

**Outsourcing of State and Local Government Services
in New South Wales and Victoria, Australia**

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Contents

| | | |
|----|--------------------------------------------------------------------------|-----------|
| 1 | Executive Summary | 3 |
| 2 | Principles of Outsourcing | 4 |
| 3 | Outsourcing in New South Wales and Victoria | 6 |
| 4 | Contracting Parks and Garden Services in Mosman, New South Wales | 10 |
| 5 | Maintenance of Physical Infrastructure in Mornington Peninsula, Victoria | 15 |
| 6 | Outsourcing of NSW Government Cleaning Services | 20 |
| 7 | Outsourcing of Land Valuation Services in New South Wales | 24 |
| 8 | Residential Aged Care Services | 28 |
| 9 | Health Care Services in Port Macquarie Base Hospital | 32 |
| 10 | Melbourne Metropolitan Ambulance Services | 35 |
| 11 | Conclusions | 37 |
| | References | 38 |

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1 Executive Summary

This report discusses the outsourcing of state and local government services in New South Wales (NSW) and Victoria, Australia. The paper focuses on outsourcing the delivery of recurrent services that are financed by government rather than on the contracting out of capital works.

The report starts with a brief discussion of the general principles of outsourcing. There follows a brief history of contracting out the delivery of public services to private agencies in New South Wales and Victoria. Sections 4 to 10 describe seven outsourcing case studies, including five cases that may be considered successful and two where there have been significant costs or other problems.

The report is based on publicly available material and the experience of the authors. Our brief did not allow for primary research. In any case, most contracted services involve commercial-in-confidence contracts and contracting agencies typically issue little information about the contracts.

On the whole, outsourcing of government services has raised productivity. In an early review of contracting experience, Domberger and Hall (1996) found that competitive contracting out of state government services produced annual savings in the order of 20 per cent of previous expenditure.

In this report we find that Mosman and Mornington Peninsula Councils achieved substantial cost savings by contracting out a wide range of infrastructure maintenance services and improved services by improving specifications and monitoring. Outsourcing also achieved major savings in NSW Government cleaning services. In the case of valuation services in NSW, outsourcing raised the quality of services but possibly not cost savings. In the case of Australian residential aged care services, intensive monitoring ensures a good quality of care generally. However, costs and prices are high, there is limited competition, and places are limited.

Contracting out often requires significant structural reform of an organization, especially when an agency has long experience of in-house provision. Successful contracting out also requires a great deal of work in drawing up appropriate specifications, which should be performance-based where possible, in the tender process, and in the monitoring of the ongoing contracts. Experience in contracting out also improved performance and outcomes.

Where governments have been reluctant to restructure, notably within the NSW Government, or alternatively in a hurry to develop contracting procedures (a common problem), the benefits of contracting out have been much smaller.

In some cases, contracting out can produce expensive outcomes or major service failures. Examples include expensive contracted services from the Port Macquarie Base Hospital in NSW and management's failure adequately to control the contracting out various functions of the Melbourne Ambulance Service in Victoria.

2 Principles of Outsourcing

Outsourcing is the purchase of goods or services previously provided internally in an organization.

Traditionally, the two main arguments for the in-house supply of public services were economies of scale (it was cost effective to have only one supplier of services) and minimizing transaction costs. However, it became apparent that, in the absence of both competition and transparent pricing, public service delivery was often not efficient in practice.

The main reasons for outsourcing are

- To obtain best value for money through competition;
- To focus on customer needs through clear specification of outputs and more independent monitoring of results; and
- To achieve greater flexibility in addressing changes in demand for services and accessing expertise.

When the NSW Government decided to call competitive tenders for public services in 1993, it adopted the following main principles:

1. Robust assessment for retaining or contracting activities

All activities should be progressively assessed to determine the approach that will contribute most to the efficient, effective and proper achievement of the organisation's mission.

2. Quality and equity in the provision of contracted services

The government was committed to establishing clear, accountable standards for service provision and to recognising special needs of different groups which should be incorporated in service contracts.

3. Consultation with staff

There should be full consultation with staff at the planning and execution stage. This includes timely communication with staff on what is planned, an opportunity to provide input, and clear communication of the decision taken and the reasons for it. This did not imply employee involvement in decision making, access to commercially sensitive material, or a veto power for staff.

4. Safety and equity in the workplace

The government was committed to promoting and maintaining safety and equity in workplaces. Contractors who disregarded their statutory responsibilities risked losing the government's business in addition to sanctions in any State or Federal legislation.

5. Clarity of roles and accountabilities

The government must clearly specify:

- The objectives of the service or activity;
- Each party's obligations;
- The form, volume and quality of the service; and
- The monitoring and enforcement arrangements.

6. Facilitation of innovation

Government should specify performance requirements (the "what") rather than describe the method of providing the services (the "how"). This allows tenderers to respond flexibly and innovatively to service provision requirements.

7. Fair and effective competition

The principle of fair and effective competition requires:

- facilitating effective competition: This includes informing the market place of contracting requirements; facilitating an open process; defining the task in performance terms; effective monitoring of actual performance; and ensuring that the contractual and operating conditions facilitate a change over of contractors when appropriate.
- ensuring competitive neutrality: When an in-house team competes with outside contractors, comparisons must be made on a similar basis to ensure optimal resource allocation and that outside contractors are not discouraged from tendering.
- ensuring proper processes: The processes of inviting and assessing tenders and selecting contractors should be open to scrutiny and safeguard against favoritism, improper practices and opportunities for corruption.

8. Full risk assessment and efficient risk allocation

The full range of risks is to be identified and assessed. The fundamental principle of efficient risk allocation is that the party most able to influence and control specific risks should be assigned responsibility for that risk.

9. Effective performance monitoring and assessment of contracts

Effective monitoring and assessment of contracts is crucial for successful contracting, whether it is in-house or external. This ensures that the terms of the contract are adhered to and encourages improved performance.

10. Limited scope for contracting between government organizations

Public sector agencies should focus on their core role and not market services which are supplied by the private sector in competitive markets.

3 Outsourcing in New South Wales and Victoria

In Australia, Liberal (right-of-centre) governments have tended to promote outsourcing more than have Labor governments. When successful, outsourcing provides benefits to private firms and to consumers. On the other hand, the workforce currently providing the public service may lose jobs or suffer from a decline in wages.

New South Wales (NSW)

In NSW, outsourcing of government services was part of broader public sector reforms that started in the late 1980s. The Liberal-National Party Coalition government elected in 1988 introduced a series of reforms aimed at improving public sector management and increasing productivity and efficiency. It reduced the size of government, exposed monopoly public services to private competition, and gave greater autonomy and accountability to its agencies. Contracting-out was a core part of this program, especially for budget-funded agencies where there was a lack of effective measure of financial performance. Government trading enterprises (GTEs) outside the budget sector were expected to be motivated by the required rate of return on assets and equity and to implement contracting at efficient levels in any case.

To ensure a consistent approach to contracting across departments, the Government developed a policy framework for contracting. As part of their corporate planning processes, agencies were required to evaluate the suitability of each function for market testing and contracting. All savings achieved by contracting were to be retained by agencies for redirection to priority areas. Training workshops were held. Contracting progress and savings targets were monitored in annual surveys. Costing Guidelines were issued, case studies published and research commissioned to assess results and identify areas for improvement.

The Independent Commission against Corruption issued *Pitfalls and Probity*, a publication that provided examples of common problem areas and suggested possible solutions.

The Government established a steering committee, chaired by the Treasurer, to advise on implementation of the policy. The private sector was invited to propose innovative approaches to meeting public sector needs. The NSW Treasury and Premier's Department were given responsibility for promoting contracting initiatives.

In 1995, the newly elected Labor government announced its continuing commitment to Service Competition Policy in its June 1995 Financial Statement. It broadly adopted the Coalition government's Outsourcing Policy and its principles with the following two provisions:

- the essential factor is the pursuit of best value for money rather than adoption of particular means to achieving that end, and

- market testing should include testing in-house performance against market offerings. Tenders should be invited only where efforts to improve in-house performance have not shown clear potential for substantial benefits.

The new government set up an Office of the Council of the Cost of Government to provide research and information to departments. In 1997 it issued *Service Competition Guidelines*, with inputs from the Labor Council and public sector unions. These Guidelines gave protection of public sector employment a high priority and, where activities were to be contracted out, the Government stated a preference for contractors who offered comparable employment to displaced staff.

However, the government did not promote contract and market testing and, after an initial survey (*1996 Survey Findings*), stopped monitoring the progress and related savings. Some services that were contracted out are now provided again in-house.

The current government focuses on shared service arrangements between government agencies, particularly for corporate support and information technology services, to increase productivity and achieve savings. Agencies are directed to buy services from other government service providers. Some public sector organisations have been created specifically for this purpose. Government-wide service agreements are encouraged.

Surveys of contracting in NSW between 1993 and 1996 (such as Domberger and Hall, 1996; NSW Treasury, 1997) revealed that:

- Expenditure on contracting in the budget sector increased from \$966 million in 1994-95 to \$1762 million in 1995-96 and the number of contracts more than doubled from 13,852 to 28,479 over the same period.
- The average saving resulting from contracting was approximately 19.6 per cent.
- Ten agencies accounted for more than 90 per cent of the total contracting expenditure and numbers of contracts in place.
- The services with most contracted expenditure were health and welfare, transport, property, training and education, and information technology. Collectively they accounted for over 80 per cent of total contracting expenditure for 1995-96.
- Many agencies nominated efficiency (90%) and effectiveness (92%) as primary reasons for contracting. Another important reason (72%) was a lack of internal resources.
- Approximately 63 per cent of contracts had durations greater than or equal to one year and less than 5 years, 15 per cent of contracts were without fixed term. Premature termination of contracts occurred in a very few contracts (34 or 0.12 per cent), representing expenditure of \$5.7 million (0.32%).
- Almost half the in-house staff affected by contracting was retained within the agency after contracts had been awarded. Other staff were transferred to the contractor, redeployed within the public sector, or accepted redundancy.

The major issues that emerged during the review into the implementation of contracting policy in NSW were the need for competitive neutrality, fair and effective

competition, value for money, transparency and effective management of the tendering process and contract.

It is uncertain whether the efficiency gains achieved through service competition have been maintained, or perhaps eroded, with the emphasis in recent years on whole of government internal efficiency. Because government does not report results, there is little comparative evidence.

Victoria

Contracting out was a key reform initiative introduced in 1994 by the newly elected Liberal (Kennett) Government. This reflected in part fiscal pressure. The central agencies drove contracting and an Outsourcing and Contract Management Unit was created in the Department of Treasury and Finance. The contracting guidelines (1993), designed to assist public agencies implementing this policy, closely followed the NSW guidelines but included industry and regional development as objectives for outsourcing.

Achievements in contracting were reported in 1998 following a survey of contracting activities across government departments (Victorian Government, 1998). Contracts for capital works, employment contracts and grants provided to external parties for a wide range of services were excluded from the survey.

By the mid-1990s, the state government was letting out nearly 5000 new contracts in a year and the total value of contracts amounted to nearly \$1500 million. This was double the amount of a few years previously. The Justice, Education, and Infrastructure Departments accounted for 86 per cent of contracts. Transport services accounted for the largest proportion of the expenditure, followed by information technology, infrastructure maintenance, and building and property services.

The major reasons cited for outsourcing were access to skills/expertise, improved service quality, and an ability to manage fluctuations in demand. Lower cost was among the less important reasons for contracting. However, agencies reported, on average, savings in excess of 28 per cent of the cost prior to contracting.

After the Labor (Brack) government was elected in 1999, the emphasis switched (as it did in NSW) to sharing services with other government agencies, government-wide procurement contracts, and use of information technology to increase productivity. Outcomes from this change in policy direction have been largely unreported.

Where the private sector is involved, government has moved from outsourcing to engaging in partnering agreements. The aim of these agreements is to reduce the potential adversarial nature of traditional contracts by adopting a team approach that pursues common agreed objectives. The parties work out the method of selection, assignment of risk and dispute resolution procedures. However it is not clear how much this change to partnering reflects a change in practice or a change to a more acceptable terminology.

Local Government

In 1993, the NSW state government introduced, through the *Local Government Act 1993*, a more managerial style of local government. The *Act* replaced the traditional job of town clerk with the more business-like position of chief executive officer or general manager. This managerial change coincided with a move within local councils towards outsourcing, partly in response to fiscal pressures.

In 1994, Victoria introduced *compulsory* competitive tendering as a requirement in the *Local Government Act*. The legislation required all local councils to subject at least 50 per cent of their operating budget to market testing within five years. In addition it changed local government boundaries and forced council amalgamations. However, following a change in state government in 1999, the compulsory feature was dropped and councils were required to adopt a series of measures that would demonstrate that best value is achieved in service delivery.

Within NSW, the Council of the City of Sydney (a small area of six square kilometres in the centre of Sydney) provides an example of the significant role of outsourced services, especially before the 2000 Olympics. Council had always outsourced swimming and recreational centres and child care services. However, in 1996 the general manager estimated that \$50 million of funds would be required for the 'City Improvements Program' and that a large part of this would be achieved by reductions in corporate support costs and competitive tendering.

To achieve the cultural change required, the Council worked within a two-year industrial agreement that gave a framework for change and included a commitment to market testing and a focus on measuring performance and specific outputs. The organisation embarked on staff training, including contract management, provided business support so that in-house bids could be successful and invested in information technology. It realigned the organisation into purchaser and provider groups and separated asset management from asset ownership responsibilities.

In 1996 an implementation schedule was developed which included developing plans for the 13 core services, the organisation was realigned, and a program for market testing agreed to by end June 1997. Council staff was extensively involved in the process. As a result of competitive tendering, services such as property management, parks maintenance and light fleet management were outsourced, while the tender for street cleaning was won by the in-house team.

However, after the 2000 Olympics some contracts were not renewed and some activities were brought in-house again. Following the amalgamation of the City of Sydney with South Sydney Council in 2003 and the election of a new Lord Mayor, the council has focused on combining the administration of the two former councils and outsourcing has not been a priority. It is presently unclear to what extent services will continue to be outsourced or provided by an in-house group.

As part of an overall management initiative, outsourcing in the City of Sydney has been important and successful. Council reports that the target savings of \$7 million per annum were achieved and that staff numbers were reduced. It appears that reviewing activities, specifying output, and market testing gave a good indication to the Council of what they were doing well or poorly.

4 Contracting Parks and Gardens Services in Mosman, New South Wales

Overview

Mosman is located about 5 kilometres north of the Sydney CBD. It contains 850 hectares and 25,000 people. The Mosman Council is a leader among local government jurisdictions in NSW in contracting out of services. Since 1990, Council has opened virtually all of its works and services to the marketplace. These include road and footpath maintenance, beach and reserve cleaning, bush regeneration, parks and gardens maintenance, grass cutting, tree management, sporting field maintenance, weed spraying, irrigation maintenance, playground inspection and maintenance, garbage and recycling collection, street sweeping, toilet cleaning and building maintenance. In that time Council's approach to the various contracted works and services has altered considerably with improvements and enhancements added to each generation of particular contract as it has come up for renewal.

Many of its contracts are now in the third generation. They have evolved from highly prescriptive, activity based contracts to asset based contracts where outcomes and performance measures are specified. The contractor is able to determine the best work practices and methods that will allow him to achieve the desired results. In many instances this has enabled Council to deliver an increased level of service at a similar or lower cost to the local community.

In this paper we focus on the open space area as there has perhaps been more progress in this functional area of Council than others.

When the decision was first taken to outsource works and services, specifications were developed for activity based contracts including grass cutting (small and large areas), bush regeneration, weed spraying, tree trimming, turf wicket preparation and garden maintenance. Successful contractors were responsible for these activities in a range of different areas throughout Mosman. For example, the grass cutting contractor had to mow the grass in passive reserves, sporting fields and in larger areas of open space such as unmade roads. Another contractor would spray the weeds in the same areas.

The contracts in place today are asset based with one contractor responsible for all activities to maintain the particular asset. For example, the contractor for maintenance of sporting fields is responsible for preparing the turf wickets, mowing the outfield, spraying the weeds, installing and removing the goal posts at the change of season,

re-turfing worn areas, and so on. This has produced greater ownership from the contractors, eliminated unclear areas of cross responsibility between contractors, and reduced Council supervision and administration requirements. It has delivered considerable savings to the Mosman Community.

Establishing the Outsourced Project

In the early 1970s Council had a day labour staff establishment of 156. By 1989, Council had reduced the establishment to 69 and there appeared to be a good mix of day labour and contracting. However, by the early 1990s Mosman Council had an operating budget of \$12 million, a debt of \$6.2 million and over 20 cents of every dollar that Council collected in rate revenue went towards servicing or paying off this debt. Council considered that this was not sustainable.

Although day labour staff numbers were falling, for a council of its size, Mosman was spending a disproportionate amount of its revenue on wages and overheads associated with maintaining this workforce. Importantly, Council often did not know exactly what its workforce was doing. Work often responded to political pressures—the elected Councillors who made the loudest noise obtained most attention for their areas. Also, Council was experiencing difficulties in attracting and retaining reliable staff for outdoor workforce positions due to the high cost of living in Mosman and adjacent areas.

Accordingly, to improve service quality and to reduce the cost of providing services, Council decided to test the market for provision of most of Council's works and services. The savings would be quarantined and diverted to paying off the debt and give the Council a more secure platform for the future.

Importantly, the General Manager took personal responsibility for the change in management and ran the process along with some key employees whose expertise was brought into the organisation. The Council was reorganized with the Engineer's department split into a contracting section and into an in-house supply section. However, while the Council initially had an in-house purchaser/provider split, this is now not necessary because there are no internal bids for work.

Key Features of Outsourced Project

Councils have traditionally provided most services to the community by employing qualified staff to undertake the necessary work. The decision to outsource works and services required a rethink of this philosophy. Council still determines the services to be provided and to what standard, but relies on the private sector to do the work. Council purchases services from the private sector on behalf of the Mosman community.

Council has become more proficient at determining the levels of service to be provided, measuring whether the required levels of service are provided and supervising and auditing the performance of its private sector contractors.

Each contract has a series of performance indicators in place to measure the level of compliance of the contractor with the requirements of the specification. For example the bushland management contracts have fixed photo points where photographs are taken over time to measure the level of improvement. They also have reporting requirements and an annual assessment is undertaken of the native vegetation density to ensure continuous improvement, to the level required under the contract, is occurring.

There are a number of issues associated with risk management of outsourced projects. The direct risks associated with the performance of the work have been transferred to private sector contractors. Appropriate requirements are included in the contract document to achieve this. However, Council carries the responsibility for ensuring that its contractors are properly managing the risks associated with their particular contract. Under the *Occupational Health and Safety Act 2000*, Council can be held responsible for accidents and incidents that occur with its contractors if it has not taken reasonable steps to ensure that contractors have appropriate systems in place and implement them. Thus, the risks for Council have shifted from the direct risks associated with carrying out the work to risks associated with auditing the systems and performance of others.

To ensure the appropriate level of service is achieved, contract supervisors undertake regular audits of the work undertaken to check compliance with the specifications. Staff audit every site covered by the specification at least once per annum and more regularly for higher use areas.

There are also in place a number of independent performance measures to assist in assessing contractor performance. For example, the sporting fields used for cricket are rated by the NSW Cricket Umpires Association that provides the umpires for the matches. The cricket fields as prepared by the contractor must achieve a minimum rating of 7 out of 10 as independently assessed by the umpires.

In the bushland management contracts, the native vegetation density was initially measured by a contractor that undertook a flora and fauna survey for Council. The findings of this survey provided valuable information as input to the development of the specifications for the contract. A further flora and fauna survey will be undertaken half way through the life of the ten-year contracts to measure, among other things, native vegetation density. This will give an independent validation (or rebuttal) of the Council's assessment of progress by the contractor.

Feedback is provided to contractors on their performance in a number of ways including written reports, regular face to face and site meetings and notices issued under the terms of the contract. If service standards are not met on a regular basis and the contractor fails to address these issues, Council has a range of options available. These include withholding payments, options to rectify defects at contractor's cost, termination of contract and removal of individuals from performing work under the contract.

The contractors submit monthly reports to Council which is their opportunity to provide feedback on issues that are creating problems for them in the delivery of the service. Council can consider these issues and determine whether they are covered by the existing specification or if an adjustment to the specification is required.

Each contract also has a built-in review process where Council has the choice to either terminate the contract or take up an option to renew it. For example the bushland management contracts have a review at the end of the first, fourth and seventh years.

However, the most important aspect of contract administration is a professional and open relationship with the contractors.

Assessment of Outsourced Project

Mosman Council estimates that contracting in the early 1990s achieved savings of approximately 20 per cent across the board compared with in-house supply. These included the following savings in:

- Weed spraying 8%
- Grass cutting 16%
- Bushland management 25%
- Tree Pruning 35%

The savings achieved by moving from a reactive service regime to a planned maintenance approach meant that more public areas could be maintained and to a higher standard.

There were savings in the second round of tendering in the mid/late 90s and Council continued to improve its management of the process. Contract specifications in this second round of contracts did not alter significantly and savings were smaller (only in the order of 1% – 2%). There was a creeping increase in costs due to the reliance on the consumer price index for annual increases.

However, several of Council's outsourced services in the third generation of contracts are provided at significantly lower cost than in the second generation contracts. The current Street Tree Management Contract is delivering a higher level of service than the previous contract at a cost saving of \$18,000 (19%) per annum in the first year, \$26,000 (26%) in the second year and \$38,000 (39%) in the third year. The higher level of service has also greatly reduced complaints/enquiries from the public (by about 80%) with a corresponding reduction in staff time dealing with these matters.

The new Parks Management Contract let in 2004 combines a previous series of five separate contracts and has resulted in savings of \$66,000 (20%) per annum, totaling \$330,000 over the life of the contract. The specification also requires higher levels of service in some areas.

Because Council no longer employs blue collar workers to undertake these tasks, there has been a significant reduction in workers compensation claims and insurance premiums. It is difficult to quantify the savings that can be attributed to outsourcing of services as insurance premiums are influenced by many factors. However, in 1991 Council's workers compensation insurance premium was \$131,000 and in 1993 it had dropped to \$90,000, when several services were outsourced.

The third generation of Parks and Gardens contracts also provides considerably higher levels of service than the original contracts in the 1990's. This has been achieved largely through progressive improvements implemented each time the contracts have come up for renewal. The biggest leap forward came in the most recent round of contract renewals where specifications were altered considerably from very prescriptive "how and when" type specifications to "what" the required outcome is. Contractors have more flexibility in scheduling of required work, work methods to be used, and materials and equipment which allows them to deliver the same, or often an improved level of service for a better price.

The cost savings have been used to increase the scope of services. For example, in the 1990's Council was maintaining 10 – 12 separate bushland areas with a total area of 19.8 hectares. The funding was barely enough to maintain these areas in their current condition and not sufficient to make real improvements. Compared to Council's other contracts these were very poorly structured and the results reflected it.

In 2000/01 Council undertook a comprehensive review of the bushland management program. The result was a new approach to bushland management and a contract that Mosman Council regards as unique in the industry. Most bushland management contracts (as Mosman's old bushland contracts were) are structured around what the available budget is. In the tendering process contractors are often advised what the budget is and asked to submit a proposal based on the number of staff hours they can provide for the available budget.

Mosman's new approach was to establish the key performance indicators that have been discussed and to build these into a specification that required specific outcomes/improvements in each bushland area. Council also provided additional funding to allow all of the major bushland areas in the municipality to be included in the contracts. Council now has all 28.5 hectares of the larger bushland areas in the area under contract.

There were many problems associated with downsizing the organisation in the early 90s, not the least of which was determining maintenance programs and educating officers in contract management and administration. Additionally, Mosman worked under the ethos that the expectation is the specification. Although Council demanded that contractors adhere to the specification, it enabled Council to press for higher standards when items were not specified. When new specifications were developed, the lessons learnt were incorporated in the new documentation.

Overall, Council considers that contracting of services has been an outstanding success. Council continues to do more with less and downsizing has resulted in the disposal of a work depot, the proceeds of which were partly used to retire debt. A market place approach to the delivery of works and services has led to better planning and co-ordination and makes it harder for elected members to become involved in operational issues. If issues arise, they are prioritised and slotted into established programs at the appropriate point. Considerable savings have been achieved and the local community now enjoys considerably higher levels of service than in the 1980's and 1990's.

5 Outsourcing Maintenance of Physical Infrastructure in the Mornington Peninsula, Victoria

Overview

The Mornington Peninsula Shire is an area of 720 square kilometres and 130,000 people located approximately 75 kilometres south-east of the Melbourne CBD.

In 1995 the Mornington Peninsula Council resolved to substantially increase the scope of outsourced works and in 1997 the Council entered a contract with Transfield Services, a major private company, to manage the maintenance of roads, buildings and open spaces in the community. To implement this, Council had to restructure its workforce into purchasing and providing departments. This contract with an extension ran through to 2001 and produced small savings for Council. The savings were smaller than expected because the tender specifications were drawn up quite quickly and revisions were required as work went on.

Drawing on this experience, in 2000 Council started a new two-year program involving detailed new specifications of works for contractors, consultations with the community about service standards, and a thorough expression of interest and tendering program. Late in 2003, Council let out five contracts for cleansing services, parks and roadsides, furniture and signs, building maintenance and road maintenance. There is a detailed review and monitoring program for each contract. Council reports that these contracts have produced high quality services, significant cost savings, and no significant disputes with contractors. Council expects to build on the established processes.

Establishing Outsourced Services in the Mornington Peninsula

In 1994, the Victorian Government introduced Compulsory Competitive Tendering as a requirement in the *Local Government Act*. This legislation required all local councils to subject at least 50 per cent of their operating budgets to market testing within five years. As it happened, there was a change in government in 1998, before the five-year period expired. However, under a revised Act, all councils were required to comply with a series of measures that together would demonstrate that service delivery represented *best value* for the local community.

Following the 1994 legislation, the Mornington Peninsula Council reviewed the outsourcing potential for each major council service. Council already contracted out some services such as waste collection. The choice of additional possible contracted services depended principally on the deliverability of the required legislative outcome and the possibility of significant savings. Council decided to outsource the maintenance of all physical infrastructure services in the Shire because this was a substantial service unit and suitable for tendering as most services could be specified in terms of measurable outcomes. Specifically, Council would develop a tender for the management of roads, buildings and open spaces.

Starting in 1995, Council spent a little over a year in developing the tender documents and in the open tendering process. To facilitate this process, the Council restructured its staff organisation, separating out the purchaser and provider functions. Council created a contract management unit within the Corporate Support group to oversee the contract (purchasing) process. On the other hand, it created an in-house team within the engineering division to bid to undertake the work.

In early 1997, Council signed a three-year agreement with Transfield Services for all the tendered services. The work on maintenance of roads, building and open spaces would start in April. All of these services were performed previously in-house. The cost of the services amounted to approximately \$12 million per annum. In December 1999, the Shire resolved to extend the contract for all works with Transfield Services for a further two-year period.

In 2000, Council started a major new contracting initiative (Sustainable Infrastructure Maintenance Services, SIMS). This was based on a more comprehensive consultation and specification process taking well over a year. In all there would now be five separate large contracts for cleaning (including drainage), parks and roadsides, furniture and signs, buildings, and roads (see more details below).

This process and timing of SIMS took the following form:

- Initial community consultation (July to September 2000)
- Community workshops (July 2000 to March 2001)
- Establishing service standards (December 2000)
- Expressions of interest (August to December 2001)
- Tender specification (March to July 2002)
- Tender period and evaluation (August to December 2002)
- Final selection of tenderer (December 2002)

The selection process was thorough and lengthy. There was open advertising for Expressions of Interest and a long initial list of possible tenderers was filtered on competencies and company credentials and values. A first short list of firms was developed and nominees of the firms were interviewed for two hours. Council then developed a second and shorter list and held detailed interviews with the proposed contract manager of the candidate companies (not with the company CEO or PR

manager). Following the selection of firms for the five tenders, Council officers held a pre-start Quality Relationship Management workshop over two days with each successful tenderer including a final combined workshop detailing integration issues and transition measures.

Key Features of Outsourced Services

From the start, the aim was to contract out all routine maintenance activities and some minor cyclic maintenance activities of all asset groups. The specifications for the 1997 contract with Transfield were based on a combination of in-house operational plans where they existed and Vicroads maintenance standards along with other corporate documents that were originally administrative guidelines and position description documents.

The first stage contract with Transfield included the following main elements

- *Road maintenance*
Road, roadside and path maintenance, drainage maintenance (cleaning and minor repairs), car park maintenance, roadside furniture and signage maintenance, street sweeping
- *Open space maintenance*
Open space maintenance, foreshore maintenance, tree maintenance, cemeteries.
- *Buildings maintenance*
Inspection and routine maintenance of buildings

As noted, in the first round, an in-house bid was submitted but was not successful. The engineering staff involved were then transferred to new entities or retired. A few remained as field supervisors with a role change.

The SIMS process that started in 2000 built on the existing contract package, added specification documents provided by the original contract provider, and used Aus-Spec as the specification reference framework. Service standards were modified to fit the Aus-Spec structure for consistency. Council determined the intervention standards and response standards through a workshop process with residents, who were asked such questions as the levels of potholing, rutting, roughness etc that would be tolerated and the preferred response time having regard to current standards and to the costs of other standards.

The SIMS contract included the following main services and successful provider companies:

- *Cleansing - Nepean Waste*
All drainage infrastructure; litter collection from commercial areas and public open space, barbecues, and public toilets; boat ramp and beach cleaning.

- *Parks and roadsides – Transfield Services*
All road verges on the local road network, all playing fields, passive recreation areas and fire management services.
- *Furniture and signs – Urban Maintenance Systems*
All signage roads, parks etc., all road and park furniture, steps, walkways, ramps and structures.
- *Buildings – Urban Maintenance Systems*
All public building routine and cyclic maintenance including major nominated council building cleaning.
- *Roads – Emoleum Maintenance*
Routine maintenance services on local road assets, shoulders, drainage infrastructure repairs.

Contracts were based on a lump sum price for routine maintenance activities. This lump sum was indexed against the consumer price (trades) index, which is applied quarterly. Also there is an annual review of growth impacts. The review considers major item impacts separately at an annual appraisal time with each contractor. The growth factor is set nominally at 3 per cent but is adjusted annually.

Council bears the external risk factors, for example price increases in major consumables (such as bitumen and crushed rock). The contractor bears any operating cost increases within the review period. Also, nominally at least, the contractor bears the risks associated with not achieving required service quality.

There are numerous comprehensive and detailed schedules and specifications in place to measure service standards along with threshold and trigger points, intervention standards and an audit program. Examples of trigger points for road maintenance are the extent of cracking in pavement and the extent and severity of potholing or rutting or failures. Another example of a trigger is the number of items of litter per square metre within one week of cleansing.

The following is an example of activity specification for traffic island maintenance.

- *Activity definition (what work is included?)*
This activity covers inspection and maintenance of all concrete kerbed islands including all traffic calming devices located on the carriageway and in car parks, including those with hard or paved infill areas. The activity includes repair of any damaged kerbing and removal of any defects that could constitute a safety hazard to road users and pedestrians. The Cleansing Contractor sweeps the medians and collects litter. The Parks and Roadsides Contractor controls weeds and vegetation on traffic islands and medians.
- *Performance distress and defects (what does Council look for?)*
Damaged kerbing or median noses, interrupted longitudinal drainage flow, tripping hazards in hard paved areas.

- *Performance criteria (why does Council require it)*
The aim is to provide a safe refuge for pedestrians crossing the road. To ensure that the traffic islands continue to regulate and guide traffic movements without constituting a safety hazard to road users.
- *Performance standards*
Infill or paved area to be compact and free of depressions or mounds. Kerbing is to be continuous with no loose or broken sections and formed such that longitudinal drainage flow is not impeded.

To ensure service standards, Council holds biannual senior management group meetings to oversee strategic issues. Council has a team of contract surveillance officers for each of the five service contracts. There are quarterly meetings with contract managers and quarterly, monthly and weekly inspections as specified. A Relationship Management Agreement sits over the contract to ensure sustainable retention of agreed behavioural values and standards.

The contracts specify a mediation process and use of independent mediation panel as a final resort. However, mediation has not been required to date.

Assessment of the Outsourced Services

Council reports that the out-sourced projects are well accepted. There are high performance standards and accountabilities. There is strong ownership of outcomes. Council strategy is to build on what has been achieved. There are no moves to reverse this strategy.

Council reports that the quality of service is generally very good. The outcome depends on the quality of the specification and staff resources used by both Council and the contractor.

For the 1997 to 2000 contract, based on the difference between the quote by the successful bidder (Transfield) and the quote by the in-house team, Council expected to save \$5 million per annum. In practice, these savings were not fully achieved because, following reviews of the tender scope and adjustments of unit rates, the expected savings were taken up in addressing gaps in service specification.

These gaps arose partly because of the speed with which the contracts were specified initially. Also, on governance grounds, the contract staff preparing the documents was not allowed to discuss the issues with the engineering unit who would compete for the work. Consequently the contract staff did not fully understand the nature and extent of the service requirements and tasks. Probity and procedural correctness presented obstacles to full understanding of the requirements. Nor was there any community input with regard to service improvements.

The subsequent SIMS process addressed these weaknesses. Council took much more time (two years instead of one) to develop the contracts. Also Council engaged the

community comprehensively through forums, workshops and questionnaires. The Council was intimately involved in the consultation and scoping process so that it “owned” agreed service standards and intervention levels.

The second round of contracts, which started in 2003, brought in further cost savings. Council estimates that there is a further effective saving of \$5 million per annum compared to the first round arrangements.

Moreover, Council reports that few problems have been encountered in the current out-sourcing arrangements and that none have been unresolved.

6 Outsourcing the NSW Government Cleaning Service

Overview

This case study describes the decision of the NSW Government to reform the Government Cleaning Service (GCS) and its political, legal and economic ramifications. This marked a major phase in the process of restructuring government business in NSW.

The NSW Government established the GCS in 1915 for the dual purpose of cleaning schools and providing assistance for war widows who were not adequately covered by the existing social security system. The labour force was largely female, older and from non-English speaking backgrounds. Its clients were mainly government agencies such as the Department of Education, colleges of technical and further education, police and court houses. These agencies were required to use the GCS under a tied agreement.

In the late 1980s, the NSW Government’s established a Commercial Services Group within government to provide common services to government agencies, to improve quality, and to reduce costs in order to compete against the private sector. The GCS was part of this group, but in spite of paying neither sales tax nor notional corporate tax, its costs before 1989 far exceeded its revenue.

Over the following three years, the GCS achieved efficiency gains of 40 per cent through the removal of restrictive work practices and voluntary redundancies under an agreement with the Federated Miscellaneous Workers Union (FMWU). The work force was reduced from 12,500 to 7,500 cleaners.

Subsequently the government resolved to outsource the service and it divided the state into five geographic zones. Following an exhaustive tender process, cleaning services zones were awarded to three contractors. As described below, the outcome has been a significant decrease in the cost of cleaning without loss of quality.

Establishing the Outsourced Project

As the tied service agreement was due to lapse on 30 June 1992, the Government extended it for a further two years in order to allow for planning and consultation. During this time the Government engaged consultants to provide options to achieve major efficiencies in the GCS. The FMWU was not invited to participate in this study and, in anticipation that the tied arrangement would end in June 1994, the Union investigated the viability of an in-house bid.

The consultants presented the following options to Government:

1. Maintain existing GCS structure until completion of the tied arrangement in June 1994 and allow it to compete against the private sector, estimated cost \$296m;
2. Bring GCS into line with industry standards in regard to pricing and productivity while maintaining public ownership, estimated costs \$94m to \$120m;
3. Sell GCS as an ongoing concern with cleaning sites tied until June 1994, estimated costs \$105m to \$123m; and
4. Sell GCS under the condition that cleaners and their entitlements be transferred to the purchaser. Cleaning services would be provided by the purchaser for five years. Estimated costs \$130m.

Although option two was financially attractive, the Government perceived the risks of not achieving the reforms and timely efficiency gains under public ownership were significant. More importantly, the Government did not want to be involved in the cleaning business.

In July 1993 Government announced that it would implement the 'sale with conditions' options (option 4). It cited the results of independent analysis which estimated that savings in the order of 20 per cent and productivity improvements of 15 per cent would be possible through contract cleaning.

The FMWU tried to reverse this decision and fought it in the industrial, legal and political arenas. It was concerned for the jobs of the 7,500 cleaners and argued that the standard of hygiene in public schools would fall if contract cleaners were allowed to reduce cleaning hours.

The Government advertised the tender in the local and national press in July 1993. Overseas firms and large service companies without prior cleaning experience were able to tender if they could show that they could obtain the necessary expertise.

The tender had to take into account that employees transferred to the contractor had to be paid for accrued leave, were entitled to preserve superannuation entitlements, and that transferred staff had a mandatory guarantee of employment for 18 months on a broadly comparable basis to their previous employment. Cleaning staff were not offered redeployment or redundancies as transferring them to the successful tenderers was seen to be essential so contractors would have sufficient cleaners.

The tender process involved restructuring the GCS into five independent regional business units, each covering a geographical zone in New South Wales. The 'sale' of each zone consisted of the sale of GCS plant and equipment at a predetermined price; the transfer of employment liabilities; and a five year contract for cleaning.

At the close of tender, 12 expressions of interest were received. Of these, ten satisfied the pre-qualification of scale and financial capacity. Ultimately seven tenders were received. The in-house group did not obtain adequate financial backing and withdrew.

The tender process was lengthy and thorough and involved the use of independent consultants. The Government, in order to avoid creating a monopoly and to foster competition, indicated that it was not prepared to allocate more than two zones to one contractor but recognised that allocating neighboring zones would yield significant operational efficiencies.

Each tender was assessed against six criteria, one related directly to cleaning costs while the other five related to performance and commercial risk. The tender evaluation panel prepared three final options for awarding cleaning zones, costing \$402m, \$403m and \$405m respectively. Since the difference in price between the options was marginal, qualitative indicators were used to determine the final outcome. A comparison of the tendered price with the comparable GCS price indicated that, by year three, government would save \$60 million per annum (approximately 30 per cent) by contracting out cleaning services. The contracts were awarded in December 1993.

Key Features of the Outsourced Cleaning Services

Each winning tenderer demonstrated good human resource policies and practices and the former GCS cleaners were offered employment beyond the minimum mandatory requirements.

A condition of the sale was that the contract cleaning industry could introduce its own productivity standards. In order to increase productivity, contractors modified cleaners work practices. While employed by the GCS, each person was responsible for cleaning a specified area. Under the contract arrangement, cleaners were working in teams each with specified tasks (eg dusting). Team members could change tasks weekly to add variety and to enable those on rehabilitation to perform lighter duties.

Productivity improvements were also achieved through using new equipment and removing restrictive work practices.

Although the FMWU secretary accepted that the introduction of contractor work practices to former GCS staff increased productivity, he argued that contractors were making cleaners work harder, rather than smarter. Subsequently the FMWU argued in the Industrial Relations Commission that cleaners were not involved in considering options for their future, were not offered redeployment or redundancy, and their employment conditions were significantly different from those at the GCS.

The Judge hearing the case concluded that, as the GCS made the decision to terminate employment and that this decision was not related to work performance, former GCS staff were due some compensation. This resulted in Government paying some \$25 million for redundancies.

An independent cleaning inspection program was introduced to assess and document cleaning standards, identify systematic problems and monitor user satisfaction with the cleaning service. Random inspections took place and a complaint investigation and follow up service was created.

Each site was inspected without the presence of either the site or the cleaning contractor's representative. Where unsatisfactory cleaning was observed, copies of the inspection report were sent to the cleaning firm and the client. The client was contacted within 14 days to find out whether remedial actions had taken place.

The NSW Teachers Federation (TF) surveyed all government schools in the State about the quality of the contracted out cleaning service. In February 1994 the TF criticised performance of the contractors, citing dissatisfaction amongst school principals about the time allocated for cleaning and the numbers of cleaners. The decline in service was seen as putting students' health at risk. The complaint focused on the numbers of hours cleaned rather than the quality of the cleaning.

The Government subsequently carried out its own review of standards. It found little evidence of reduction in cleaning standards, but provided an additional \$20m per annum for the cleaning of schools.

Assessment of Outsourced Project

Reforms of the GCS involved complex policy issues for the Government. With annual operating costs of \$180 million before contracting, the potential for achieving significant savings through outsourcing made it an attractive proposition for the Government. On the other hand, as GCS was a major employer in the State, satisfactory resolutions of staff redeployment had to be achieved.

Increased productivity was achieved through introduction of new equipment, cleaning in teams, and removal of restrictive work practices. However, as noted, the FMWU has challenged these claims, arguing that increased productivity was brought about by harder work and changed working conditions.

Although the original estimated savings of \$60 million per annum by the third year were not achieved, partly for industrial reasons, significant ongoing cost savings have been made. Importantly, the NSW Government as a whole has ceased to be in the cleaning business. There appears to be no evidence that the quality of cleaning has diminished.

The Industrial Relations Commission's judgment, however, had significant implications for future reform, which may reduce the financial savings from contracting arrangements. Also, building employment guarantees into out-sourcing contracts reduces the potential for resource efficiencies and financial savings.

It was recently reported in the Sydney press that school cleaners went on strike until the NSW Government agreed to written guarantees of employment under new contracts.

7 Outsourcing of Land Valuation Services in New South Wales

Overview

The NSW Valuer-General (V-G) is responsible for the valuation of all land in New South Wales each year on behalf of the State government. Currently this amounts to some 2.25 million valuations. The V-G issues all valuations to the Office of State Revenue for land tax purposes and to local councils for their rating purposes. Land valuations are recorded in the Register for Land Values that is maintained by the Department of Lands.

In 1994, as part of wider public sector reforms, the Government reviewed the Office of the V-G with the intent to make it more commercial. In 1996, the Government introduced legislative provisions to authorize competitive tendering. In 1997 the Government split the V-G's Office into two new bodies, the State Valuation Office (SVO) to carry out mass valuations (the provider) and the Valuer-General's Department (the regulator) to control the statewide valuation records and to manage outsourced valuation contracts.

The SVO won all but one of the first set of tenders for valuation services. However there are now eight contractors providing valuations, with the SVO providing close to 50 per cent of valuations. One-third of land valuation services for the State are tendered annually.

Although it took some years to create a competitive environment, outsourcing of valuation services has resulted in significant productivity gains, enabling more extensive services to be provided. In addition the climate is now such that other services are being contracted. However, so far, there have been no significant savings in expenditure or reduction in costs to consumers.

Establishing Outsourced Valuation Services

The Office of the V-G's is a statutory body formed under the authority of the *Valuation and Land Act* to carry out a range of statutory duties. These include the management and contracting out of mass valuation services, the maintenance of the

valuation roll (data base), dealing with objections and appeals and making valuations under a number of Acts.

When Government decided to outsource valuation services and to separate the regulator from the provider, a V-G's Office Steering Committee was charged with responsibility for implementing the reforms. Four staff were moved out of the V-G's Office to set up the new government organization (the SVO) and to tender for the impending competitive valuation bid.

The first tenders were called in November 1996 and in March 1997 the contract for providing land valuations for most of NSW was awarded to the newly created SVO, a business unit of the then Department of Land and Water Conservation. Government awarded a private contractor valuation services for one area in the Hunter Region. Not all valuation contracts were contested.

At the same time, in order to produce efficiencies, traditional valuation methods were replaced by mass valuation techniques. This major change in valuation method required grouping of properties that react to market forces in a similar way and updating values by a market-based factor that is used as a multiplier of the prior land value. Traditional valuation methods, or handcrafting, are also used when appropriate.

In the 1996 call for tenders, the objectives of contracting valuation services were listed as:

- To lower costs to valuation users,
- To provide opportunities for developing new mass valuation methodologies, and
- To maximize opportunities of employment for existing V-G Department/State Valuation Office staff to provide valuation services.

In 1998 further contracts for a number of Sydney local government areas were contested and a private firm won the contract for Sydney East. After this initial tender process the State Valuation Office held the contracts covering every contracted area in the State except Sydney East and Outer Hunter and provided about 90 per cent of all valuations.

There were several reasons for the small involvement of the private sector in winning the initial contracts:

- the SVO, which was staffed with former employees of the Valuer-General's Department, had experience in carrying out mass valuations;
- the evaluation criteria included a preference for contractors who would take on existing staff; and
- the responsible Minister stated that there would be no job losses from contracting out.

Because of significant public concerns about land valuations flowing from changes to land tax laws, and the impact that valuations have on individual rating and taxing liabilities, the NSW Premier (in 1999) called for an inquiry into the operation of the *Valuation of Land Act 1916*.

The terms of reference for the inquiry, the Walton Inquiry, included a reference to assess: *'the efficacy of the reforms introduced in 1997 under which valuation services are provided through a mix of contested contracts and uncontested contracts'*.

The Inquiry concluded that it was too soon to judge the efficacy of the competitive tendering process as too many other changes had been introduced over the same short period. These included the split of the SVO from the V-G's Office, a change in valuation method, and the introduction of a new tax (the Premium Property Tax) at a time when land values were rising significantly.

The Walton Inquiry also noted that the competitive tendering process, which searched 'for new valuation methodologies to reduce cost by minimizing "expensive handcrafting" but that did not allow for testing was not wise'. It further observed that the process of competitive tendering required systematic quality control measures and contract managers who were focused on managing contracts rather than on the valuation process.

Key Features of the Outsourced Services

There are now eight contractors providing land valuation services. However the State Valuation Office still provides some 50 per cent of land valuations. Every year one-third of land valuations for the State are tendered. Previously all contracts were for fixed periods of three years in metropolitan areas and four years in regional areas, however the current request for tenders is for a three year period, with an option to extend for up to two years (two one year periods). This change in the contracting process has been implemented in response to industry concerns that establishment costs could not be amortised over initial contract periods and were a significant disincentive to enter the market for the services.

If a tenderer is a government business, it must comply with the State's policy on competitive neutrality, bids must be comparable to the private sector and adjusted for effects of taxation exemptions.

Of the selection criteria, one-third relate to price and the other two-thirds to suitability of staff, the valuation methodology proposed, experience, ability to take on the work and quality assurance.

The contractor is required to make accurate and complete valuations on behalf of the Valuer-General and may be required also to assist the V-G in the determination of objections from third parties and with appeals.

The services provided are to achieve the objectives of the V-G, namely:

- a) the competitive and commercial supply of valuations to the public including lowering the cost of services to end users;
- b) to make accurate and complete valuations; and
- c) to provide a high level of probity and quality control to support the continuing use of mass valuation as a tax base of the NSW government.

The contract details the standards to be achieved by the contractor, reporting requirements, and the valuation procedures to be followed. The V-G provides a procedures manual explaining the mass valuation system and the reporting and approval requirements. The manual specifies that contract management is to be based on the concepts of partnership, transparency, consistency of process and creating positive outcomes.

The contractor must provide valuation recommendations that comply with the requirements of the Act and undertake the appropriate quality control processes specified in the procedures manual. These include statistical tests and market analyses designed to measure the accuracy and quality of recommended valuations. However, the V-G bears the ultimate responsibility for quality of valuations.

The contractor bears the risk of meeting deadlines and any operational cost increases within the contract period. The contractor also bears the risk of not meeting service standards and reporting requirements contained in the detailed schedules of the contract.

The V-G uses a scorecard designed to evaluate objectively the contractor's performance.

Assessment of Outsourced Services

The Chief Valuer reports that outsourcing of the valuation function is now well accepted and that valuations will be provided in-house only on a competitive basis through the SVO. The Walton inquiry also found that there was no need to unwind the reforms as the high cost of initial separation of funder and provider, setting up systems, and contracting processes have now passed.

The V-G's Office has improved tender specification and quality control procedures and has increased the skills of its contract managers. With increased skills available in the private sector, tendering has become competitive within the metropolitan area and it is likely to become so throughout NSW. The V-G now contracts for other services such as preparing reports on objections.

One of the main reasons for separating the roles of purchaser and provider was to reduce costs to users of data, primarily the Office of State Revenue and local councils. However, although productivity has increased, savings have not been achieved.

There appear to be several reasons for not achieving anticipated savings:

- all valuations are now carried out to a full valuation standard, which was not previously required. This has increased workload;
- a backlog in valuations has been eliminated and all valuations are provided on time;
- start up costs were high;
- there have been significant salary increases; and
- increased workload due to the numbers of objections received each year. (This may be exacerbated in the coming years due to further changes to the land tax regime).

8 Residential Aged Care Services

Overview

In Australia, the Commonwealth (Australian) Government is responsible for residential aged care services (nursing home and hostel care). These residential care services are outsourced to the not-for-profit sector (65%), local and state government (10%), and private sector entities (25%). The Australian Government pays a subsidy to providers based on the care needs of its residents. Contributions based on ability to pay are also sought from residents.

The high market share of the not-for-profit sector reflects their competitive low costs, based partly on supportive donations and the use of volunteers as well as less restrictive work practices. Also not-for-profit agencies are often perceived as caring organizations. On the other hand, they may be small agencies with limited management skills. Also they may have discriminatory admission policies. For profit agencies are often run more efficiently.

To ensure that the capital requirements of the industry are adequate, residents requiring low care and those needing extra high services pay an accommodation bond to providers. Others pay a weekly fee which is means tested. The Government pays a resident supplement on behalf of residents who cannot afford the contribution themselves.

The industry is highly regulated to ensure equity of access and quality of care, to protect residents from exploitation and because of the significant levels of government funding. The Australian Government regulates quantity, quality, location and price of residential services. The *Aged Care Act 1997* (the Act) provides the regulatory framework on how aged care services should be delivered.

The quality of care is monitored by the Government's Aged Care Standards and Accreditation Agency through an accreditation process. If accreditation is not passed, the licence is revoked and can be sold.

Although the Act introduced greater flexibility to residential care, a recent review (Hogan, 2004) found that Government should consider replacing the current needs-based planning arrangements with more market based solutions and that there might be a need for establishing a contracting agency that negotiates prices and conditions for residents on behalf of the Government.

The Outsourcing Process

The Australian Department of Health and Ageing selects licencees for provision of residential care places through an open tender. Initially (in 1997), the Department granted provisional accreditation to providers for two years as this was deemed to be sufficient time to achieve the prescribed standards or to leave the industry. Since 1999 licencees are granted in perpetuity, subject to regulatory requirements, but can be revoked for failure to perform.

A common framework based on the provisions of the Act relating to *Quality of Care Principles 1997* is used to assess and rank applications. These provisions identify a range of important matters used in the assessment process, such as the ability of applicants to provide continuity of care and appropriate levels of care; the expertise and experience of the management and staff; provision of care for people with special needs and past conduct as a provider of aged care services.

The Department may also request that financial information be independently verified and may consider information available through the Aged Care Standards and Accreditation Agency.

Tenders are selected on the basis of a written application and no interviews are held. Success depends on the Department's perception of the provider. The Department keeps a scorecard of compliance with prescribed standards and the completeness and accuracy of statistical and financial returns.

Applications for capital grants are assessed on a competitive basis. The matters considered include the need for capital works to meet essential building standards, such as fire and occupational health and safety, the range of services available in a particular region and the demonstrated lack of capacity to obtain funds elsewhere.

Key Features

Aged Care Assessment Teams (ACATs) act as gatekeepers to subsidised aged care services. ACATs ensure that people obtaining services for the first time receive the right level of care and that access to subsidy is based on objective determination of care needs.

The monitoring of aged care homes under the *Aged Care Act 1997* is a responsibility of both the Aged Care Standards and Accreditation Agency (the Agency) and the Department of Health and Ageing (the Department). The Agency has been set up for

the purpose of accreditation of Commonwealth funded residential aged care services. Its functions include managing the accreditation process; promoting high quality care and helping industry to improve service quality by identifying best practice and providing information, education and training. It assesses and strategically manages services towards achieving accreditation.

The Department must ensure that homes meet their other obligations under the Act and imposes sanctions where approved providers have breached their responsibilities. These arrangements are designed to provide residents and their families with the assurance that they are receiving quality care and that their user rights are respected.

Accreditation is for three years, there are annual visits, support contacts and desk audits. If a service fails accreditation review, the licence is revoked and can be sold.

Accreditation is based on the achievement of four standards that are detailed in the *Quality of Care Principles 1997*. These are:

1. management systems, staffing and organisational development;
2. health and personal care;
3. resident lifestyle;
4. physical environment and safe systems.

There is a clear statement of the principle used to guide the assessment of each standard. There are 44 expected outcome indicators for the four standards. For example, Standard 2: *Health and personal care*, and three of the outcome indicators, are set out below:

Principle: Residents’ physical and mental health will be promoted and achieved at the optimum level in partnership between each resident (or his or her representative) and the health care team.

| <u>Matter Indicator</u> | <u>Expected Outcome</u> |
|-----------------------------------|-------------------------------------------------------------------------------------------------------------------|
| Clinical Care | Residents receive appropriate clinical care |
| Specialized nursing care needs | Residents’ specialized nursing care needs are identified and met by appropriately qualified nursing staff. |
| Other health and related services | Residents are referred to appropriate health specialists in accordance with the resident’s needs and preferences. |

The Agency may carry out a review audit on site if it has reasons to believe that, for example, there is non compliance with the standards or there has been a change of ownership or key personnel. Audits may be scheduled or unannounced. The auditors assess the quality of care by reviewing documents; interviewing staff, residents,

relatives and others (such as visiting doctors, pharmacists); and observing the environment and practices of the home.

Within 14 days of receiving the audit report and considering any submission from the provider, the Agency may decide not to revoke the accreditation, vary the period of accreditation, or revoke accreditation. However, the Agency is not bound to follow the recommendations of the review team.

Where there is non-compliance with the Standards, the Agency maintains close supervision of the home to ensure that improvements are implemented and residents are protected. The Agency encourages regular self-assessment.

The *Quality of Care Principals* in the Act set out a structured approach to managing quality and place the ultimate responsibility for the quality of performance in each facility on the professional staff and management.

Assessment

The *Aged Care Act 1997* introduced greater flexibility to residential care, supported higher standards of care and accommodation through accreditation and certification and improved quality of care. These measures also resulted in some rationalization of providers.

The current tightly regulated place allocation system and the monitoring requirements benefit residents. They ensure that the quality of care is generally high.

However the regulated system has some costs. It is expensive to administer and to assess individual client's needs. It reduces competition between providers and makes it more difficult for others to enter the industry. Capital requirements and the availability of trained staff are also barriers to entry for new providers. The current system is dominated by the relationship between government and providers and there is little choice for consumers. Prices are fixed and, largely because of the needs based assessment, bed occupancy rates are high in the industry (96%).

A recent review (Hogan, 2004) found that the residential aged care sector required structural reform to become more efficient and to ensure its long-term financial sustainability. The review recommended more flexible planning and allocation arrangements for residential care places, streamlining the administration of the Resident Classification Scale to increase efficiency, and the expansion of government support for the education and training of aged care nurses and care workers.

To increase choice for consumers and to shift the focus on bed-allocation to a more competitive system, the report canvasses the need for establishing a contracting agency that negotiates prices and conditions for residents on behalf of the Government and an auction system for the allocation of places to providers. Government is currently considering these recommendations.

9 Health Care Services in Port Macquarie Base Hospital

Overview

Port Macquarie is located on the coast about 400 kilometres north of Sydney. The town services the Hastings Region, which has a catchment of 7000 square kilometres and population of about 60,000 people. Within the town, the Port Macquarie Base Hospital has been managed by a private company, Health Care of Australia (HCOA), under contract with the NSW government since the hospital opened in November 1994. The private provision of services was part of a wider agreement between the NSW Government and a private consortium to build, own and operate the hospital. In this paper we focus on the private provision of services and related arrangements.

The private provision of public hospital services at PMBH was possibly the first case in Australia in which a private firm was responsible for providing all the services at the public hospital, not just part of the services such as cleaning or pathology services. Since then, despite the costs noted below, there have been several similar projects including Latrobe Regional and Royal Women's Hospital in Victoria, Noosa and Robina Hospitals in Queensland, and Modbury Hospital in South Australia.

There are limited public data on the arrangements for PMBH. In this paper we draw heavily on the 1996 report by the NSW Auditor-General¹ as well as on our knowledge of the arrangements from media and other reports. Doubtless there have been detailed changes in arrangements since 1996, but the key issues appear unchanged.

Overall, it appears that there were few significant benefits in the out-sourcing arrangements for PMBH. The NSW Government apparently paid a high price for the service without a significant increase in the quality of service or a reduction in the risk to government

Establishing Services at PMBH

The operating contract was part of a broader build, own and operating contract between the NSW Health Department and five private companies, involving the private owner (Port Macquarie Base Hospital Pty. Ltd, PMBH P/L), two finance companies, a construction company, and HCOA. This contract included construction of a new hospital of 161 beds in Port Macquarie between 1992 and 1994. The contract allowed for two main annual payment streams. One was an 'availability' charge, which would enable the private firms to recover construction, finance and other costs associated with building the hospital. The second was a 20-year 'service' charge to HCOA that would cover the operating costs of the hospital. The hospital is contracted to treat 80 per cent public patients and 20 per cent private patients. At the end of 20 years, PMBH P/L has the right to sell the hospital.

¹ NSW Audit Office, 1996, *The Auditor General's Report for 1996*, Volume 1, Appendix 4.

The reasons for establishing the project were partly political and partly financial. Successive NSW governments had promised a new hospital to the local community but failed to deliver possibly because it was not a marginal seat in the NSW parliament. However, the Government claimed that its \$300 million per annum for capital health works was fully committed to other projects. Producing the hospital by private finance had the short-term attraction that it did not take funds away from these projects.

The contract was established by a competitive tender process. In October 1990, the NSW Government approved the calling of expressions of interest from the private sector for involvement in the project. In September 1991, the Government invited four groups to tender. Three tenders were received and evaluated by the end of the year. In February 1992, the Government authorised the Department of Health to proceed towards finalising a Services Agreement with the preferred tender group. The contract was finally signed in December 1992. As is typical in this process, most of it is competitive. However, in the final stage, there can be protracted negotiation between the government and the preferred tenderer, from which the government cannot easily withdraw and where competitive pressures are reduced.

Key Features of Services at PMBH

Under the Services Agreement with the NSW Department of Health, HCOA agrees to provide services for public patients presenting themselves to the hospital. Performance guarantees are built into the agreement, which specify that no person requiring urgent or essential treatment will be denied appropriate care.

The Department of Health sets the number of individual services to be provided annually, which has regard to a range of factors including changes in demographics and in other demand factors. It also specifies the quality level for each type of service at the expression of interest stage. According to the NSW Audit office (1996), the quality levels specified were generally greater than those applicable to the public hospital that it replaced.

The Department of Health pays a 'service' charge to the operator for the treatment of public patients. Most of the budgeted service charge is calculated on a set fee per service. This fee was set equal to the top cover, private insurance rebate. In addition, the NSW Audit Office (1996) reported that payments for non-inpatient services were set initially on a fixed budget basis. The budgeted annual service charge in any year is not to be less than the total service charge in the previous year.

HCOA also negotiates additions. After the signing of the contract, the Department of Health agreed to add \$1 million to the service fees to allow for treatment of Department of Veteran's Affairs patients that were not identified in the negotiations before signing of the Agreement. Further, under threat of litigation, HCOA successfully claimed an extra \$3 million from the Department in 1997 to cover the cost of providing for medical patients (Collyer, 1997).

In terms of the allocation of risk, the Department of Health bears the risks related to changes in taxation and legislation, litigation during operation, and termination. It also bears the risk of poor performance because it would be very difficult to terminate the contract with HCOA. Significantly, the Department is required to consult with both PMBH P/L and HCOA before planning any new health facility in the region.

The private operator bears the risk for use of the hospital up to a point (given that the annual service charge cannot fall), maintenance and repairs, outgoings of the hospital, insurance, and disputes between the parties. However, HCOA owns and operates the main private hospital in the town and so has a monopoly position with private patients.

In terms of monitoring standards, a Contract manager of the Department monitors the provision of services at the Hospital and the Department receives regular reports from HCOA on performance. Also, HCOA is accredited with relevant bodies as specified in the contract. However, the NSW Audit Office (1996) was unable to verify whether these controls on standards were effective in practice.

Assessment of the Out-sourced Services

Assessing the efficacy of these arrangements is complicated by the variety of services being provided and by the lack of public data and benchmarking.

There seems little doubt that the Government paid a premium price for financing the hospital by private finance. Chung (2003) estimates that, even with a 10 per cent discount rate, the present value of the 20 annual availability charges is \$67 million compared with the actual capital outlay of \$52 million.

It appears that operating expenditure has been significantly higher than in publicly-run hospitals at least in the early years. Because of the secrecy provisions of the Services Agreement, the NSW Government does not release data on the service charge for PMBH. However, Chung (2003) found early evidence that PMBH was costing NSW Health significantly more than comparable regional hospitals. The NSW Hansard (29/05/1996) showed that recurrent funding for PMBH was \$28 million for the year. Chung estimated that this was \$6 million more than the average for seven similar regional hospitals namely Albury, Coffs Harbour, Dubbo, Lismore, Orange, Tamworth and Wagga Wagga.

The evidence on clinical quality of service is less clear. The NSW Hansard (29/05/1996) reports that, in 1996, PMBH had a good comparative record with fewer unplanned returns to the operating theatre or to the hospital as well as fewer post-operative embolisms and contaminated wounds. On the other hand, examining the records for 1998 and 2002, Chung (2003) reports that waiting times and the number of patients with waiting times greater than a year were comparatively high.

Without information on the contract details it is not possible to know whether there are ongoing incentives to control operating costs or to improve service quality. Given

the length of term of the Service Agreement and the way in which it was bundled together with the provision of infrastructure, there must be some concern the benefits of out-sourcing were not fully achieved.

As has been noted the NSW Government bears a significant amount of risk. This is perhaps inevitable where the quantum of services cannot be specified precisely in the contract.

The risk is exacerbated by political inequality between the parties. Government has to maintain continuous health services. It can litigate if a service is unsatisfactory but it cannot easily walk out of an agreement. This is not true for a private firm. When Australian Health Care started to make large losses from the Latrobe Regional Hospital, it first litigated for more funds and then in October 2000 abandoned the contract.

Overall, it is hard to find significant benefits in the outsourcing arrangements for the PMBH. It appears that the NSW Government paid a high price for the service without a significant increase in the quality of service or a reduction in the risk to government

10 Outsourcing the Melbourne Metropolitan Ambulance Service

Overview

In the early 1990s, the Victorian Government decided to outsource a large number of the state-run ambulance services in Melbourne. However, whatever the potential merits of outsourcing such services may be, the process was highly flawed. Contracts were poorly specified and, worse, often awarded to favoured parties without competition or due process. In this case study, we draw on the report of the Victorian Auditor-General's Office (1997) to describe a contracting out process that was seriously flawed and the subsequent corrective measures taken within the Metropolitan Ambulance Service (the Service) to improve outsourcing practices.

Outsourced Services

Between 1993 to 1995, the state-run Melbourne Metropolitan Ambulance Service to outsourced some major contracts for services. These included:

- Engaging consulting firms to manage the tendering for and subsequent management of several contracts.
- A new computerized communications system for \$7.5 million over 4 years;
- The operation of new financial and management information systems at a cost of approximately \$15 million over 4 years;
- The management and maintenance of ambulances and other vehicles for approximately \$2 million per annum, and
- Non-emergency ambulance services at an estimated cost of \$6 million per annum.

Poor Practices and their Consequences

In 1996-97 a performance audit by the Victorian Auditor General revealed serious deficiencies in the Service's outsourcing program. These were attributed to poor management practices and corrupt activity that would have been avoided had proper procedures been followed.

The Audit noted that the manner in which the contracts were managed enabled consultancies *'to reap significant financial benefits without challenge.'* and resulted in poor advice being provided, a poor level of service and in failure to achieve the estimated \$20 million in savings anticipated from outsourcing.

Management of the outsourcing was characterized by inadequate documentation and a total disregard for the Government's outsourcing guidelines.

The deficiencies continued for some time and had a seriously adverse impact on the operations of the Service.

Highly dubious practices included:

- Appointment, without tenders being called, of a private firm which had previous commercial associations with the chief executive officer;
- Serious deficiencies in the development and implementation of its new communication system. These included: using systems specifications which contained major shortcomings; the absence of documentary evidence to substantiate the short-listing of potential suppliers; and the inability to produce critical information to support the evaluation of tenders;
- The failure to observe acceptable standards for the engagement of two consulting firms, including irregularities in the tender process; failure to formalise agreements specifying the consultants roles and responsibilities; and lack of evidence that the technical competency of these firms had been investigated;
- Total delegation of responsibility to the two consultants without assessment of their performance;
- The existence of a conflicts of interest in the tendering process for delivery of non-emergency services; and the absence of a cost-benefit analysis to support the decision to enter into long-term contracts
- Payment of significant sums over approved budgets without evaluation of the basis of such claims.

Corrective Management Measures

Following the performance audit, the Service's new chief executive initiated a range of actions aimed at improving the Service's contract management practices. These included:

- the recruitment of experienced contract administrators;

- development of policies and procedures for all aspects of contract management;
- the introduction of performance criteria in all contracts; and
- a formal system of delegations.

In addition, the Department of Human Services introduced more stringent accountability arrangements for the Service, including the requirement that all tenders greater than \$100,000 be approved by the Department's accredited purchasing unit.

The Service was also requested to establish an audit committee and to meet regularly with the Department for the purpose of reviewing financial and operational performance.

Conclusions

This case study demonstrates the importance of good governance and due process for contracting out of services and how significant the consequences of poor management and control of an outsourcing program can be. These included failure to achieve the overall objective to achieve savings of \$20 million and a reduction in the quality of services. Importantly it draws attention to the need for management to retain control of any outsourcing program. However, it should also be acknowledged that the incompetence and corruption of the management became transparent eventually through the failure of outsourcing. In the absence of outsourcing, the same poor management qualities may have continued hidden but with equally poor outcomes.

11 Conclusions

Outsourcing of government services to raise public sector productivity has been successful on the whole. In a review of early contracting experience in New South Wales and Victoria, Domberger and Hall (1996) found that competitive contracting out of state government services produced annual savings in the order of 20 per cent of previous expenditure. However, it is hard to tell whether these savings have been maintained since then as current (Labor) administrations in the two states are not actively pursuing contracting and are not reporting on the subject.

In this report we have found that Mosman and Mornington Peninsula Councils have achieved substantial cost savings by contracting out a wide range of infrastructure maintenance services and improved services by improving specifications and monitoring. There have also been major savings in NSW Government cleaning services and improvements in the coverage of valuation services in NSW, though possibly not cost savings in the latter case. We have also found that extensive monitoring of residential aged care services ensured a good quality of care generally. However, in this case costs and prices are high, there is limited competition, and places are limited.

Contracting out often requires significant structural reform of an organization, especially when an agency has long experience of in-house provision. Successful

contracting out also requires a great deal of work in drawing up appropriate specifications, which should be performance-based where possible, in the tender process, and in the monitoring of the ongoing contracts. Experience in contracting out also improved performance and outcomes.

Where governments have been reluctant to restructure, notably within the NSW Government, or in a hurry to develop contracting procedures (a common problem), the benefits of contracting out have been much smaller.

In more extreme cases, contracting out can produce expensive outcomes of major service failures. Examples include the lack of scrutiny of the contract with Port Macquarie Base Hospital and management's failure to maintain control of the process of contracting out various part of the Melbourne Ambulance Service.

In NSW and Victoria, the Governments are currently emphasising shared service arrangements within the public sector, state-wide procurement contracts, and the protection of public sector employment. Where the private sector is involved, the emphasis is on service partnerships. Partnering requires both parties to own and develop a common agenda – a sharing of the risks and rewards that is commensurate with the contribution made by each party. However, it is not clear that such policy rhetoric is a real substitute for the hard decisions of allocating work or resources. It seems likely that contracting out will, in one manner or another, remain an important economic and social issue.

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