Enmail: admin@audit.tas.gov.au
Home Page: <http://www.audit.tas.gov.au>**

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21 September 1999

President
Legislative Council
HOBART

Speaker
House of Assembly
HOBART

Dear Mr President
Dear Mr Speaker

**PERFORMANCE AUDIT NO 29 - COMPETITIVE TENDERING AND
CONTRACTING BY GOVERNMENT DEPARTMENTS**

This report has been prepared consequent to examinations conducted under section 44 of the Financial Management and Audit Act 1990, for submission to Parliament under the provisions of section 57 of the Act.

Performance audits seek to provide Parliament with assessments of the effectiveness and efficiency of public sector programs and activities, thereby identifying opportunities for improved performance.

The information provided through this approach will, I am sure, assist Parliament in better evaluating agency performance and enhance Parliamentary decision making to the benefit of all Tasmanians.

Yours sincerely

A handwritten signature in black ink, appearing to read 'A J McHugh'.

A J McHugh
AUDITOR-GENERAL

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LIST OF ACRONYMS AND ABBREVIATIONS

ACHS	Australian Council of Healthcare Standards
CEO	Chief Executive Officer
CPI	Consumer Price Index
CTC	Competitive Tendering and Contracting
DCHS	Department of Community and Health Services (now the Department of Health and Human Services)
DELM	Department of Environment and Land Management (now part of the Department of Primary Industries, Water and Environment)
DPAC	Department of Premier and Cabinet
DVA	Commonwealth Department of Veterans' Affairs
DHHS	Department of Health and Human Services
DHSH	Commonwealth Department of Human Services and Health
DPIWE	Department of Primary Industries, Water and Environment
EOI	Expression of Interest
FMAA	<i>Financial Management and Audit Act 1990</i>
GVS	Government Valuation Services
HCOA	Health Care of Australia Pty Limited, a subsidiary of Mayne Nickless Ltd, operator of the Mersey Community Hospital
Healthscope	Healthscope Pty Limited, operator of the North West Private Hospital and North West Regional maternity services
HR	Human Resources
IT	Information Technology
LRP	Legislative Review Program
LVRC	Land Valuation Review Committee
Mersey Hospital	Formerly called the Mersey Division of the North West Regional Hospital, now the Mersey Community Hospital
MI	Medical Imaging
MSA	Maximum Service Amount
MNSC	Maternity and Neonatal Services Committee
NATA	National Association of Testing Authorities, Australia
NMI	Northern Medical Imaging (trading name of Grant & Paech Pty Limited)
NW	North West

NWPH	North West Private Hospital
NWRH	North West Regional Hospital
NWRHB	North West Regional Health Board (now dissolved and part of DHHS)
OSG	Office of the Surveyor-General
OVG	Office of the Valuer-General
PI	Performance indicator
RHH	Royal Hobart Hospital
RIS	Regulatory Impact Statement
SOR	Statement of Requirement
TI	Treasurer's Instruction
Treasury	Department of Treasury and Finance
VISTAS	Valuation Information System of Tasmania
VMO	Visiting Medical Officer

INTRODUCTION

Under the provisions of section 44(b) of the *Financial Management and Audit Act 1990* the Auditor-General may

"carry out examinations of the economy, efficiency and effectiveness of Government departments, public bodies or parts of Government departments or public bodies".

The conduct of such audits is often referred to as performance auditing.

This report relates to a performance audit carried out by the Tasmanian Audit Office during the period December 1998 to May 1999 on the competitive tendering and contracting (CTC) practices for a selection of outsourced services.

The objective of this performance audit was to assess whether the application of CTC used by agencies met the standard set out in the Treasurer's CTC Guidelines as an indicator of best practice as well as probity and accountability.

The approach taken in this audit was to examine the processes used during the setting up of contracts as well as subsequent management of the contractor and the degree of rigour in assessing future viability of outsourced service delivery.

Accordingly, a selection of outsourced services was reviewed which covered all three general phases.

The findings and recommendations in this report should be of use to other agencies when considering the application of CTC to their own service delivery strategies.

AUDIT OPINION

Report Title	Competitive Tendering and Contracting in Government Agencies
Nature of the Audit	The objective of this performance audit was to assess the extent to which competitive tendering and contracting (CTC) has been managed by agencies in a manner which is consistent with best practice principles, as well as having regard to the broader concepts of probity and accountability. Conformity with these principles as outlined under the audit criteria is liable to assist in, but is not determinative of the underlying activity.
Responsible Party	Heads of the relevant Agencies.
Mandate	This audit has been carried out under the provisions of Section 44(b) of the <i>Financial Management and Audit Act 1990</i> which provides that: <i>“The Auditor-General may carry out examinations of the economy, efficiency and effectiveness of Government departments, public bodies or parts of Government department or public bodies.”</i>
Applicable Standards	This audit has been performed in accordance with Australian Auditing Standard AUS 806 “Performance Auditing” which states that: <i>“The objective of a performance audit is to enable the auditor to express an opinion whether, in all material respects, all or part of an entity's activities have been carried out economically, and/or efficiently and/or effectively.”</i>
Limitation on Audit Assurance	A case study approach was used to ascertain the approaches used by two agencies in situations where CTC was adopted.

Audit Criteria

The management of the CTC process was ascertained under seven criteria:

- *CTC opportunity identification and scoping is thorough;*
- *Evaluation of identified options includes identification of both financial and non-financial costs and benefits, and is rigorous in terms of analysis;*
- *Tendering and evaluation of bids/proposals received is equitable and upholds standards of probity;*
- *Contract negotiation, implementation and transition is carried out in a strategic and equitable manner with regard to stakeholders;*
- *Contract management and performance monitoring is effective;*
- *Past experience in regard to the success or otherwise of the currently outsourced service, together with updated information on future service requirements, are examined in reference to a structured re-assessment of options; and*

Adequate knowledge capture through records management and integration of experiences gained into the organisation's standard practices for future CTC situations.

Opinion and Conclusions

Based on the evidence collected, I conclude that the management of most of the competitive tendering and contracting process was carried out in a manner consistent with best practice. In particular:

Complete information regarding the soundness of outsourced service delivery was collected and analysed in an objective manner prior to determining whether CTC was appropriate;

Complete documentation was generally available to show transparency of decision-making when determining who should be the successful tenderer (however this was not the case in the instance of the evaluation of the benefits of outsourcing the NW maternity services);

In all cases examined, the issue of defining commercial-in-confidence and ensuring it does not inhibit performance management was satisfactorily addressed;

Financial and service delivery performance is generally monitored by Departments to ascertain whether value-for-money is being achieved by outsourcing (however management of the NW medical imaging contract was not

found to include regular reviews of the service);
In most cases, requests for proposals were invited from the largest market possible. It is considered that this did not occur for the outsourcing of NW maternity services;

While only two of the services examined had carried out a re-evaluation of options, this was considered satisfactory in all but one case (NW maternity services), due to the considerable length of time left to run on the agreements;

and

In the cases examined there was little or no sharing of knowledge with other staff in terms of the experiences gained when participating in the CTC process.

SUMMARY OF AUDIT FINDINGS

The Audit Office recommends that the Department of Health and Human Services (DHHS) should commence regular reviews of Northern Medical Imaging's performance in delivering North West regional medical imaging services.

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The Audit Office commends the Department of Health and Human Services on its successful implementation of outsourcing for pathology services on the North West and continued management of the contract.

Page 25

In regard to agencies' future outsourcing situations, the Audit Office recommends that a transparent approach to governance be achieved in terms of documentation and evaluation, and that, consistent with the requirements of the Treasurer's Competitive Tendering and Contracting (CTC) Policy Guidelines, more than one potential private supplier should be given the opportunity to submit a proposal, particularly for larger projects.

Pages 32 and 40

The Audit Office commends the Office of the Surveyor-General on its highly successful implementation of competitive tendering and contracting through the brokerage function. Although parts of the planning occurred prior to the release of the CTC Policy Guidelines, the entire process was found to comply with the Guidelines and is considered to set an example for adopting CTC which other agencies can follow.

Page 47

The Audit Office commends Office of the Valuer-General on the standard of its tender documentation, including the deed of confidentiality and the draft contract for local government valuations.

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AUDIT OBJECTIVES, APPROACH AND COST

Audit Objective

The objective of this performance audit was to assess whether competitive tendering and contracting (CTC) has been managed by agencies in a manner which addresses best practice principles, as well as having regard to broader concepts of probity and accountability. This assessment was carried out with regard to the following audit criteria:

- CTC opportunity identification and scoping is thorough;
- Evaluation of identified options includes identification of both financial and non-financial costs and benefits, and is rigorous in terms of analysis;
- Tendering and evaluation of bids/proposals received is equitable and upholds standards of probity;
- Contract negotiation, implementation and transition is carried out in a strategic and equitable manner with regard to stakeholders;
- Contract management and performance monitoring is effective;
- Past experience in regard to the success or otherwise of the currently outsourced service, together with updated information on future service requirements, are examined in reference to a structured re-assessment of options; and
- Adequate knowledge capture through records management and integration of experiences gained into the organisation's standard practices for future CTC situations.

These criteria are discussed in more detail below.

The Audit Office also wished to identify, develop and report better practices to promote overall improvements in public sector management in regard to the above areas.

Scope of the Audit

Due to the focus of this audit on the entire CTC cycle, we restricted our testing to a selection of outsourced services for which we considered all criteria would apply, namely:

- North West pathology services;
- North West medical imaging services;
- North West maternity services;
- Mersey division of the North West Regional Hospital;
- Surveying services; and
- Valuation services for local governments.

Particular areas examined during the audit included:

- Degree of rigour in analysis at various stages of the CTC process;
- Obtaining authorisation to proceed to the next stage;
- Equity afforded to all tenderers, including those in-house, by having standardised, pre-determined assessment methodology and criteria;

- Thoroughness of the contractual process to ensure the Crown's and community's interests are protected;
- Smoothness of the transition from in-house to outsourced provision of services;
- Effectiveness of contract management to ensure the services are delivered as agreed in the contract;
- Integration of new service requirements either in the existing or future contractual frameworks; and
- Comprehensiveness of an 'audit trail' in terms of the documentation relating to the CTC process.

The services examined were previously provided by two former agencies:

- Department of Community and Health Services (now the Department of Health and Health Services); and
- Department of Environment and Land Management (now part of the Department of Primary Industries, Water and Environment).

As a general comment relating to the DHHS contracts, it should be noted that the audit was conducted within what might be considered a somewhat narrow framework, namely that relating to compliance with proper procedures. In other words it was restricted to examining aspects that are readily quantifiable in accounting or contractual terms. The Audit Office did not examine, and makes no comment on, broader questions raised by out-sourcing, such as whether the private operators have created an environment conducive to research, teaching and development, attributes commonly thought predominantly to be the domain of public services. Thus the fact that in most cases it was found that due process was followed and the contractors fulfilled their contractual obligations, is not conclusive in the philosophical debate concerning the relative value of public versus private provision of services.

Audit Criteria

The Audit Office evaluated the six CTC processes selected for this audit against the policy requirements and implementation guidelines taken from the 'Treasurer's Competitive Tendering and Contracting Policy Framework' document and accompanying *CTC Implementation Handbook*, released in September 1996 and May 1997 respectively. Even though the four DCHS/DHHS CTC processes predated these publications, the Audit Office considers that the principles and criteria represent best practice benchmarks that should have been adhered to by competent administrators.

The audit criteria mirror the six main stages of a CTC process, plus 'knowledge management'. The seven criteria/stages are:

1. *Identification of CTC opportunities* — This entails a critical review of all the organisation's functions in terms of a 'scoping report', a differentiation of the purchaser and provider roles in the context of the services provided, and identification and prioritisation of possible functions for CTC in terms of a risk analysis. The Audit Office also ascertained whether a structured project management approach was set up at the commencement of this stage, to ensure a thorough approach is taken, and that formal approval is obtained before moving to the next stage. As in later stages, the extent to which consultation with stakeholders was sought was also examined.

2. *Evaluation of the CTC opportunities identified* — Includes a structured determination of future service requirements, actual separation of the purchaser and provider roles with re-engineering of the processes as required, undertaking a more detailed risk analysis compared to stage one, a preliminary cost/benefit analysis, and the preparation of a business case. This stage may also include calling for expressions of interest in order to 'test the market', and the valuation of assets if applicable. If the business case recommends further development of the CTC option, then high level approval should be sought to have additional resources allocated to the project.
3. *Tendering and evaluation of submissions received* — Includes the formation of an evaluation panel and evaluation criteria, identification of evaluation methodology to be used. This stage also includes placing advertisements to tenderers, preparation of a statement of requirement, request for proposal and a draft contract, issuing the request for proposal and assessment of the responses, and the selection of the preferred service provider. The Audit Office assessed the adequacy by which any in-house delivery unit which was interested in tendering for the work was able to participate in the CTC process, as well as the completeness of the documentation at this key phase in the process to ensure transparency.
4. *Contract negotiation, implementation and transition* — Entails finalisation of the negotiations and documentation relating to the contract and management of the transfer of the function to the contractor, including the type of performance management information to be provided to the agency. As well, the Audit Office reviewed contracts for inclusion of clauses to ensure clarification of 'commercial-in-confidence' areas so as not to disrupt the regular provision of performance information to the agency for monitoring purposes, as this problem has arisen in other States and Territories¹. The *CTC Implementation Manual* also recommends that a post-implementation review be conducted at the end of this stage to provide assurance on the processes followed to-date, as well as input for the next stage².
5. *Contract management and performance monitoring* — Involves systematic monitoring and evaluation of the contractor's performance as well as the adequacy of the service requirements overall, and taking action as appropriate. The Audit Office ascertained whether an officer was specifically charged with the responsibility of assessing the performance, and liaising regularly with the contractor regarding service provision matters as they arise, as well as determining whether a service level performance audit was conducted to assess any changes which may have occurred since the contract was entered into. Contingency plans were also reviewed to ensure seamless service delivery takes place.
6. *Re-evaluation of the options* — A structured re-assessment would assist the agency in determining future service requirements and options for delivery, as well as desirable qualities of a future service provider.

Following stage six, the cycle is then repeated.

The Audit Office examined one other aspect of best practice for CTC, knowledge management. 'Knowledge management' is a catch-all term for managerial activities that support organisational memory and learning by making the information within the agency useful, through records management and sharing experiences with other staff³.

¹ See for example AONSW 1998, pp 3-66; NTAGO 1998, pp 59-62; NTAGO 1999, pp 100-102.

² DTF 1997, p 48.

³ CSC 1998, p 1.

Audit Methodology

The following methods were used during the course of the audit to gather evidence from which conclusions were drawn:

- Discussion with managers involved in the CTC processes examined;
- Review of documentation relating to the CTC process, including: initial scoping of CTC possibilities, cost benefit analyses and business case strategy documents, tendering process, negotiation and finalisation of the contract, transition management, contract management and post implementation/service delivery reviews; and
- Comparison of approaches taken for each of the contracts reviewed against the Treasurer's CTC Policy Framework.

Audit Resources and Timing

Planning for the performance audit commenced in November 1998. Testing at Agencies occurred in December through May 1999. The report was finalised in July 1999.

The total cost of the audit, including the cost of Tasmanian Audit Office staff but excluding report production costs is estimated at \$66 650.

BACKGROUND

Over the last decade there has been a trend for government bodies in Australia to focus on their 'core businesses' and outsource where possible, as a means to improving the efficiency, effectiveness and economy of the management of limited financial resources. This has been occurring in relation to internal corporate services, such as information technology and payroll, as well as the external 'business', namely the delivery of services to the general community.

What is Competitive Tendering and Contracting?

The Treasurer's Competitive Tendering and Contracting (CTC) Policy Framework defines CTC as 'a process of selecting and contracting with a preferred service provider from a range of potential contractors by seeking offers (tenders) and evaluating these on the basis of agreed selection criteria'⁴. Although the services are contracted-out, the Government retains accountability for the quality and level of the services provided.

CTC is one element of the Tasmanian Government's larger financial management reform strategy. As the contractual approach to service delivery clearly separates the roles and responsibilities of purchasers and providers from an output perspective, rather than focusing on processes and inputs, it complements the other recent reforms introduced in Agencies such as output-based budgeting, accrual accounting and reporting, commercialisation and strategic asset management.

Examination Focus and Approach

A case study approach was used for this audit, and six service contracts were selected for examination:

- North West medical imaging services;
- North West pathology services;
- North West maternity services;
- Mersey division of the North West Regional Hospital;
- Valuation services for local government; and
- Surveying services.

The valuation and surveying contracts differ from the first four in that overall systems were set up which constantly go through stages 1-5 ('Identification of CTC Opportunities' through 'Contract Management and Performance Monitoring') as required, based on the requests received by the Offices of the Valuer-General and Surveyor-General. Stage 6 ('Re-evaluation of the Options') is carried out on the same frequency as a longer single provider contract, namely, at least a year after the contract commenced.

As described in the previous section, each of the six cases examined were reviewed using the CTC Policy Implementation Manual as a benchmark, as well as against best practice knowledge management principles. Although the CTC Policy Framework was not formally in existence at the time the DCHS/DHHS services were outsourced, the

⁴ DTF 1996, p 1.

Framework is still a useful point of comparison as it is based on common sense principles.

Reviews and Audits in other Jurisdictions

A number of reviews have been carried out by other Audit Offices in relation to outsourcing:-

- The Victorian Auditor-General's Office, conducted three reviews which were considered useful for this report—'Office of the Valuer-General' in 1993, 'Privatisation: An Audit Framework for the Future' in 1995 and 'Metropolitan Ambulance Service: Contractual and Outsourcing Practices' in 1997. The first report concerns the commercialisation of valuation services; the second report, while addressing privatisation rather than CTC was still useful in its best practice recommendations for procedures and contractual clauses; and the last report concerns accountability and transparency matters relating to the consultancy and outsourcing contracts entered into by the Service;
- The Australian Capital Territory Government Audit Office produced a report in 1995 titled 'Contract for Collection of Domestic Garbage'. The audit examined a particular tender process in depth, especially in regard to accountability and transparency issues;
- The Western Australian Office of the Auditor-General issued its report 'Contracting for Services', also in 1995, which reviewed four case studies where CTC was adopted;
- Three of the Australian National Audit Office's reports were referred to during this audit: 'Commercial Support Program' in 1998, 'Management of IT Outsourcing', tabled in 1996, and 'Defence Contracting' in 1995. All of these audits raised the importance of setting out statements of requirements in detail at the earlier stages of the process, as well as monitoring the service level provided by the contractor;
- The Auditor-General for the Northern Territory's August 1998 and February 1999 Reports to the Legislative Assembly included a discussion of accountability and public law implications of contracting out services, particularly in regard to commercial-in-confidence arrangements, and the need for staff with appropriate skills to actively manage these contracts; and
- Similarly, the Audit Office of New South Wales' 1998 report, 'Department of State and Regional Development – Provision of Industry Assistance' also examined the effect of invoking commerciality-in-confidence on monitoring performance and overall accountability of agencies to Parliament.

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

North West Medical Imaging Services

Background

Prior to November 1994 the State Government directly provided medical imaging (MI) services through its Government-operated hospitals on the North West (NW) coast. A private radiologist also operated in the area at the time.

Medical imaging services include general radiology, including storage and tracking of X-rays, ultrasound, CT radiology, teaching, on-call services and medical photography.

Prior to the outsourcing of the services, the annual operating cost to the Government was approximately \$2m for the 1993-94 financial year. Operating costs in 1997-98 for this service was approximately \$1m. The Audit Office reviewed the processes surrounding the CTC approach used in outsourcing MI services in the region, as well as the level of contract management to-date.

Identification of Opportunities

Project Management Approach

A project manager was appointed as well as a working party set up which included one other Departmental officer, a representative from the (then) North West Regional Health Board (NWRHB), four staff involved in NW medical imaging, and two union representatives.

Scoping Report

The Regional Finance Manager prepared a discussion paper in August 1992 which explored various options for delivering radiology services on the NW coast. It contains a discussion of the objectives of the NWRHB in terms of providing MI services. Various aspects of service delivery are analysed, such as organisational structure, ownership, staffing, financial and operational matters. The paper adequately distinguishes between purchaser and provider roles, and there is a detailed analysis of what the CTC arrangement should cover.

Approval

While the discussion paper was to be tabled at NWRHB's Finance Committee, the Audit Office was not able to locate Committee minutes directly approving the paper, but did sight subsequent minutes which approved other stages of the CTC process. Following the expression of interest received from the successful tenderer, Cabinet approval was given in January 1994 for the Board to enter into formal negotiations with NMI.

Risk Analysis

A financial analysis was carried out which addressed financial and funding implications for both the Agency and the Board. A cost-benefit analysis was also performed in January 1994 which was forwarded to Cabinet as well as senior Agency management, addressing both financial impacts as well as industrial issues and service levels to the

community. The 1992 discussion paper also addressed non-financial effects of the CTC proposal.

Consultation Strategy

The working group to implement CTC comprised members from the Agency, NWRHB, radiologists and union representatives. Minutes from the group's meetings show that consideration was given to consultation with staff, as well as low-income earners and visiting medical officers (VMOs).

Evaluate Identified Options

Business Case Development Strategy

The paper prepared in March 1994 by the Regional Finance Manager and a DCHS officer was interpreted by the Audit Office to be a combination of a business case development strategy as well as a cost-benefit analysis, and as mentioned above, the Cabinet submission they prepared also contains a cost-benefit analysis.

Preparing the in-house provider for competition was not considered relevant to this contract, as almost all radiographers previously involved in service delivery were VMOs; the only full-time specialist was in the process of retiring, and it was this latter situation which had been the main catalyst for considering the CTC alternative in the first instance.

Expressions of Interest

An expressions of interest (EOI) document was prepared, containing a statement of requirements (SOR), and evaluation/selection criteria. It is understood that while the EOI request was advertised in both Tasmanian and interstate newspapers, two responses were received, but one subsequently withdrew, leaving Grant & Paech Pty Limited, then trading as Northern Medical Imaging (NMI), as the sole interested party.

Approval Obtained

As stated above, Cabinet approval was given for the NWRHB to enter into negotiations with NMI in January 1994.

Valuation of Assets

A valuation of all MI equipment to be transferred to the contractor was carried out by an independent valuer, and the agreed value was set out as the purchase price in the contract.

Tendering and Evaluation

Tender and Evaluation strategy prepared

As only one response to the EOI was received, a further tendering process was not undertaken; hence there was no requirement to develop a strategy.

Composition of evaluation panel

The evaluation of the EOI received was carried out by a radiographer, as well as a senior Departmental officer with expertise in hospital management and the future contract manager.

Documentation and Approval

A draft contract was prepared by NMI as part of its EOI documentation. Clauses of the contract include references to performance monitoring criteria.

Cabinet approval was obtained in January 1994 to proceed with contract negotiations with the sole tenderer, NMI.

Equity to In-House Providers

As the radiologists who were to continue working in the NW were VMOs, there was no in-house bid in this instance. However, documentation sighted confirms that extensive negotiations were held between the Agency, unions and the proposed contractor to ensure there was equitable employment terms offered to those staff who wished to be re-employed with NMI.

Contract Negotiation, Implementation and Transition

Strategy for negotiation

Documentation sighted verified that a strategy was in place; a consultative committee was set up consisting of the project manager, NMI, representatives from Burnie and Mersey Hospitals, the Regional Finance Manager, and the NWRHB Acute Care Manager.

Finalisation of negotiations

The Audit Office sighted documents showing that formal written negotiation of terms and conditions occurred. The final, signed version of the contract includes clauses relating to the price of stock on hand and equipment, service failure, early contract termination, and performance monitoring.

Implementation and Transition

A transition team was set up and addressed matters such as industrial relations, communications with staff, and disposal of assets. A considerable amount of correspondence was sighted showing thoroughness of addressing staff's concerns about the redundancy and re-employment offers. More detailed discussions took place with the contractor in regard to locations of service delivery, various responsibilities, and the exact time of transfer. A valuation of assets was undertaken by an independent specialist. Agreement was reached on the nature and frequency of the performance reports.

The Audit Office notes, however that the consequential licence variations for Authorised Personnel and Authorised Products required by the *Radiation Control Act 1977* were not initiated promptly by the parties.

Post-Implementation Review

It is understood that analyses of the contractual arrangements were carried out by the Regional Finance Manager and other Regional and Departmental officers but these have not been sighted by the Audit Office.

Commercial-in-Confidence clarified

Besides clauses in the final contract which relate to confidentiality, there are also provisions that guarantee the Agency access to particular records necessary to evaluate the contractor's performance, as well as enabling the Board to carry on its hospital business.

Contract Management and Performance Monitoring*Adequate Contract Management*

The current contract manager is the CEO of the NW Regional Hospital. His responsibilities include administration of the terms and conditions of the contract, receiving and actioning the contractor's performance reports, liaising with internal management regarding the contract and service provision matters, and monitoring performance against the contract.

Payments are administered by the Hospital's Finance Manager, and the Agency's Legislation Manager is responsible for monitoring privacy arrangements.

There are regular meetings of the NMI Contract Monitoring Committee, and a committee of medical practitioners which NMI attends.

Ongoing performance monitoring

The contract specifies that the contractor is to provide regular reports on performance and quality including client satisfaction surveys. However the contractor has been unable to supply a summary of services provided because of an incompatibility between computerised records. As a result the burden of preparing summary information has fallen back on the Department. The Department believes that the statistical data should be provided by the contractor in a user-friendly format.

In addition, the Audit Office was unable to locate any client satisfaction surveys required to be supplied pursuant to clause 20.1 (vi) of the contract.

The hospital has retained accreditation through ACHS including medical imaging services. However it has not utilised fully the contractual provision entitling it to receive data that would assist in monitoring overall performance.

Service requirement monitoring

Service delivery on the West Coast decreased due to the resignation of the full-time radiographer in March 1995. As NMI was unable to find a replacement employee, the service was reduced, and the contractor invoked a clause of the contract which states that where NMI makes a reasonable effort to fill the vacancy, but is unsuccessful, this shall not deem NMI to be in default of its obligations.

In terms of the impact of decreased services on costs, there is not any negative impact on the Agency, as NMI is paid on a fee-for-service basis.

It is understood that the contractor participates in the teaching of junior medical staff and students and attends relevant meetings as required.

Contingency plan

It is understood that due to the shortage of adequately skilled medical imaging staff in the NW region the Agency is unable to put together a contingency plan should the contract be terminated before it comes to an end.

Re-evaluation of Options

Structured Re-assessment of Options

Because the current contract will run until 2004, there has not yet been a reassessment of whether a continued outsourcing in its current structure will be appropriate in the future, taking into account any changes in service requirements for the community.

Knowledge Management

Records Management Quality

During its review of the contract, the Audit Office was able to locate all documents which related to the CTC process. The quality of records management was found to be high, and this is commendable, particularly due to the change in corporate structure of the Agency, which meant that documents were in Burnie as well as Hobart, and to the high staff turnover of officers who were involved in the project.

Organisational Memory Capture

It is understood that an intra- or inter-Agency briefing has not yet occurred in relation to this contract, to provide feedback on experience gained from this process, and enable organisational learning to occur, particularly in regard to alternatives to manage the non-receipt of performance information received and lack of personnel to ensure service levels do not decrease.

Conclusion

The Audit Office understands that service delivery in less densely-populated areas has its difficulties, due to a lack of suppliers or providers. This has been borne out in the MI contract both at the EOI stage, when only one interested party persisted with an interest, as well as after the contract was implemented when service delivery had to be decreased due to staff shortages within the contractor's firm.

However, a key aspect of outsourcing is ensuring that the performance of the contractor is constantly monitored as the Agency is ultimately accountable to the community for the quality and quantity of services delivered. The lack of follow-up of the performance report requirement by the Agency is considered a serious shortcoming in its management of this contract to date, although it is noted that the level of service has met ACHS accreditation standards for the NWRH.

Recommendation

The Audit Office recommends that DHHS should commence regular reviews of NMI’s performance in delivering MI services.

Response from the Department of Health and Human Services

‘The cost of the service has varied in each financial year. The timing of payments by the agency has contributed to this. The cost of the service has decreased from 1995 to 1998. The price paid for 1999 is less than the 1996 contract year by approximately \$12 000. This is in spite of major increases in high imaging services such as orthopaedics. The expenditure for this service is monitored monthly as an indicator of volume. This is reasonable due to the consistent profile of services.

The major substance of the contract and its initial purpose are being met with good outcomes both in terms of meeting quality and value for money.’

North West Pathology Services

Background

Prior to July 1993 pathology services were carried out directly by the (then) North West Regional Health Board (NWRHB). For 1997-98 pathology costs on the NW coast totalled \$1.2m (excluding Mersey Hospital). Pathology services include histology, blood transfusions, haematology, biochemistry, cytology, microbiology sterility and infection control. Since July 1993, pathology in the NW region has been outsourced to Diagnostic Services Pty Limited and Consultant Pathology Services Pty Limited, trading as North West Pathology (NW Pathology).

Identification of Opportunities

Project Management Approach

A DCHS officer was selected as project coordinator/manager, and two private sector expert consultants were contracted to carry out a scoping report. A steering committee was set up in November 1992, and was given terms of reference and a timetable.

Scoping Report

As noted above, two private sector consultants were engaged to carry out a State-wide review of pathology services. Their report included the following:

- Background on the current situation of pathology services, as well as planning issues and future directions for the area;
- Critical examination of all aspects of pathology services, including forensic pathology;
- Recommendation for the Agency to take on more of a coordinating role in pathology services rather than direct provision of services; and
- Recommendation that each public pathology laboratory should exist as a separate business unit, and that contracts with the private sector for the provision of selected specialist services by pathologists should be adopted as the favoured policy option for application in appropriate situations, particularly the north and north west regions.

Approval

In a cover letter sent to participants in the State-wide review in May 1993 the Minister gave his support to the findings and recommendations contained in the report.

Risk Analysis

The consultants' report examined advantages and disadvantages of a fully commercialised model, bearing in mind negative effects which could come about through outsourcing, such as higher prices and the risk of over-servicing. Potential disadvantages included:

- Substantial funding requirements for staff redundancies; and
- Creation of a possible monopoly situation, due to the low number of pathology practices in Tasmania.

The main advantages of outsourcing pathology services noted were:

- To address the problem caused by the lack of pathologists who were unwilling to work in the public system, particularly in the NW region; and
- Assuming a competitively priced contract could be effectively negotiated with a private sector firm, reduced costs could flow to the State Government.

Consultation Strategy

As set out in the terms of reference for the State-wide review, a State Reference Group was set up which consisted of representation from the following groups:

- DCHS Corporate Office;
- The three (former) Regional Health Boards;
- (Former) Tasmanian Public Sector Association;
- (Former) Health Services Union;
- Royal College of Pathologists of Australasia;
- Tasmanian Salaried Medical Practitioners' Society;
- Combined professional scientific Associations; and
- University of Tasmania.

A timetable was also developed for consultation, and the report includes a list of groups who submitted feedback to the consultants during the review process.

Evaluate Identified Options

Business Case Development Strategy

The Audit Office considered that the above-mentioned State-wide review contained the information recommended in the CTC Implementation Manual to meet the criteria of a business case development strategy as well as a scoping report, as it contained the following:

- Separation of purchaser and provider roles;
- Determination of future service requirements;
- Examination of CTC viability; and
- Preliminary cost-benefit analysis.

As well, detailed costings on two different outsourcing scenarios for the NW region's pathology services were prepared by the consultants, and these were closely analysed by NWRHB management who found that only minor amendments were needed.

Expressions of Interest

The Agency considered that there was only one eligible private supplier of pathology services in the State, the expression of interest background information was only sent out to NW Pathology. The Audit Office notes that this proposal was not advertised in any Tasmanian or national newspapers, thus enabling other providers to offer their services, even though the contract was worth in excess of \$50 000, the Treasurer's stipulated minimum amount for conducting a public tender. This issue is discussed in more detail in the next chapter. EOI documentation was sighted, such as Working

Group minutes which included a timetable, as well as an EOI strategy and statement of requirements, and assessment of NW Pathology's submission.

Valuation of Assets

A valuation specialist was engaged to carry out an assessment of the fair value of assets proposed to be included in the transfer of service provision to NW Pathology.

Tendering and Evaluation

Similar to the outsourcing of medical imaging services, as there was only one interested provider, a further tender and evaluation was not undertaken, as the EOI received was deemed satisfactory to the evaluation panel.

Contract Negotiation, Implementation and Transition

Strategy for negotiation

The same Working Group which was set up following the release of the scoping report had in its terms of reference the management of the transition to outsourcing. Working Group minutes included an implementation and transition plan.

Finalisation of negotiations

The final version of the contract contains detailed terms and conditions for a variety of areas, including payment of employee entitlements, lease conditions for the premises around the NW, and price and payment procedures. Included in the contract was the provision for a transitional period to exist between July 1993 until the expiry of a six-month period after the date that the pathology ward is set up at the new Diagnostic Centre in Burnie. This actually occurred in February 1995, at which time the post-transitional period commenced.

Comprehensive provisions covering dispute resolution are included in the contract, with different scenarios addressed for valuation of asset, pathology matters and other general issues.

Implementation and Transition

A signed and stamped contract was sighted. Working Group minutes showed that issues such as particular assets to be disposed of, IT links, level of service to be provided were discussed and clarified before completion of the contract.

The contract states that the pathologist shall use its best endeavours to employ as many of the staff of the Crown as possible. Such successful staff were to receive 'reasonable access to an independent consultant who shall be an expert in human relations,' to assist them in the transition to the private sector.

A memo that was forwarded to all NW Regional staff was sighted, notifying them of the implications and timing of the change in servicing arrangements.

Commercial-in-Confidence clarified

Clauses in the contract state that the contractor shall provide the Crown access to various data and information as well as pathological specimens, and clarify the confidentiality of other matters between the parties.

Contract Management and Performance Monitoring

Adequate Contract Management

The CEO of the NWRH is specifically charged with managing the contract. There is evidence of regular management of issues as they arise in relation to the contract, the receipt and analysis of performance reports from the contractor, liaison with management through the Pathology Services Contract Management Committee, and the management of ad hoc instances of disagreements between hospital practitioners and the contractor. The Business Manager in Burnie administers monthly payments as well as incorporating CPI increases, and the DHHS Legislation Manager is responsible for looking after privacy arrangements.

Ongoing performance monitoring

The contractor supplies a satisfactory level of information. DHHS receives monthly reports setting out cumulative services provided at various centres in the Region, with a breakdown of inpatient and outpatient requests. The contractor has conducted two client survey reports to-date, with a third in progress. NW Pathology also obtains accreditation from the National Association of Testing Authorities, Australia (NATA), and advises the Agency of its results.

The performance information DHHS receives is consistent with that set out in the contract. Documentation sighted has shown that the contractor's reports are scrutinised and any variances noted are followed up.

Although the contractor first proposed regular meetings to discuss service delivery matters in 1995, it appears that the first meeting of the Contract Management Committee referred to above did not occur until, late 1996, and that there has only been one additional meeting to-date, in September 1997. However, the Audit Office understands that several issues are addressed by phone and memos between the parties.

Client satisfaction reports received to-date appear to reflect a partnership-type relationship with DHHS in their open and candid tone, including both negative and positive feedback received, and how the former has been dealt with.

In terms of financial savings, the recent operating costs of the contract are approximately \$1.2m annually compared to the 1992-93 operating cost of \$1.93m, but it should be noted that this does not take into account the redundancy pay-outs or savings from not purchasing capital equipment over the past six years. The Audit Office asked the Department to provide details of the number of redundancies and costs, but the Department was unable to provide the information despite having two weeks to do so.

In regard to the original advantages and disadvantages posed by the consultants in the scoping report, it is noted that while a monopoly situation has arisen, the Audit Office found that the issue of over-servicing did not appear to have been identified in Departmental and Board documentation.

Service requirement monitoring

Regular feedback is obtained through fortnightly meetings of hospital management and medical practitioners, including the pathologists who are involved in the contract. This enables the doctors to directly discuss their problems and criticisms with both the Agency and the contractors face-to-face. The outcome has been timely resolution of problems not foreseen in the contract. Documentation sighted verifies that these problems are

worked through and incorporated into future servicing approaches. Service level performance audits are carried out at regular intervals and fall into three categories: ACHS accreditation, which includes examination of pathology services; NATA testing specifically on pathology services; and surveys done of medical practitioners during client surveys.

Contingency plan

The contract includes a clause which states that if the Government is no longer in the 'business' of direct health care provision in the NW region, the Crown will do all it reasonably can to have the new entity use NW Pathology to carry out its pathology service needs. This happened on a smaller scale when HCOA took over the Mersey Hospital. The Agency successfully persuaded HCOA to use NW Pathology for its diagnostic service provision. NW Pathology takes on full responsibility for ensuring that there are adequate pathologists to carry out the work needed, including arranging for Hobart pathologists to work in Burnie as required.

However, as with the MI contract, there are no other providers who could be called in to take over the provision of services should the contract be terminated, due to the monopoly situation present in the NW region for diagnostic services.

Re-evaluation of Options

Structured Re-assessment of Options

The Audit Office understands that there has not yet been such a review in regard to NW pathology services.

Knowledge Management

Records Management Quality

The nature of record keeping appears satisfactory. As there has been a high turnover of staff in the region, as well as the overall Agency, the CEO has set up a comprehensive set of documents relating to the various stages of outsourcing this service.

Organisational Memory Capture

As with other contracts examined during this audit, there has yet to be an inter- or intra-Agency presentation of experiences gained during the CTC process in this instance, in order to incorporate them into a comprehensive Agency policy.

Conclusion-Best Practice Example

Overall the Audit Office considered that this outsourced service has been managed in a satisfactory manner throughout the CTC process, and commends the Department on its successful implementation of outsourcing for pathology services, and continued management of the contract.

North West Maternity Services

Background

Prior to 1993 maternity services in the NW region were provided by both the private and public sectors. The public hospital sector provided services for low risk maternity services at Smithton and Queenstown hospitals. Medium and low risk services were provided at the public facilities at Latrobe and Burnie. A private provider (Healthscope Pty Limited) provided a service for low risk patients at its Brickport Road facility approximately 5km from the public facility in Burnie. When it was decided to collocate the private and public hospitals in Burnie, a proposal was put forward by the operator of the private hospital (Healthscope) to provide both public and private maternity services at that site as well, thus replacing the two units. The contract came into effect in 1993.

Payment to the contractor is monthly and is based on activity. Total annual payments were approximately \$2.1m in 1997-98. This audit reviewed the CTC processes concerning both Healthscope's bid as well as an in-house proposal, and the subsequent contract management.

Identification of Opportunities

Project Management Approach

A steering committee was set up which included NWRHB officers as well as representatives from the DCHS and Healthscope. It is understood that the Minister at that time was also a key instigator in promoting the concept of an outsourced provider for public and private maternity services.

However, standard project management documentation, such as terms of reference and a timetable have not been sighted, and perusal of Board minutes for the meeting in November 1992 indicated that a number of Board members considered that the proposal was being 'rushed' and that more time should be taken to discuss and evaluate the matter in order to make an informed decision.

The Agency has conceded that evidence of a project management approach is not available, such as in an overall written plan, but various people were assigned specific roles throughout the CTC process.

Scoping Report

Early in the 1991-92 financial year, a private consultancy firm carried out a preliminary report on options for the delivery of obstetric services in the NW region following a request from the Secretary. Conclusions reached stated that significant operating inefficiencies had arisen from the split of public patient services on two sites, and that the development of a new hospital facility in Burnie offered the opportunity to review options available for obstetric service delivery. Three scenarios were put forward; it was considered that the continuation of the current method could involve future capital costs of between \$2m and \$3m at the new hospital site, and inefficiencies would continue. An option of outsourcing public maternity services specifically to Healthscope at the NWPH was preferred.

The option of a single public maternity service in the region from one site was seen as unsatisfactory as one part of the region's community would not have easy access to the services.

Healthscope prepared a service delivery proposal in December 1992, and an independent report was also prepared for the Minister in 1992 in relation to staffing practices at the NWRH (the 'Olley Report'). The Director of Nursing prepared a list of areas to be included in the contract, which was considered to be comprehensive. In preparing the list, reference was made to a 1989 NSW report, 'Maternity Services in New South Wales', which set out risk areas to be addressed.

Approval

Minutes of the NWRHB from January 1993 were sighted which approved the proposal to co-locate public and private maternity services in the future private hospital site.

Risk Analysis

The independent consultant's report prepared for the Secretary appears to have included a risk analysis for three different options: a single public maternity service from one site, continuing two public services at NWRH in Burnie and Mersey, and purchasing services from Healthscope (note that the option of opening the tendering process to the private sector generally was not seen as an option). It was considered that the continuance of directly providing public maternity services at two sites was not satisfactory, due to the following factors:

- A lack of throughput at the new NWRH site when just dealing with public patients, resulting in inefficiency;
- High capital costs of setting up a maternity ward at the new NWRH site; and
- Three maternity units (Burnie public, Mersey public and Burnie private) would operate at inefficient levels from both a service quality and cost aspect.

In contrast the option of contracting with NWRH/Healthscope to provide public maternity services was favoured because:

- An estimated throughput of 1000 births per annum would provide a more efficient operation;
- A similar contract operating in Port Macquarie, NSW was reported to run at a high standard of quality; and
- There would be benefits of payroll tax revenue to the Government.

Consultation Strategy

In December 1992 two medical staff employed by the Southern Regional Health Board provided an expert opinion on the collocation proposal for the Minister. As part of their approach, they gathered feedback from other Agency and NWRHB staff, as well as specialists at the University of Tasmania/RHH teaching hospital and a representative from Healthscope. It was recommended that the proposal should go ahead.

In regard to the wider community, consultation occurred with stakeholders such as the Nursing Mothers Association, the Maternity Unit Must Stay action group, public meeting forums and unions. Considerable concern with the proposal was expressed by each of these groups and this was addressed through meetings, letters and Ministerial briefing notes. While concerns were acknowledged and responded to, the Audit Office's perusal of documentation did not show that issues raised were incorporated into the proposed outsourcing framework.

Evaluate Identified Options

Business Case Development Strategy

The paper submitted by the Clinical Nurse Consultant to the Olley Report discussed the current operations of the two maternity units but did not include any strategic outlooks or forecasts and how these should be addressed by the units.

There was considerable discussion and disagreement between the Agency, the Region, the in-house proposal team and Healthscope's proposal team in regard to the operating costs and related savings applicable to an outsourced maternity service delivery model. This resulted in a number of adjusted proposals being put forward by both parties.

Expressions of Interest

It is noted that similar to the pathology contract, formal invitations to submit proposals were not sought as the Region and Agency considered that only one provider was seen to be a viable proposition. However it is noted that both the Handbook of Government Procurement and the Treasurer's Instructions state that 'the procurement of goods and services with a value greater than \$50 000 per item must be undertaken through public tender'⁵. As well the CTC implementation manual states that 'targeted distributions may result in exclusion of potential innovative service delivery solutions, therefore, selective EOI should only be undertaken in exceptional circumstances'⁶. Although the Board was not bound by the Treasurer's Instructions and the Handbook was released after the tendering process was completed, the Audit Office nevertheless considers that for a multi-million dollar project such as this, a more open process should have been pursued by inviting public tenders.

It is understood that the reason for not distributing the EOI request more widely was that the existing North West Private Hospital (NWPB) operator, Healthscope, would not have found the continued operation of the hospital attractive without the maternity services contract as well. However, the Audit Office does not consider that this is a sufficient reason to depart from the general principle that the CTC process should be fully open and public.

Approval Obtained

The document referred to above in December 1992 which approved the collocation of services also gave a recommendation to the Minister that Healthscope would be the preferred provider. The Agency could not locate a formal approval of this decision by the Minister and/or Cabinet.

Valuation of Assets

According to Agency officers, the plant and equipment was inventoried and internally valued at the written-down cost. No formal record of the valuation could be supplied by the Department, except for the final lists of assets which were either transferred to the Tasmanian Ambulance Service or made available for sale to the NWPB, neither of which had any costs assigned to them on the documentation sighted.

⁵ TI 902 (2)(b); DTF 1997, para 2.3.

⁶ DTF 1996, p 34.

Tendering and Evaluation

While the contract did not go to tender, there were two proposals received for the provision of maternity services, namely that from Healthscope and a proposal by an in-house team. Accordingly, portions of this phase of the CTC process are considered to have applied.

Tender and Evaluation strategy prepared

While the Department has stated that the following criteria were used to evaluate both proposals, formal documentation from the Department specifically setting out the evaluation criteria and methodology were not able to be located by DHHS. The only apparent basis of assessment sighted was on a 2 ½ page memo from the panel, as follows:

1. Improvement in or maintenance of quality care and service to all maternity patients;
2. Improvement in or maintenance of quality care and service to the neonate;
3. Teaching registered medical officers/students;
4. Incentive considerations in having a large and more viable unit;
5. Proximity to general medical services;
6. Management by the NWRPH; and
7. Costing.

The wording of the sixth criterion was of concern to the Audit Office as it seemed to indicate that there was a higher burden of proof on the in-house bid to show an appropriate standard of management.

It is noted that during this stage of the CTC process both Healthscope and the in-house team had changed their costing bids at least once after submitting their original proposals. As well, internal Departmental documentation showed uncertainty as to what level of savings would actually ensue should the service be outsourced. A May 1994 memo stated that the decision to award the contract to Healthscope was 'not based on cost alone, but rather the decision was primarily based on quality of care grounds'.

In reviewing the documentation for the evaluation stage the lack of clearly defined definitions of quality which could have been used to assess both proposals seemed to give the impression of 'moving goalposts' and clouds the degree of transparency and accountability required at this key point in the CTC process. It is noted that in contrast, the approach used by the Department in outsourcing pathology services a year earlier did have a much better defined set of evaluation criteria, as well as documentation for the evaluation stage.

Composition of evaluation panel

The panel consisted of an officer from the Commonwealth Government, an Obstetrics/Gynaecology specialist, and an acting Director of Nursing (the latter were employed by the Southern Regional Health Board), however only the last two people signed the memo setting out their recommendations.

Documentation and Approval

NWRHB approval was given in regard to Healthscope's proposal in January 1993. That month the Minister also made an announcement confirming the choice of Healthscope to be the maternity service provider.

Equity to In-House Providers

It is understood that the in-house team who prepared the proposal had access to the skills of the Regional Finance Manager, the Director of Nursing as well as clinical information.

Contract Negotiation, Implementation and Transition

Strategy for negotiation

A formal and explicit strategy for managing this phase was not found. However, minutes from meetings held between the parties were sighted which shows that outstanding contractual matters were formally addressed. It is understood that high level negotiations were conducted directly by the Minister's office and Healthscope.

Finalisation of negotiations

Although the contract was signed, NWRHB minutes in May 1993 note that the Board had approved for signature 'an agreement for public maternity services which the Board had not seen or been involved in [negotiating]', even though the Region would be held ostensibly responsible for these services.

A series of meetings were held between the two parties which covered more detailed aspects of service delivery, as well as continued discussions on costs involved with providing the service.

Implementation and Transition

Transition meetings were held between the Agency, Region and Healthscope with a project manager appointed for this phase of the CTC process. Her responsibilities included the transfer of assets, while a human resource manager coordinated the industrial issues involved in having job opportunities and redundancies organised for the maternity staff, as well as providing staff with assistance in interview techniques and job application preparation.

Post-Implementation Reviews

In May 1994 the contractor forwarded a copy of its 'Report on Public Maternity and Neonatal Services since 1 July 1993'. The report contained responses to queries raised by either the Agency, the Board or the community. Matters discussed include the increased cost of service delivery, as well as aspects of practice, such as examinations of babies. As well statistics were provided, both in narrative form and broken down by diagnostic related group for July through the end of April 1994.

An internal review was carried out in July 1994. The report includes details of the contract management framework set up to-date (discussed below), as well as quality assurance issues that had arisen, and the extent to which the anticipated savings had occurred. Issues which arose included the need to monitor caesarean section statistics, length of stay, and frequency of induced births. Early discharges to District Hospitals had been analysed as a result of concerns raised by various interest groups.

Commercial-in-Confidence clarified

The final contract contains an overall confidentiality clause, as well as more detailed provisions which enable the Agency to gain access to particular records and data.

Contract Management and Performance Monitoring

Adequate Contract Management

The Maternity and Neonatal Services Committee (MNSC), which was specified in the contract, was set up in March 1993, and consists of Healthscope management representatives, as well as medical and nursing representatives and a nominee from the NWRHB.

There is also a Contract Monitoring Committee whose function includes review of the maternity services contract.

The terms of reference of the MNSC include the development and review of policies and procedures, maintenance of quality standards, and obtaining quality of service feedback from the community.

Since the termination of the regional structure, it is understood that an increased number of issues are also being dealt with by the exchange of letters.

The CEO of the NWRH has the responsibility of managing contract issues.

Ongoing performance monitoring

It is a requirement of the contract that Healthscope maintains ACHS accreditation in respect of maternity services, and this has occurred. As well the MNSC looks after the quality of services provided on a regular basis to ensure that any incidents are addressed by improving the overall systems and procedures at the hospital.

Service requirement monitoring

The Contract Monitoring Committee receives feedback on areas involving all service delivery contracts, including the maternity services agreement. When issues need to be addressed, it is understood that there is a formal exchange of letters, but that has not yet occurred for this contract.

Contingency plan

There are two maternity service sites in the region, NWPH in Burnie and the Mersey Hospital in Latrobe. When the maternity services outsourcing was carried out, the Mersey's services were still directly provided by the Government. As two different private operators currently deliver public services at the two sites, the Department is operating on the strategy that if one of the contracts is terminated, maternity services can continue in the region at the other site.

Re-evaluation of Options

Structured Re-assessment of Options

It is understood that a review recommending options for future service delivery has not yet been carried out, although the contract is renewed on an annual basis. However, it is probable that any such strategy would have to include an analysis of Healthscope's other contract to carry out services at the NWPH.

Knowledge Management

Records Management Quality

The Agency conceded that the documentation for the outsourcing of maternity services was not thorough. Accordingly, the Audit Office encountered some minor difficulties in establishing the precise approach followed by the Board and Agency in applying CTC processes to this contract.

Organisational Memory Capture

The Audit Office understands that experiences gained from this example of outsourcing have only been used to a limited degree with regard to further development of other in-house bids in the Agency. Unfortunately few of the people involved in the process are still working in the Agency, so the opportunity for inter-Agency learning may have been lost.

Conclusion

There was a lack of transparency in this case of outsourcing. The Audit Office considers that better practice would have involved:

- A more flexible timeframe enabling a well thought-through strategy following an assessment of the quality of proposals received, together with a formal, written timetable;
- Expressions of interest sought from a broader community, by advertising the request in at least one major Australian newspaper, as well as in at least one Tasmanian paper, particularly for such a major aspect of service delivery;
- More detailed and objective evaluation criteria and methodology, to assist the panel as well as to give all interested parties the opportunity to address an established set of factors, rather than to give an impression of 'moving goalposts' which the consequential costing amendments appear to have done; and
- A detailed, independent re-assessment of options which includes a holistic evaluation of service delivery, apart from purely financial considerations, particularly as the contract has been renewed on an annual basis since 1994. This would give the Agency and the general community an opportunity to ascertain whether the savings and service delivery targets promised at the outset have actually been achieved.

It is interesting to note that other contracts which the agency was working on at that time (medical imaging and pathology, referred to earlier in this Report) appeared to have met many of these factors, and quite often the same Departmental and Board officers were involved in all three projects.

Recommendation

In regard to agencies' future outsourcing situations, the Audit Office recommends that a transparent approach to governance be achieved in terms of documentation and giving more than one potential private supplier the opportunity to make a proposal. This is especially important in the public arena. The *CTC Implementation Guide* should be of assistance in this regard.

Mersey Division of NW Regional Hospital

Background

The Mersey Hospital which is located in Latrobe, was previously managed directly by the former North West Regional Health Board (NWRHB). From July 1995 acute and ancillary services were outsourced to Health Care of Australia Pty Limited (HCOA), which is a subsidiary of Mayne Nickless Ltd. The Mersey Hospital provides 90 public inpatient beds as well as public emergency department services, as well as HCOA's 20 private beds. This part of the audit examined the approach taken by the NWRHB, working with the Department of Health and Human Services (DHHS, previously the Department of Community and Health Services, DCHS) to outsource the hospital's services.

Identification of Opportunities

Project Management Approach

A steering committee was set up after the release of the consultant's scoping report. Members included a solicitor, the NW Regional Finance Manager, NW Regional Director of Nursing and representatives from Treasury and DCHS.

Scoping Report

In October 1993 the Legislative Council's Select Committee on NW and West Coast Health Services released its final report which included an examination of the Mersey Hospital. One of the recommendations made in the report was that DCHS 'undertake a thorough and detailed investigation into the feasibility of leasing the [Mersey Hospital] to a private operator to provide health services to both public and private patients.' Accordingly a private consultancy firm was contracted to carry out a more detailed study; this became known as the 'Solomon Report', named after one of the consultants, and was released in January 1994.

Between the two reports, it is considered that the desired aspects of a scoping report had been addressed: While the Legislative Council's report discussed the background of service delivery and applicable issues, differentiation between purchaser and provider functions, and possibilities for CTC, the Solomon Report discusses the above areas, and goes into more detail in terms of a critical review of particular agency functions, and analyses risks and benefits of outsourcing the services. In regard to financial benefits, the consultants concluded that it was difficult to say what the possible savings could amount to without calling for EOIs and seeing what the proposals contained, and this was recommended.

Approval

It is understood that the Board approved of the Solomon Report's findings and recommendations that EOIs be sought as soon as possible in order to 'test the market'

Risk Analysis

The Solomon Report discusses a number of risks and benefits under the broad headings of quality, level and mix of services, specific service and operational issues, and financial feasibility.

The main risks that are raised in relation to outsourcing include: decreasing the quality of care by cutting staff numbers to increase profits, premature discharge of patients, cost-shifting private patients to the public health system, and overservicing. The report offers several recommendations to address the risks raised.

Benefits included: less patients referred to other hospitals by doctors after the confidence in the Mersey is increased with an economies-of-scale flow-on effect should the number of patients admitted increase and a financial gain between \$2.9m and \$4.9m with the proviso referred to above.

A proposed time-line was also included in the report, as well as suggested evaluation criteria for assessing proposals.

Consultation Strategy

The Solomon study involved extensive consultation with:

- Staff at the Mersey Hospital;
- Councils and community organisations connected with the hospital;
- Unions;
- Clinical Staff at the NWRH in Burnie;
- NWRHB;
- General practitioners in the Devonport area; and
- Private hospital operators in the NW and northern regions.

Evaluate Identified Options

Business Case Development Strategy

It is considered that the Solomon Report contains information which would have been included in such a study. It included an analysis of the following topics:

- Separation of the purchaser and provider roles;
- Determination of future service requirements, together with flow-on effects of outsourcing in regard to other community and health services;
- Examination of CTC viability under different scenarios; and
- Preliminary cost/benefit analysis as discussed above.

Expressions of Interest

Acting on the recommendations from the Solomon Report, EOIs were sought by advertisements in all three Tasmanian newspapers as well as the *Australian* in early February 1994. Five companies responded with proposals.

Approval Obtained

Government approval to proceed to the EOI stage to 'test the market' was given in December 1993.

Valuation of Assets

The Valuer-General carried out a valuation of the Mersey Hospital in regard to the land and buildings, while a private valuer appraised the plant and equipment at the current market value.

Tendering and Evaluation

Tender and Evaluation strategy prepared

A memo dated 3 February 1994 was circulated to officers in DCHS and NWRHB as well as liaison officers in DELM, Treasury and the Crown Solicitor setting out the text of the advertisement to be placed in various newspapers, and the allocation of responsibility to various memo recipients. The advertisement stated that a two-phase process was to be carried out to seek 'optimal arrangements for the provision of acute hospital services' from the Mersey hospital; the first phase being the EOI request and evaluation of submissions received to provide the basis for the short-list, and the second phase being receipt and analysis of the short-listed, more detailed proposals.

Composition of evaluation panel

The evaluation of EOI submissions was carried out by the Mersey Hospital Steering Committee noted above, which appeared to have consisted of persons with expertise in hospital administration, financial and legal skills.

Tender documentation prepared

The first stage EOI information included an advertisement which stated that guidelines for submissions and copies of the Solomon Report recommendations would be made available to any interested parties, as well as a comprehensive information package which included a population and service profile of the NW region, Mersey Hospital activity data and other relevant details on service delivery, staffing and finance issues.

Distribution of request for proposal

The advertisement appeared in the *Australian*, as well as all three Tasmanian newspapers in February 1994.

Evaluation of Proposals

The information package sent out to those who responded to the advertisement set out the 14 assessment criteria, which included financial capacity, expertise and relevant experience, unit price of treatment of patients, compliance with quality of care standards, and commitments on levels of service provision.

Five companies responded to the EOI advertisement, and were all later requested to provide more detailed proposals. Three companies responded to this second round, with one subsequently revoking its proposal. After DCHS requested more detailed submissions from the two remaining companies, the companies made presentations to the Steering Committee in August 1994.

Detailed evaluation notes of both the EOI submissions and more detailed proposals from the two shortlisted companies were sighted, including an 18-page assessment form that was used which was consistent with the evaluation criteria.

Documentation and Approval

This phase of the CTC process is considered to be well-documented. Apart from the above-mentioned assessment form, a lengthy report on the evaluation results was prepared, as well as a cost/benefit of nine possible options based on the quality and nature of the proposals received which is consistent with the recommended approach set out in the Solomon Report.

It is interesting to note that in regard to the option which was later taken as the preferred approach, namely outsourcing the Mersey to a private operator, potential savings of up to \$1.25m were identified, taking into account a loss of \$1.9m per annum in relation to private compensable and DVA patients, but excluding one-off redundancy costs of between \$4.5m to \$5m as well as an accelerated pay-out of employee entitlements between \$10m-\$12m.

The Steering Committee made an initial draft recommendation on the basis of these evaluations that the Government establish whether improved proposals from the two companies could be attained as the Committee did not consider that the submissions in their current state met the standards originally sought. However, the same consultancy firm that prepared the scoping report was re-engaged by the Government to carry out its own evaluation of the two submissions.

In September 1994 the consultants recommended that HCOA be the preferred contractor, and this was endorsed in the same month by the Government.

There appears to be a gap in documentation as to how the two differing evaluations could be reconciled.

The relevant Cabinet submission contains the consultants' recommendations as well as their analysis of advantages and disadvantages of various scenarios, and a comparison of the two proposals based on capability, service quality, and access. There was no reference to any Departmental or Board evaluation. **This is particularly important because the Steering Committee's evaluation shows that direct provision of services is cheaper by \$1.3m pa even before accounting for redundancy payments.** The impact statements attached to the submission included:

- Financial impact;
- Economic and employment impact;
- Family impact;
- Community impact; and
- Financial estimates.

In contrast, the consultants stated that annual **savings** to the Government would be approximately \$3.9m. Similar to the Steering Committee's estimate, the costs proposed for the redundancy payments are over \$5m, but other employee-related costs are estimated to be slightly lower, namely just under \$10m.

The costs and revenues used in calculating the savings for both scenarios varied between the two recommendations as well. While the consultants estimated annual net operating cost of the direct provision of services to be \$18.7m, the Steering Committee's estimate was only \$16.6m including \$250 000 for capital expenditure. Likewise the consultant's estimate for HCOA running the hospital was \$14.7m compared to the Steering Committee's \$17m.

It should also be noted that in terms of staffing levels, an outsourced situation was estimated at requiring roughly 100 less FTEs than were currently employed at the

Mersey. No reason was given as to why a lower staffing level could not be achieved under direct provision of services.

During the following month the draft contracts were drawn up and negotiations commenced with HCOA.

Contract Negotiation, Implementation and Transition

Strategy for negotiation

Responsibility for preparing the service agreement and related contracts and to finalise the contract was given to two DCHS officers who used the services of a law firm. Regional officers had limited involvement. As well a firm of consultants was engaged to provide independent advice to the Department in relation to the outcome of negotiations with HCOA mainly with respect to financial analysis.

Finalisation of negotiations

Two contracts were drawn up covering hospital services and ancillary services. Areas covered by one or both of the contracts include:

- Calculation of the maximum service amount;
- Performance monitoring and management;
- Payment terms and procedures;
- Default by either party;
- Termination rights;
- Dispute resolution; and
- Mediation.

In the midst of these negotiations, the Commonwealth Department of Human Services and Health (DHS) raised concerns about possible cost shifting and the possibility of imposing a \$3m penalty under the Medicare Agreement unless this matter was attended to. This was considered of high importance to the DCHS, as such a penalty would have easily negated the estimated savings from the outsourcing. DCHS then negotiated to provide the Commonwealth with required data on hospital inpatients and outpatients, and the Department considers that this matter is now settled, based on the data provided to-date to the Commonwealth. Nonetheless, it is of interest to note that both the Steering Committee and the consultants estimated substantive cost reductions in outpatient and emergency costs and these costs have indeed declined sharply between 1993 and 1998, while inpatient costs have remained relatively steady (1993: \$15.83m; 1997: \$16.7m) and weighted separations of patients have fluctuated between 5 484 and 6 175 over the past four years, lending weight to the Commonwealth's earlier concerns.

It is understood that HCOA took over the Mersey site on 22 July 1995, but not all contracts were signed and stamped until later dates: the Ancillary Services agreement was not completed until 12 October 1995, the sub-lease was completed on 20 October 1995, and the lease was completed on 10 August 1995.

Implementation and Transition

Industrial relations issues are dealt with in the contract, including the transfer of staff, redundancy restrictions, as well as a memorandum of understanding between the Crown, and unions. A draft HR plan for the outsourcing was sighted which made

reference to current staffing levels, expressions of interest by staff, a proposed HCOA organisational chart for the hospital, position descriptions and other related matters.

The transition project team included a DCHS Communications Officer and Staff Liaison Officer, who were responsible for the establishment and implementation of a communication strategy. This included preparation of Ministerial briefings, staff newsletters and 'hotline' responses, as well as staff forums and ad hoc discussions with individual officers about their concerns.

To assist with the other transitional matters, a project team was established following the announcement on 29 September 1994 that the Government approved detailed negotiations to commence with HCOA. The Team included a Project Coordinator, Project Officer for HR matters, Agency Liaison Officer, two Staff Liaison Officers and a Communications Officer. The Team's role included the preparation of a project plan, which the Audit Office sighted.

One clause of the contract details the performance management information to be provided by HCOA, including monthly reports as specified in one of the schedules to the contract.

It is considered that this phase of the CTC process was managed in a thorough fashion.

Post-Implementation Review

A team of four officers drawn from DCHS and NWRHB carried out a post-implementation review in early 1996. A SWOT (strength, weaknesses, opportunities and threats) analysis was also prepared.

Commercial-in-Confidence clarified

Two of the clauses in the Services Agreement address confidentiality as well as schedules to the agreement which clarifies the information to be provided to the Agency and Board, thus minimising any possibilities for commercial-in-confidence conflicts to arise.

Contract Management and Performance Monitoring

Adequate Contract Management

A Mersey Liaison Committee was established in 1995 which consists of regional and DCHS staff and originally met with HCOA representatives on a monthly basis to discuss and resolve management issues. Minutes of the Committee were reviewed. With the restructuring of the Agency, meetings are now held less frequently and the CEO of the NWRH represents the Agency at the meetings, and is the point of contact in relation to any issues which arise. The Director of Hospitals and Ambulance Services represents the Agency at high level meetings with HCOA.

Monthly invoices are reviewed by the NW Business Manager and the NWRH CEO before payment.

Ongoing performance monitoring

It was noted from perusal of documentation that follow-up action is taken where significant discrepancies between performance indicators and target rates as set out in the Services Agreement occur.

In terms of achieving the financial savings target, 1993-94 actual operating costs were approximately \$15.83m for inpatients and \$2.48m for outpatient and emergency services, versus recent annual payments to HCOA of \$16.7m and \$1.3m respectively, thus indicating that on a purely financial basis, savings in annual operating costs appear to have been made from the outsourcing approach. However, this ignores the impact of redundancy costs incurred at the commencement of the outsourcing as well as the foregone revenue from private and compensable patients.

The Audit Office asked the Department to provide details of the number of redundancies and costs, as well as comparable pre- and post-outsourcing data on weighted separations, but the Department was unable to provide the information despite having two weeks to do so.

The performance indicators monitored include areas included in the original statement of requirement, such as quality of care, possible overservicing, and financial management.

There is currently a dispute between the parties concerning the calculation of the Maximum Service Amount (MSA). One clause in the contract provides for the MSA in relation to the third and subsequent years of the contract to be calculated by reference to movements in the consumer price index (CPI). The dispute centres on whether the indexation should be linear or compound. However, the hospital services have been continuing throughout this period.

Service requirement monitoring

The calculation of the MSA provides for changes in service levels to be accommodated. The number of weighted separations determines the number of inpatient services provided under the contract. The price per weighted separation is based on the latest national average cost per separation. At the start of each financial year the maximum budget is defined per the MSA, and the latest national average cost is ascertained. HCOA then submit a workload plan to provide the necessary service level. Non-inpatient costs are based on providing emergency department services plus an agreed cost for the provision of extended care midwifery, antenatal classes and patient transport, including ambulance. A management fee is also included in this amount. Minimum staffing levels are defined.

Another clause in the Services Agreement provides for changes to the basis of funding of public hospitals in Tasmania, which could address any change which may occur to the casemix model used in Tasmania.

The Ancillary Services Agreement also provides for the services provided by HCOA to be reviewed for appropriateness.

Contingency plan

Under one of the Services Agreement clauses, the Crown may appoint a new operator if the current operator is dismissed and contract is terminated.

Re-evaluation of Options

Structured Re-assessment of Options

In 1997-98 the current leasing arrangements for the hospital premises were explored. It is understood that preliminary discussions are now occurring with HCOA regarding this matter.

Knowledge Management

Records Management Quality

The nature of record keeping appeared to be satisfactory, which has been the case for other documentation sighted and sought relating to outsourced NW regional services. Other information stored by DHHS in Hobart was also obtained. Records sighted at both areas included faxes and e-mail messages. There was a high level of documentation of the various CTC stages for this case study.

Organisational Memory Capture

It is understood that only limited opportunities have arisen for officers involved in the outsourcing to share their knowledge with other Agency staff.

Conclusion

The Audit Office found that in most phases of the CTC process, a comprehensive project management approach was used, together with a well-documented audit trail which enabled the Audit Office to retrace the steps taken by Regional and Agency officers. The Audit Office commends DHHS on this approach.

However, as noted above, there appeared to have been a gap in the documentation around September 1994 which does not explain how the two different evaluations as to the viability of the proposals received in terms of meeting the Agency's requirements for service delivery were reconciled and the consultants estimates accepted rather than those of the Steering Committee.

Another matter which warranted our attention was that HCOA commenced management of the Mersey Hospital site prior to all relevant contracts being signed and stamped, thus having the potential to expose the Agency to risk.

Recommendation

Similar to our findings for the outsourcing of NW regional maternity services, it is recommended that in regard to agencies' future outsourcing situations, transparency in decision-making should be incorporated in the CTC process, particularly when reconciling different evaluations made by persons involved in the project.

Brokerage of Cadastral Survey Services

Background

The Office of the Surveyor-General (OSG) contributes to the delivery of the Survey Systems and Services output together with other operational branches of the Land Information Services Division at the Department of Primary Industries, Water and Environment (DPIWE). In 1997-98 the expenditure for the output was \$1.967m, and the 1998-99 Budget Estimate is \$2.039m⁷. Revenue earned during 1997-98 totalled \$543 000⁸.

The objectives of the output are the provision of cadastral survey (ie, pertaining to land ownership and boundaries) systems and services essential for the continuing management of the Crown estate, provision and maintenance of a geodetic system appropriate to the spatial information needs of Tasmania, and ensuring the maintenance of survey standards within the cadastral fabric⁹.

OSG is also responsible for policy development, program definition review, statutory duties and the custodianship of data sets.

In regard to the cadastral survey fabric, the Office has a major role in preserving its integrity as it forms the basis for land title and tenure-related land information systems. The OSG has undergone a number of structural changes in regard to its delivery of cadastral survey services. In 1993 there was a consolidation of survey and mapping services previously carried out in several agencies by bringing them all under OSG's control. As well, a brokerage system of cadastral surveys was set up in 1997 in which the OSG administers the tenders for survey instructions received and also monitors the quality of work performed by contracted surveyors. It is this brokerage system which was the subject of the Audit Office's examination.

Identification of CTC Opportunities

In April 1993 the Budget Committee initiated an investigation of opportunities for the consolidation of survey, mapping and land acquisition services within the State Government sector. This directive was part of an overall Treasury project aimed at rationalising in-house government services across all agencies.

Project Management Approach

The project manager/sponsor was the Surveyor-General. No steering committee was formally set up, but another officer carried out much of the information collection and liaised with other agencies who were also carrying out surveying services at that time, namely the (former) Departments of Transport and Works, State Development and Resources, Forestry Commission and Hydro-Electric Commission. Terms of reference for the project were set out in the Budget Committee's directive. The Audit Office considers that due to the limited nature of the review, the project management approach taken was appropriate, as it enabled OSG to fully consider the issues as well as address and manage any applicable risks.

⁷ DTF 1998, p 394.

⁸ DELM 1998, p 36.

⁹ DELM 1998, p 36.

Scoping Report

A preliminary assessment on viability of amalgamating government survey and related services within OSG was prepared by the Surveyor-General as a response to the Budget Committee's directive. The report was extremely comprehensive as it included a description of the OSG's existing situation as well as strategic directions, analysis and recommendations in regard to the nature of services currently carried out, a breakdown of full-time equivalent staff employed for each service and applicable award descriptions, funds applied to the services from the Consolidated Fund, and brief descriptions of assets used with notional values. There was also a risk analysis of the possible consequences of rationalisation of services in terms of operational costs, data custodianship, geographic information services, core business, career path outlooks, agency-specific expertise and the possibility of charging for services rendered.

While the focus in terms of cadastral surveys was in regard to amalgamating services, there is a brief discussion of the possibility of a brokerage role for the OSG, as well as distinguishing between purchaser and provider roles.

Annual cost savings of \$50 000 to \$100 000 were proposed in relation to combining the various agencies' survey services, but there were no savings or revenue estimates mentioned in relation to the brokerage of surveys. From discussions with the Surveyor-General it is understood that the upper range of savings proposed was the indicative savings target previously determined by the Budget Committee and without consultation with the OSG; the lower end of the range was based on estimates of reduced demands for vehicles and other equipment due to the proposed amalgamation.

There is evidence that consultation with stakeholders was carried out from the feedback noted from various agencies and staff concerned. It was noted that the professional surveyors' associations were not consulted at this time, but this is considered acceptable, as the brokerage idea was not firm at the time.

The report also discusses issues relating to transition and implementation, and included a proposed timetable.

Approval

Formal Budget Committee approval was given to the consolidation of survey services in April 1993, and in the following month DELM was requested to prepare a report setting out issues relating to implementation of the reorganisation. The Department of Premier and Cabinet (DPAC) was asked to prepare a Minute outlining options to be presented to Cabinet.

Evaluate Identified Options

Business Case Development Strategy

The document prepared by DPAC dated July 1993 is considered to be comprehensive as it addressed the following matters:

- Purchaser/provider split—discusses difference between the brokerage role and direct service delivery;
- Future service requirements of client agencies, derived from consultations with them;
- Examination of CTC viability;

- Statement of impact on other agencies, Treasury funds, the economy, legislation and the general public; and
- Financial impact of the recommendations.

As the brokerage system proposed did not include in-house tenders, the issue of helping employees become ready for competition was not applicable. Through the Audit Office's discussions with some of the OSG officers, it is understood that staff were adequately consulted in regard to the proposed program.

Expressions of Interest

As part of this phase DELM asked client agencies for their feedback, as well as professional surveyors through their associations.

Approval Obtained

Cabinet approval was given to all of the recommendations in September 1993.

Valuation of Assets

A valuation of assets was included in the preliminary assessment, but this related only to the consolidation of surveying services, not the brokerage function, which did not have any impact on non-current assets.

Tendering and Evaluation

Tender and Evaluation strategy prepared

Following consultation with client agencies and private sector surveyors relating to various proposals for a tendering process, OSG developed a detailed set of procedures and policies.

Tender documentation prepared

Specifications relating to each survey job are posted on the OSG web site (www.delm.tas.gov.au.osg), together with the policy and procedures on brokerage of survey services. The processes followed are set out on a checklist which the officer follows.

Where the survey is required urgently or other circumstances are believed to exist (such as a less than cooperative landowner), the job is not put out to tender. The officer keeps a record of people who are willing to take on such jobs, and offers them to one surveyor on the list on a rotational basis. In this way all participating surveyors have an equal opportunity to get such work.

Distribution of request for proposal

In order to bid for jobs, the surveyor must be registered, have a certain amount of personal indemnity insurance and agree to the OSG's policies and procedures.

Consultant surveyors who are eligible are notified via e-mail and directed to the OSG web site for more details about the job.

Performance data is collected from previous tender jobs which the surveyor has bid for and used for each contract and entered into the tender software package's database, including:

- Number and values of previous quotes received;
- Number of successful tenders, with their values;
- Client feedback received in regard to the surveyor's work;
- Timeliness of service; and
- In-house quality assurance audit results.

All bids are received either by e-mail or fax. The advantage of using both media is that the correspondence is 'time stamped' objectively, thus making this stage of the process objective in regard to timeliness of receipt of bids.

The OSG also maintains a Survey Requisition Database, which records the performance of Registered Surveyors for all cadastral surveys lodged in the Data Registration Branch. Upon registration, if any material errors are encountered when quality checking the survey, the surveyor is requisitioned, requiring the correction of the error. An unsatisfactory performance rating for a surveyor, based on all of his work, not just Crown surveys, results in his exclusion from the tender process until the performance rating is satisfactory.

Composition of evaluation panel

A key element of the tendering and evaluation approach used at OSG includes the use of specialised tendering software as well as a dedicated e-mail address and the Institution of Surveyors Australia (Tasmanian Division) *Guide for Survey Fees*. An in-house professional surveyor administers the tendering system, using the Guide as an estimate for each survey job. His calculations of estimates for surveys are regularly (informally) validated by feedback from private practitioners. If there are any borderline situations which arise during a tender, they are brought to the attention of the Surveyor-General, who resolves them. The Audit Office considers that this approach is satisfactory as it ensures a thorough and fair evaluation of tenders.

Evaluation of Proposals

The software package used generates a report analysing all quotes received for the job concerned. All quotes are tabulated by OSG in ascending order of price. In determining to whom the survey instructions should be issued, the auditee has stated that 'the primary objective is to ensure that the client is provided with a survey service which meets all regulatory requirements, is error-free, completed within the stipulated time frame, and delivered at the best price to the client.' The OSG takes the following factors into account:

- Surveyors currently under suspension from the Consultant Surveyors Panel do not have their bids accepted, without prior approval from the Surveyor-General; and
- Surveyors with a record of unreliability in meeting completion deadlines for previous contracted work, but who are not suspended, may be passed over in preference to a consultant with a superior record.

The surveyors who are still eligible after this screening occurs are then short-listed, with details entered into the system regarding those who are ineligible. A short-list is then generated by the software. It is usually the least expensive quote which is chosen as the successful bid.

Documentation and Approval

Form letters are sent by e-mail to the successful tenderer on behalf of the Surveyor-General. The letter contains the specifications for the job (same as that on the web site). All generated reports relating to the tendering process are also printed off. There is no formal exchange of contracts. By registering to be eligible to participate in the program and submitting a quote, the surveyor has implicitly agreed to abide by the OSG's policies and procedures.

To test how well the above policies and processes were followed, 25 survey jobs were randomly selected over the period that the brokerage program has run to-date, and in all jobs examined this was found to be satisfactory.

Contract Negotiation, Implementation and Transition

Strategy for negotiation

The strategy for restructuring the OSG to incorporate brokerage was set out in correspondence to internal staff as well as private sector surveyors.

Finalisation of negotiations

In terms of the overall brokerage process, OSG received considerable feedback from the two professional associations representing surveyors in Tasmania and also held meetings with them. Correspondence sighted shows that a number of their concerns were addressed by the OSG into the final version of the process.

There is no negotiation in regard to individual jobs during the tender process. There is an understanding that the job is tendered on an 'as is' basis, with surveyors having the option to personally visit the survey site concerned. The risk of bidding too low for a survey of a site which turns out to be difficult to traverse is borne solely by the tendering surveyor.

Implementation and Transition

Documentation sighted on OSG files confirms that implementation and transitional processes were formally established. It is evident that much thought was given to communicating with staff, clients and surveyors through the relevant documentation reviewed.

Commercial-in-Confidence clarified

As all surveys become the property of the Crown, this issue was not applicable.

Contract Management and Performance Monitoring

Adequate Contract Management

One officer manages the brokerage function. His responsibilities include:

- Ensuring that all surveyors who tender for jobs meet requirements for personal indemnity insurance and are registered;
- Inputting results from the quality assurance audits into the tendering software database;

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- Monitoring performance information and ensuring that all short-listed surveyors have satisfactory performance records;
 - Ensuring that the invoice fee is the same as that tendered; and
 - Provides a point of contact for any disputes between contractors and clients.

Ongoing performance monitoring

As a Guide fee is calculated for every survey job put to tender, OSG can easily confirm ongoing value for money in service delivery, as the prior Government policy was to pay the Guide amount for all outsourced work. This difference is automatically calculated and stored by the software used at OSG and is included in the report facility.

Other performance measures used are those relating to the original Statement of Requirement, such as timeliness of carrying out the audit. Feedback is sought from individual clients as well as the professional associations representing surveyors. All performance information is gathered and analysed by OSG, so it does not rely upon the contractors to fulfil this responsibility.

Benchmarking is carried out as part of the brokerage process, as past performance records are included in tendering reports. As well, special reports are generated every six months for dissemination with senior agency staff including the Head of Agency. A report prepared by OSG which analyses performance of the brokerage system from its commencement in March 1997 to June 1998 showed that the savings margin between the tendered price of the contracts and the Guide price was approximately \$98 500, which is 44% of the total Guide fees.

In regard to the quality assurance audits, 1998-99 is the first year the audits are taking place. Information relating to the audit program is on OSG's web site. An in-house registered surveyor coordinates the audits which are carried out by other registered surveyors on OSG's staff. As part of the process, the surveyor is notified that the audit is taking place, and at the conclusion is given a report of the findings with the opportunity to respond before a final decision is made. If the survey has to be revised, this is noted and the information system database is updated accordingly. The method used to select jobs for audits ensures that everyone has an equal chance and no one is audited more than once until everyone has been covered. Because of this approach, it was decided that those who were found to have below standard performance would not be ruled ineligible for future tenders until the entire first round of audits is complete.

Service requirement monitoring

A review was carried out in June 1997 by the officer who manages the brokerage function to obtain both contractors' and clients' feedback. The outcome was that while clients were pleased with the faster turnaround time for surveys, contractors were not satisfied with the 'pressure' of competition, and would have preferred to restrict the surveyors who are eligible to bid for a particular job to those who work in the immediate vicinity of the site concerned. However, this could have the effect of subsidising the surveying profession as it could entail less savings for the Government through higher bids received, and thus increased expenditure for the community. The view of the OSG is that it is up to the individual surveyor whether he or she wishes to tender for each job, as well as the price of the bid.

The quality assurance program and measurable data collected for each tender enables OSG to discern between genuine changes in service needs and any failure of the surveyor to meet the terms and conditions of the contract.

Contingency plan

There has not yet been an instance of a survey contract not being fulfilled due to a disagreement between the parties, due to the 'as is, where is' policy used for those who bid for jobs. However, in a few instances reviewed, the Audit Office noted that a potential tenderer had brought some additional information to the officer's attention which could make the job more complex. In these cases, the statement of requirement is updated, and all registered contractors are notified so that they can take account of this in their bids.

Re-evaluation of Options

Structured Re-assessment of Options

Due to negative feedback from the surveying profession during the 1997 review and again in 1998, Ministerial briefings were prepared by OSG which recommended that the existing brokerage process continue in its existing format. This approach was recommended due to the favourable outcomes being achieved for high standards of quality, efficiency (due to faster turnaround times) and cost effectiveness. As well it was noted that the current approach is consistent with the spirit of the National Competition Policy to which the Government remains committed.

Knowledge Management

Records Management Quality

The Audit Office was able to review all applicable documentation, due to the completeness of record keeping. It is considered that adequate precautions are taken for the electronic based data due to weekly back-ups which are stored off-site.

Organisational Memory Capture

Although one officer is in charge of the brokerage system, the risks inherent with holding an individual responsible for such a role has been minimised by training other staff to relieve him while he is on leave.

In terms of organisational learning, however, the Audit Office understands that the rest of DPIWE, as well as other agencies who may be interested, have not been informed of OSG's success in setting up its brokerage system. It is understood that the suggestion of an inter-divisional briefing will be taken up with the DPIWE executive. However, the Minister has been informed of the satisfactory operation of the system and correspondence is currently being prepared to ensure that all other Ministers are made aware of the benefits obtained and the approach taken by OSG for across-Government implementation where possible.

Conclusion – Best Practice Example

The Audit Office commends OSG on its highly successful implementation of CTC through the brokerage function. Although parts of the planning occurred prior to the release of the CTC Policy Guidelines, the entire process was found to comply with the Guidelines and is considered to set an example for adopting CTC which other Agencies can follow.

Valuation Services

Background

The Office of the Valuer-General (OVG), together with operational branches of the Information and Land Services Division of DPIWE, delivers the Valuation Systems and Services output. In 1997-98 total expenditure for this output was \$2.9m while revenue totalled \$3.4m¹⁰. Estimated expenditure for 1998-99 is also \$2.9m¹¹.

Objectives for this output are:

- To provide impartial and cost effective valuation services upon which municipal rates, land tax and other charges may be levied;
- To deliver a consultancy service to facilitate informed decision-making by clients with respect to the compulsory acquisition, purchase, sale and rental of property; and
- To provide for the acquisition of land by the Crown and public authorities for public purposes¹².

The OVG is also responsible for policy development, program definition review, statutory duties, quality assurance of the revaluation process and the custodianship of data sets.

Since the introduction of revenue measures legislation in 1990 the valuation services function has been operating on cost recovery basis in regard to valuation lists provided to local government. Budget allocations are made for the provision of land valuation information to the State Revenue Office (for Land Tax purposes) and for the provision of information to the public, Ministerial and Ombudsman inquiries. Following a 1996 rationalisation of services inside the (then) Department of Environment and Land Management, the OVG was separated from Government Valuation Services (GVS); both function under the Land Information Services Division. This arrangement was formalised by the Government in May 1997, with the Valuer-General, as principal, retaining regulatory functions of the Office and being responsible in conjunction with Councils for determining competitive tenders (where called) for statutory valuations, monitoring standards, coordination of the valuation process, and developing technology in the conduct of mass valuations. The Valuer-General reports directly to the Minister in relation to the determination of competitive tenders for statutory valuations¹³.

We examined the competitive tendering system as part of this audit.

Identification of Opportunities

As part of the State Government's Legislative Review Program (LRP) a review of the approach used to deliver valuation services was carried out to determine whether there were any restrictions placed on competition, to ensure compliance with the National Competition Policy. Accordingly, the Land Valuation Review Committee (LVRC) was established.

¹⁰ DELM 1998, p 39.

¹¹ DTF 1998, p 394.

¹² DELM 1998, p 39.

¹³ LVRC 1998, pp 3-4.

Project Management Approach

The Government assigned terms of reference to the LVRC, and the Committee was comprised of five experts in the fields of accounting, valuation, local government, regulation, and land information systems.

Scoping Report

The Regulatory Impact Statement (RIS) was issued by the LVRC in February 1998, and is considered to be comprehensive as a scoping report. It contains descriptions and confirmation of the Agency's strategic directions and outputs which relate to valuation services, including applicable legislation and an analysis in regard to the National Competition Policy, differentiation between purchaser and provider functions, and recommendation for possible applications for competitive tendering and contracting.

Approval

The RIS was reviewed by the Secretary who approved almost all of the recommendations, including the adoption of CTC. It later formed the basis of a business case development strategy and was presented to Cabinet in March 1999. Cabinet approved the CTC option and most of the other recommendations.

Risk Analysis

The RIS included an examination of financial and non-financial issues, including the role of the Valuer-General in relation to the community as a whole and others who use valuations, staff training, issues, independence, and secrecy concerns for valuation information. A cost-benefit analysis of the existing system and the proposed one was included.

Consultation Strategy

A number of stakeholder groups were invited to provide submissions relating to the terms of reference, as well as commenting on the draft RIS. One page of the final RIS sets out all those who were consulted and provided feedback.

Evaluate Identified Options

Business Case Development Strategy

The RIS essentially served the purposes both of a scoping report and a business case development strategy. It separates purchaser/provider roles, discusses the viability of GVS as being able to successfully compete with private sector valuers, addresses future service requirements, describes the appropriate organisational structure needed to incorporate CTC into the OVG, and includes a cost-benefit analysis.

Expressions of Interest

During the review, the LVRC obtained feedback both from Local Government as well as the professional association which represents valuers, to ascertain their concerns which would need to be addressed if CTC were to be adopted.

Approval Obtained

Cabinet approved almost all the recommendations set out in the RIS, including the use of CTC in March 1999. As well, the previous Government had earlier approved of OVG evaluating competitive tenders in conjunction with Councils in May 1997.

Tendering and Evaluation

Tender and Evaluation strategy prepared

The Invitation to Tender document sets out the process followed concerning the tender, including the evaluation criteria used.

Composition of evaluation panel

The RIS recommended that the tenders be evaluated by a team consisting of representatives from the OVG, the Revenue and Gaming Division of the Department of Treasury and Finance and the Council concerned, and perusal of documentation relating to tenders awarded to date confirms that this has been the case.

Tender documentation prepared

The documentation was found to be extremely comprehensive and contained an invitation to tender which set out the statement of requirements for the contract, a quality assurance plan to be used (with a pro forma example for reporting to the OVG), the manner in which the valuation is to be carried out, and a checklist to ensure that the tenderer has included all information required.

The draft contract contains the minimum clauses to ensure the Crown's interests are protected, such as consequences of the contractor's failure to meet performance standards, intellectual property issues, due diligence, security and access, force majeure, termination and severance of the contract, dispute resolution, and confidentiality.

Overall the Audit Office found the tender documentation extremely thorough and in plain English. It is understood that following the GVS' early experiences in using the documentation when putting in its own tenders, feedback was received and enhancements were incorporated into the current version used. The original version was based on the documents used in New South Wales.

Distribution of request for proposal

The requests for tender for each job are advertised in all Tasmanian newspapers. As well, the GVS in-house valuers are entitled to submit tenders for all jobs. As well, the OVG has offered to run information sessions, but prospective tenderers have preferred one-on-one discussions to answer their queries.

Evaluation of Proposals

In reviewing documentation relating to the evaluation of a selection of tenders, it was noted that the methodology was consistent with the evaluation criteria set out in the tendering documentation.

Documentation and Approval

It is considered that this aspect of the CTC process is satisfactory as the OVG ensures that a draft contract, statement of requirements and performance evaluation and monitoring criteria are already developed and incorporated into the tender documentation. Ministerial approval is given when the contract has been finalised.

Equity to In-House Providers

Of the five Local Government contracts tendered to-date, three were awarded to the in-house GVS team, and it is considered that this attests to the successful transition to a commercialised environment.

Contract Negotiation, Implementation and Transition

Strategy for negotiation

Perusal of documentation relating to tenders showed a strategy plus structured dealings with the successful party.

Finalisation of negotiations

Although the draft contract drawn up by the OVG is considered to be a starting point, from the tenders to date there have been minimal amendments made to the contract mainly in respect of information technology and data delivery issues.

Implementation and Transition

The OVG and GVS had previously separated in 1996, following an intra-departmental separation and prior to the CTC process. This simplified the transition as GVS was already operating on a commercialised basis, as well as the fact that there were no assets for disposal.

GVS staff have had training in customer service and other skills which were considered useful to competing on a level playing field with the private firms.

From discussions with some of the GVS staff on the adequacy of communication during the transition period, it is understood that this was satisfactory.

As the RIS was fairly detailed in terms of what had to be done to establish CTC, the Audit Office considers that an additional strategic document would not have been necessary. Additional IT needed to link private firms with the VISTAS system was purchased, and software was designed to analyse contractors' performance.

Commercial-in-Confidence clarified

One of the Schedules in the contract documentation is a six-page deed of confidentiality together with a clause in the contract which addresses this issue. The contract sets out in detail the information to be supplied to the OVG in order to minimise the risk of any occurrence of a contractor not forwarding such details on the basis of 'commercial-in-confidence'. The Audit Office found that this was the most thorough approach in dealing with commercial-in-confidence matters of all the CTC case studies examined.

Contract Management and Performance Monitoring

Adequate Contract Management

The Valuer-General is responsible for administering the terms and conditions of the contract, monitoring the contractors' performance, administering payments and dealing with any privacy or security issues as they arise.

Ongoing performance monitoring

Feedback is sought from Councils and individual property owners. Meetings are held as required during the contract, but certainly at the end, as an exit interview.

As only the first contract put to tender has been completed, there has not yet been any reports written on the program's success to Agency management. However, from the outsourced jobs tendered to-date, cursory savings of between 93% and 16% have been observed. To a varying degree, valuation cost reductions include the benefit of computer assisted methodology developed by the OVG prior to the introduction of the tender process. Nonetheless, the Audit Office considers that the combination of improved technology and long-term financial savings will be of benefit to the community in terms of effective and efficient service provision.

Service requirement monitoring

As the program is still in its early stages, there has not yet been any service requirements monitoring.

Contingency plan

If the contract is terminated, the Crown has the right to get someone else to do the job (such as GVS staff), or put the job out to fresh tender at the contractor's expense.

Re-evaluation of Options

Structured Re-assessment of Options

It is understood that a cost-benefit analysis will be done for Cabinet regarding any further efficiencies that may be possible in regard to other organisational structural arrangements or changes to the current system with Council valuations.

Knowledge Management

Records Management Quality

The Audit Office was able to easily obtain all information required to review the CTC process. Records are held by the Valuer-General and an officer who represents the OVG on tender evaluation committees as well as the central records area.

Organisational Memory Capture

While the Valuer-General has shared his Office's experiences with other Valuers-General, he has not yet had an opportunity to do the same within his own Agency, or with other Agencies who are considering CTC as a brokerage tool.

Conclusion Better Practice Examples

It is considered that OVG's invitation to tender documentation and draft contract for local government valuations is of a high standard in its compliance with the Treasurer's CTC Policy Guidelines. The Audit Office commends OVG on its preparation of such thorough documentation. As well it was found that the contract was written in plain English and as such would be easy for a layperson to understand and thus comply.

Further, the deed of confidentiality attached to the draft contract appears to be comprehensive in protecting the Crown's interests for any outsourcing of this nature. Other clauses of the draft contract specify the information to be supplied to the OVG in order to minimise any occurrence of a contractor not forwarding such details on the basis of 'commercial-in-confidence'. The Audit Office commends the OVG in addressing the issues of confidentiality and commercial-in-confidence so thoroughly at the tendering stage.

OVERALL CONCLUSION

This review aimed to ascertain the manner in which Departments are adopting CTC as well as ascertaining whether the benefits proposed when deciding to outsource particular services have actually ensued.

A number of satisfactory and best practice examples have been noted, including the outsourcing of valuation, surveying and NW pathology services, in regard to the sound methodologies used to incorporate CTC into service delivery, as well as the quality of contract management after the agreement has been finalised. In contrast it was noted that in relation to the NW medical imaging contract performance service requirement monitoring is not occurring, thus leaving the Department in a position where it cannot ascertain whether the quality and quantity of service delivery is satisfactory. However, it is noted that ACSH accreditation is in place for the provision of this service in regard to NWRH.

In all cases it was noted that to-date none of the officers involved in any of the contracts examined have been involved in any inter- or intra-Agency briefings to enable others to learn from the experiences gained from going through the CTC process.

Lastly, there is a particular importance in the public sector to maintain transparency and accountability in its decision-making processes, and this includes evaluations of tenders and proposals. However it was noted that due to the lack of key documentation such as evaluation methodology and objective, well-defined selection criteria, the process of assessing the two tenders for NW maternity services gave the impression of not meeting the rigour of governance which one would have expected, and that four of the other cases examined had indeed met. Similarly, the final costing analysis used to justify outsourcing the Mersey Community Hospital to a private operator lacked a full discussion of why the Steering Committee's alternative evaluation was rejected.

The Audit Office intends that this report will inform all Departments as to the pitfalls and best practice examples already experienced in the State Government and thus enable better decision-making to take place for future adoption of CTC for service delivery. In this way it is hoped that this Report will complement the Treasurer's *CTC Implementation Manual*.

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