

Evaluation of organisational innovation in the governance of the public sector in Victoria

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Innovations in the public sector introduced over the last twenty years have changed the face of government. New Public Management introduced changes in philosophy and practices such as 'steering and rowing', purchaser-provider splits, amalgamations, corporatisation, performance management, and competition, and with them, new forms of governance and accountability. Globalisation, 'structural gaps' in public finances and sovereign bankruptcy threats, and ICT have again stimulated radical change. The purpose of this paper is to address how these impact on how public sector organisations are governed and managed and the challenges that they impose for the future of public sector organisations. It addresses the questions: What are the critical elements in transforming public sector organisations, and what are the essential elements in evaluation of new forms of governance?

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Innovations in the public sector introduced over the last twenty years have changed the face of government. New Public Management (NPM) the umbrella term for many of these, introduced changes in philosophy and practices such as 'steering not rowing', purchaser-provider splits, amalgamations, corporatisation, performance management, and competition, and with them, new forms of governance and accountability. Corporatisation referred to several innovations that included outsourcing, and establishing State owned enterprises and public, private partnerships. An essential accompanying corporatisation was the application of private sector governance principles to the public sector.

Governance

Governance guidelines that are applicable to the public sector in Australia have been issued by numerous international organisations such as the OECD (OECD 1999) and Standards Australia International (Standards Australia 2003a). Widely used corporate governance guidelines in the public sector are those distributed by the Australian Auditor-General (Australian National Audit Office 1999), the NSW Audit Office Corporate Governance Guidelines (NSW 1998), the Victorian Auditor General (Cameron 2003). Every State government has produced its own governance guidelines. One example was the State Services Authority in Victoria which produced recommendations for governance practice in Victorian government entities.

Governance was defined by the ANAO (1999) as:

The processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organisation. For Commonwealth bodies, key elements of corporate governance include transparency of corporate structures and operations, the implementation of effective risk management and internal control systems; the accountability of the board to stakeholders through, for example, clear and timely disclosure; and responsibility to society.

An evaluation of compliance with governance policy in Victoria was conducted in the Victorian Treasury. Table 1 illustrates the types of questions that were asked.

Table 1. Evaluation of compliance with governance policy and principles.

- Is there a top-level governance/audit/ethics committee of the governing body?
- Is governance a standing item on the governing body's agenda?

- Does this body have a term of reference attuned to managing governance issues and does it meet regularly to discuss these issues?
- Is there a senior executive with overall responsibility to governance in the organization?
- Is there an organisational governance plan that is endorsed by top management, implemented and monitored?
- Is there a "Governance" Manager, i.e. someone who has the day-to-day responsibility of ensuring the smooth running of the program i.e. implementation and maintenance of the organisation's governance plan?
- Is there a cross-functional middle management governance committee that oversees and pulls together the relevant aspects of governance?
- Are there adequate resources to ensure governance outcomes?
- Is corporate governance training provided?

Source: Armstrong, A. Evaluation of Governance in the Victorian Department of Treasury and Finance

The adoption of corporatisation and private sector governance practices by the public sector were aimed at increasing competition among service providers, and improving efficiency and effectiveness. Other advantages are distancing a government from corporate activities and political consequences should things go wrong; in some cases access to specialised skills and expertise; and more efficient use of resources. Vagliasindi (2008, p.8) described the potential advantages of corporatisation as:

"The empirical evidence suggests that by structuring the internal governance system of SOEs according to that of a modern corporation, corporatisation may enhance efficiency through better monitoring of managers, improvements in information-sharing channels, and a reduction in governmental political intervention. It may also affect the incentives and objectives of managers by tightly linking enterprise performance with the evaluation and remuneration of managers".

The advantages of corporatization are improved information about enterprise performance but only if they are held to the same strict accounting and reporting standards that apply to private corporations.

The main governance structures for corporatisation are outsourcing, government business enterprises and public private partnerships (PPPs). Corporatisation was introduced in stages. At first, it was directed towards internal services. These were often outsourced (particularly for IT services) or internal units were created which were subsequently obliged to tender in competition to external providers.

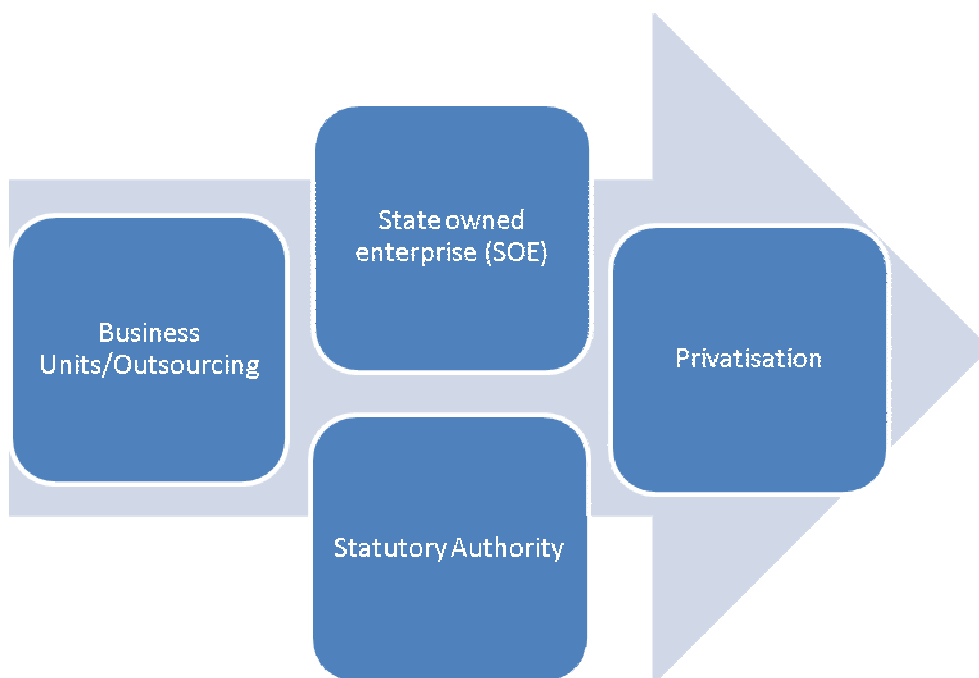
Outsourcing became popular in the private sector in the 1990s but it was when Osborne and Gahler's 1992 paper that stimulated governments to identify the difference between 'steering'

and 'rowing' that outsourcing became popular in the public sector. This meant that governments determined what services were required but tendered out the delivery of services, a process that became known as the purchaser-provider split. The aim is to shift the costs off the government's budget and increase efficiency by competition between providers in the private and non-profit sectors and with government service providers should any remain.

After outsourcing of services was achieved, the governments turned attention to converting outsourced entities, and any commercially viable service, into a government business enterprise (GBE) or state owned enterprise (SOE). Autonomy was strengthened through a separate legal identity, often a statutory authority, with separate accounts and its own board of directors. Government sector boards are not usually elected, as happens in the private sector, but appointed by the Minister under relevant legislation to be responsible for the vision of the organisation and overseeing its execution.

Full corporatisation requires an enterprise to be incorporated under similar laws to those that govern private corporations. The governance model includes separate legal status, boards of directors, accrual accounting, private sector audit and annual reporting requirements. (Guthrie, 1993). The government retained ownership and the enterprise was accountable to the Parliament via the responsible Minister. Financial accountability links are established when the Auditor-General reviews the accounts and reports directly to parliament upon those accounts.

Figure 1. The progress of corporatisation



Where assets had to be retained for legal or political reasons, an entity could be established as a Statutory Authority or Trust. Objectives and priorities are set by a government but governance and accountability arrangements are set out in general laws often supported by a specific ACT related to a particular entity.

The next step in the progress of corporatisation was full privatisation in which an entity was sold and became fully subject to the Companies Act. Qantas, Aussat, Australian National Line , Telecom, Australia Post and Australian National Railways were incorporated in this way.

The Governance Arrangements for Commonwealth Government Business Enterprises set out principles related to the arrangements for joint Shareholder Ministers. The Ministry of Finance and Administration generally took a lead role in SOEs’ financial matters and the portfolio Minister focussed on portfolio matters. One of the advantages of this arrangement is that it separated the conflicts of interest that a government typically has in its dual role as both the owner of an SOE and the representative of the SOE’s customers. Vagliasindi (2008) saw the two entities as having competing constituencies that, introduced into the corporate governance framework, were likely to subject corporate governance to more rigorous checks and balances than would a single government ministry.

Table 2. Contrasting forms of governance

	Traditional hierarchy	Market	Public Private Partnerships
Philosophy	Government knows best	Competition	Collaboration
Relationship	Legal	Contract	Contract
Structure	Pyramid	State Owned Enterprises	Partnerships
Accountability	Government department	Auditor general	Shareholders Minister
Purpose	Regulation	Efficiency	(a) Value for money (b) Risk management
Finance	Government funded	Government owned	Shared Revenue raising

Each form of governance (Table 2) has its own advantages and disadvantages and are appropriate responses to the variety of tasks addressed by the public sector.

PPPs take several forms: Build-Own-Operate-Transfer (BOOT); Design and construct (DC); Design construct and Manager (DCM) Alliancing and PFI style contracts (Mols, 2010). The government can engage one party to design, finance, construct and maintain (and in some cases operate) a facility. The contracting entity may be a single entity or a consortium. The government funds the project only after the facility has commenced operations. Payments are subject to meeting performance targets and contracts include sanctions for non-performance.

Leading in the uses of PPPs is the State of Victoria which has used PPPs in building projects as diverse as hospitals, prisons, a desalination plant, train stations and road tunnels and links. Under its policy, *Partnerships Victoria* (2001), a contract typically makes the private sector parties who build public infrastructure financially responsible for its maintenance and performance throughout the asset's lifetime. When the Treasury calls for a response to tender, it uses an interactive on-line tender process supervised for probity. The risks are transferred to the private sector by the commitment of private finance over an extended term. Some projects, such as the East Link toll road, are now self-funding. Details of contracts, less the commercially confidential information, are posted on the Partnerships Victoria web site.

Evaluation

The success of public innovations cannot be evaluated by private sector profits because the aims of the public sector projects are not profits but meeting community needs.

In general, the type of evaluation conducted depends on its purpose and what questions are being asked. For example, questions about efficiency and effectiveness are answered by performance measures. In a police environment efficiency indicators are concerned with the resources required to solve crimes, attend traffic accidents or other operations. In a health environment, the evaluation of effectiveness could be about patient recovery rates or community wide well-being.

The benefits of PPPs are said to be access to private sector innovation, commitment to continuous improvement, efficiency and quality, the transfer of risk and value-for-money (VfM). Achievement of these then become a basis for evaluating their success.

The criteria used to assess value for money on major and complex projects is based on comparison with what the same project could achieve under a more traditional procurement process. A Public Sector Comparator (PSC) is used to determine the value for money. The PSC estimates the potential cost to government of itself providing a facility, and uses this to provide a benchmark against which bids for the PPP are compared (Fitzgerald 2004). The problem appears to be that the discount rates and other assumptions underlying the model are unreliable.

Whether value-for-money is achieved is difficult to establish (Hodge and Greve, 2008) but Mols (p. 229, 2010) argues that there is “a growing body of literature suggesting we are witnessing over-reliance on PPP procurement”.

A Public Accounts and Estimates Committee (PAEC) Report (2006) identified four governance concerns evident in past private funding of public infrastructure projects: the omission or overriding of community interests; the ‘lock in’ effect of long term contracts on future governments (asymmetric lock-in favours the supplier, Mols, 2010); the lack of protection for consumers or users who pay for the services, for example, toll roads, and the lack of clarity of contractual obligations. Mols also raises the issue of conflict of interest within government when large firms make big donations to both political parties.

In one case of the government being “locked-in” to a contract, a change in the Victorian Government in 2010 led to revelations that the cost overruns of a PPP desalination plant, had expanded to \$19 billion. There was an argument promulgated in the newspapers that the desalination plant was no longer needed because of a break in a ten year drought, and the contract should be terminated. The new Premier, Ted Baillieu, said that breaking the contract would cost several million dollars and damage Victoria’s reputation (Caldwell, 2011). A similar argument was put in the case of MyKi, a transport ticketing system which, when the new government took office, was well over due and well over cost.

The contractual obligations are often confusing because of the manner of government requests for tenders. The government “bundles’ the various requirements together so that the entity awarded the contract may be a consortium of suppliers who may be in partnership or one contractor operating with subcontractors. In a recent PPP arranged to build and manage a new prison, one of the subcontractors collapsed, putting the remaining contractors under pressure. The outcomes of this are still under review at the time of writing (2012).

In respect to the major road construction and toll, ‘CityLink’, Davidson (2003) argues that the engineering expertise in this major road toll project could have been accessed by outsourcing and that the tolls are twice as high as they would be in the public sector because the private sector has

to pay higher interest rates for capital than government would. The Victorian Treasury (2012) refutes this argument saying that this is not the case but instead that the costs of risks are included in the costs of private finance so that taxpayers do not bear the costs of failures. However, when the risks are borne by the public sector, and failures (such as La Trobe Hospital PPP) occur, the government must step in because the PPPs are unprofitable and the community groundswell requires a political response.

Other criticisms of PPPs are that the bidding process commits private sector companies to enormous costs in preparing competitive responses (hence the \$50m threshold noted above) and the projects are not always value for money. Additional criticisms are that it takes too long to award contracts and that new local and overseas bidders for projects face barriers to entry.

A major aim of good governance is accountability and transparency. A Victorian Treasury paper (PAEC 2006) claims that the majority of Partnership Victoria projects are on the Government's balance sheet and are audited every year. However, the Victorian Auditor General in a submission to the PAEC (p.89) stated that in regard to PPPs "key elements of evaluation have not been followed". The 2006 PAEC report noted (p.101) "there have been few rigorous evaluations of the relative effectiveness of actual projects particularly to compare with the predictions of cost savings and the business cases submitted".

Conclusion

This paper reviewed the critical elements in transforming public sector organisations from their traditional hierarchical governance structures to market driven government business enterprises and public private partnerships. The new governance arrangements for the public sector replicated private sector governance in establishing boards, appointing members whose duties and responsibilities were captured in various Acts, and whose procedures included adopting accounting standards and practices such as risk management.,

Most of the projects described were major infrastructure projects. The aims of the innovations were to achieve value for money, shift risk from the public to the private sector, and to gain access to funds. The essential elements in evaluation of the new forms of governance were limited to questions about the extent to which these aspects were achieved. These criticised the uncertainty about reliability of the financial comparator and raised questions about the tendering process including potential conflicts of interest of governments. It is apparent that there is a need for a much more comprehensive approach to evaluation of the innovations before decisions about their real worth can be made.

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