

# PERFORMANCE EXAMINATION



Auditor General  
Western Australia

## First Byte: Consortium IT Contracting in the Western Australian Public Sector



Report No. 12  
December 2001



Auditor General  
Western Australia

THE SPEAKER  
LEGISLATIVE ASSEMBLY

THE PRESIDENT  
LEGISLATIVE COUNCIL

PERFORMANCE EXAMINATION: First Byte - Consortium IT  
Contracting in the Western Australian Public Sector

This report has been prepared consequent to an examination conducted under section 80 of the *Financial Administration and Audit Act 1985* for submission to Parliament under the provisions of section 95 of the Act.

Performance examinations are an integral part of the overall Performance Auditing program and seek to provide Parliament with assessments of the effectiveness and efficiency of public sector programs and activities thereby identifying opportunities for improved performance.

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

A handwritten signature in black ink, appearing to read 'D D R Pearson'.

D D R PEARSON  
AUDITOR GENERAL  
December 5, 2001

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# 1 Auditor General's Overview

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Contracting can have benefits for government in terms of better performance, lower costs and shifting the risks of asset ownership to the private sector. For information technology services, public sector agencies can also shift the risks of attracting and retaining appropriately skilled and experienced staff and keeping up to date with the rapid technological changes of the IT industry. However, outsourcing does not eliminate risks. It merely substitutes one set of risks for another, particularly given the loss of direct control over the outsourced services.

To keep these risks to a minimum and to get best value from contracting, contracts need to be closely monitored, actively managed and regularly evaluated. This requires the contracts to have clear and measurable objectives, for agencies to have the systems in place to monitor and check the contract outcomes, and for them to actively manage the contracts.

The two contracts examined in this report – BIPAC and BDMW – were large consortium contracts let as part of the then Government's IT outsourcing program in the mid-1990s.

For these contracts, the initial processes of planning, tendering, negotiation and transition were generally undertaken in a thorough and well documented way. However, since they commenced, management of the contracts has been less effective. Agencies generally have not established the systems to monitor and actively manage cost savings and service level performance. Consequently, they cannot demonstrate that they have benefited from the contracts. A particular concern is that, in the absence of this information, when these contracts expire over the next two years, agencies will have limited information on which to assess whether or not they should continue contracting the services or pursue some other alternative.

A new arrangement is being developed by the Department of Industry and Technology to replace these two contracts when they expire. It is imperative that the new arrangement, SPIRIT, takes into account the lessons learnt from the BIPAC and BDMW contracts, especially the need for clear and measurable objectives to enable proper evaluation of contract outcomes. It is also critical that agencies effectively manage any new contractual arrangements by establishing the necessary monitoring and management systems and ensuring their contract managers have the appropriate training and support to ensure that they are best placed to maximise the benefit to the government from the contracts.

# 2 Executive Summary

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## Background

In the mid-1990s the government undertook a major IT outsourcing program as part of its competitive tendering and contracting program.

This followed a 1995 proposal to the Information Policy Council for the IT mainframe outsourcing framework to comprise three groups:

- the BDMW consortium which was already being established by the agencies concerned – the **B**uilding Management Authority (now part of Department of Housing and Works ), **D**epartment of Land Administration, **M**ain Roads Western Australia, and the **W**ater Corporation;
- BIPAC (**B**usiness **I**nformation **P**rocessing **A**gencies **C**onsortium) – comprising agencies which used the then Bureau Services, Department of Housing and Works (formerly Homeswest) and the Department of Mineral and Petroleum Resources; and
- SIPAC (Sensitive Information Processing Agencies Consortium) – intended to comprise a cluster of agencies with sensitive government information which would retain their computer operations within the public sector.

This approach was proposed as it was hoped that the two consortia contracts would attract two competing large international IT companies to the State. SIPAC, was intended as a repository of sensitive information, a public sector benchmark and a means of retaining IT skills in the public sector.

While the BDMW and BIPAC contracts were let in July 1996 and October 1997 respectively, SIPAC did not proceed.

The two contracts involve large expenditure by the government, with current spending on each ranging from about \$11 million last year for BIPAC to around \$25 million last year for BDMW and totalling some \$105 million for both contracts since they commenced. However, the importance of these two contracts lies not just in their value but in the nature of the agency systems they support such as the State's electoral, land titles and taxation collection systems.

They are both consortium contracts and contain some key features which were “cutting edge” at the time they were let, including an open book (or cost-plus) pricing system and a scorecard approach to measuring performance linked to an “incentive” system.

As both contracts are due to expire towards the end of 2002 (though some BIPAC agencies have extended to 2003), the Department of Industry and Technology has been developing a new approach to IT contracting, known as SPIRIT.

## Have These Contracts Been Successful?

This audit aimed to evaluate the success of the contracts in terms of the extent to which they have achieved their objectives. The evaluation has been limited because some of the objectives are not capable of measurement and those that are, have not been fully monitored by the agencies.

However, the information and data collected in this review indicates that while performance and cost savings have not been fully monitored, risk has increased particularly with the lack of proper bedding down of disaster recovery arrangements in a number of agencies.

### What Are The Objectives?

The two contracts contained the same set of objectives including improved service levels, cost reduction, development of a competitive IT market place in Western Australia and greater flexibility in acquiring new technology and IT staff skills.

In addition, BIPAC contained two whole-of-government objectives. These were to wind down the existing government Bureau Services and to attract a competitor into the State for the then BDMW contractor.

### Were The Contract Objectives Achieved?

#### *Improved Service Levels*

The review was not able to determine conclusively whether the contracts have led to improved service level performance.

Only two of the six agencies examined collected independent data to monitor service level performance. Only one of these, the Department of Mineral and Petroleum Resources (DMPR) collected independent performance data both before and after the contract commenced to enable an assessment to be made of whether service levels have improved.

The DMPR data indicated that while transactions through the mainframe computer have remained steady since the BIPAC contract commenced, the average response time has increased though reliability has improved.

The contractor undertook a survey of staff in BIPAC agencies in early 2000. This indicated that 46 per cent were satisfied with the overall service provided by the contractor.

The Department of Industry and Technology has also undertaken satisfaction surveys of IT managers of the agencies involved in the two contracts, in 1999 and 2000. The results are over too short a period to draw any strong conclusions, though they do suggest that in broad terms the BDMW agencies were generally more satisfied with the contractor than the BIPAC agencies.

### *Cost Savings*

The cost savings estimated in the business cases prepared at the time the contracts were negotiated were \$3.3 million for BDMW and \$4.4 million for BIPAC (including expected savings of \$2.7 million from the winding down of Bureau Services) over the period of the contracts. This was a saving of 10.7 per cent of expenditure on the services for each of the contracts.

None of the agencies examined can demonstrate whether the expected savings have been achieved.

From the data collected by this review, however, payments to the contractor for the agencies examined during the periods considered have exceeded the estimates in the original business cases by \$1.8 million for BIPAC and \$1.7 million for BDMW (though growth in volume and changing nature of the business since the original estimates were prepared need to be taken into account).

### *Other Contract Objectives*

The contracts did increase the opportunities for private sector participation. However, the objectives of “greater flexibility in acquiring new technology and staff skills” and “developing a competitive IT market place in Western Australia” have not been evaluated in this review as they are not capable of objective measurement.

## Were The BIPAC Whole-of-Government Objectives Achieved?

Letting of the BIPAC contract achieved the objective of winding down Bureau Services, the mainframe Bureau run by government on behalf of a range of agencies.

However, it has not been so successful in attracting a competitor for Ferntree, the BDMW contractor at the time. BIPAC was initially successful in attracting CSC (Computer Sciences Corporation) Australia Pty Ltd as a competitor for Ferntree. Through a series of company takeovers, CSC is now the sole contractor under both contracts.

## Have These Contracts Been Managed Effectively?

The procurement and transition processes for both contracts were generally handled in a systematic and thorough way and were well documented.

However, the contracts have not been managed well since the contractor commenced.

Active management of these contracts is particularly important given the open book pricing approach which requires careful scrutiny. None of the agencies examined have undertaken regular audits of charges and some have not had controls in place to monitor and manage costs and regularly check invoices against monthly reports.

Similarly, only two agencies collected independent data to validate the performance data provided by the contractor in the scorecards in its monthly reports to agencies. In addition, monitoring of performance was hampered in a number of agencies by scorecards not being reported for an extended period of time

because they were “under development” or “under review”. The effectiveness of the scorecards as performance monitoring mechanisms was also limited by their complexity, the technical nature of the indicators and the focus on penalties rather than incentives.

While risk was generally well managed, the review found that a proper risk assessment was not undertaken during the procurement process. Moreover, important government systems supported under these contracts are at risk because of inadequate disaster recovery arrangements for mainframe and mid-range computers under the contracts for some of the agencies examined. In addition, agencies have failed to ensure the continuation of confidentiality agreements for the contractor’s staff, putting at risk valuable commercial and personal data.

## Recommendations

The most important recommendations of the report are:

- to enable contract evaluation:
  - the objectives must be clearly targeted outcomes and worded so as to be easily measurable;
  - agencies, with the assistance of the Department of Industry and Technology, need to establish systems which enable them to collect data on the full costs of the contracts and independent data on performance; and
  - agencies and the Department of Industry and Technology should assess at least annually the extent to which the objectives have been achieved.
- to enable the maximum benefits to be achieved:
  - the contracts need to contain provisions which ensure that agencies have a clear mandate to validate charges, invoices and data for performance measures and the means to do this quickly and inexpensively. Prices charged in the contracts should be benchmarked on a regular basis;
  - effective bonus systems should be built into the contracts to ensure the contractor is continually challenged to improve performance;
  - performance measures must be based on user requirements and preferably monitored by someone independent of the contract manager. In addition, agencies should undertake periodic independent benchmarking of performance;
  - agencies should have designated contract managers for the contracts with appropriate contract management experience and training as well as the authority and executive support to actively manage the contracts. They should also have appropriate succession arrangements in place; and
  - the Department of Industry and Technology must more actively support agencies in the management of the contracts, including establishing specialist contract management advice units and developing IT contract management training programs. It should also more clearly delineate its role from the agencies and specify the basis of any charges it imposes.

- to plan for, and manage, risk effectively agencies need to:
  - undertake a thorough risk assessment for both procurement planning and contract management;
  - ensure that fully tested disaster recovery processes are put in place as soon as contracts commence and are maintained thereafter; and
  - ensure that contractors comply fully with any confidentiality requirements.
- in developing the new SPIRIT arrangements, the Department of Industry and Technology needs to ensure that the report's recommendations are fully taken into account, especially in relation to setting clear and measurable objectives and establishing systems to estimate in-house costs up-front so that cost savings can be measured under new contracting arrangements.

# 3 Introduction

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## Background

The outcomes of, and risks associated with, the widespread outsourcing of government services in Australia during the 1990s has received considerable attention in recent years. Most of the studies, however, have focused on the outsourcing of services provided by governments to the public (eg bus and hospital services).

It is only over the past year or so that attention has shifted to the outsourcing of inputs used by government, particularly information technology (IT) services. For example, the Federal Government's approach to IT outsourcing (using clusters, or consortia of government agencies) was examined in a report by the Australian National Audit Office (ANAO)<sup>1</sup> in September 2000.

## IT Outsourcing In Western Australia

In Western Australia, government agencies have used outsourcing as a means of obtaining IT services for some time.

Until the mid-1990s, agencies generally owned their own computer equipment and employed their own staff to provide most of their IT services. In addition, a number of agencies<sup>2</sup> used a shared mainframe service from a central government body known as Bureau Services.

However, in the mid-1990s, the government embarked upon a major IT outsourcing program. This was based primarily around two large consortium IT contracts – the BDMW contract [derived from the four agencies initially involved - the former **B**uilding **M**anagement **A**uthority (now part of the Department of Housing and Works), **D**epartment of Land Administration, **M**ain Roads Western Australia and the **W**ater Corporation] in 1996 and the BIPAC contract (**B**usiness **I**nformation **P**rocessing **A**gencies **C**onsortium) in 1997.

These contracts stemmed from the recommendations of the McCarrey Commission<sup>3</sup> which had proposed that the 14 mainframe sites which existed in different agencies at the time be rationalised to an indicative target of four.

This became a project within the government's competitive tendering and contracting (CTC) program, but was guided and driven by the Information Policy Council<sup>4</sup> (which had been formed by the government in early 1995 to advise on information, IT and telecommunications policy).

As a first step, the four BDMW agencies agreed to participate in a pilot project to test the market, forming a consortium and contracting out their mainframe requirements.

At the same time, the Information Policy Council had commissioned a study to examine the future mainframe needs of the remaining agencies and to suggest potential groupings for rationalisation and contracting out.

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<sup>1</sup> Australian National Audit Office – *Implementation of Whole of Government Information Technology Infrastructure Consolidation and Outsourcing Initiative*, Report No.9, 2000-01.

<sup>2</sup> Department of Education, Electoral Commission, Department of Land Administration (Valuer General's Office), Office of State Revenue, Metrobus, Department of Police and Westrail.

<sup>3</sup> Report of the Independent Commission to Review Public Sector Finances, August 1993 (McCarrey Commission), Pages 138 and 144.

<sup>4</sup> The Council provided strategic and policy direction to government on contracting out mainframe computers, but the projects were managed as part of the broader CTC program by the then Public Sector Management Office.

This study<sup>5</sup>, delivered in July 1995, suggested that there should be three groupings:

- the BDMW consortium which was already being established;
- BIPAC (Business Information Processing Agencies Consortium) – this consortium was initially to include the agencies who at the time used the then Bureau Services as well as the Department of Housing and Works, the Department of Mineral and Petroleum Resources and the Totalisator Agency Board (TAB). In the end, however, the TAB did not join the Consortium; and
- SIPAC (Sensitive Information Processing Agencies Consortium) – this consortium was intended to comprise a cluster of agencies with sensitive government information [ie Department of Police, Department of Justice, Department of Community Development and the Department of Treasury and Finance’s in-house applications]. These agencies were to retain their computer operations within the public sector.

The rationale for this approach was that the two consortia contracts were expected to attract two competing large international IT companies to the State while SIPAC would be a repository for sensitive information as well as providing a public sector benchmark and a means of retaining IT skills in the public sector. However, while both the BDMW and BIPAC contracts were let (under a competitive tendering process), SIPAC did not proceed.

The BDMW contract commenced in June 1996 and the BIPAC contract in October 1997. Both contracts are due to expire in 2002, BIPAC in October (though some agencies have agreed to extend the contract to October 2003) while BDMW has been extended to December 2002.

With the imminent expiry of the two contracts, the Department of Industry and Technology has been developing a new approach to IT contracting, known as SPIRIT.

## Examination Focus and Approach

This review has examined the performance of the BDMW and BIPAC contracts in terms of whether:

- the objectives of the contracts which are capable of being measured (eg cost savings and service level improvement) have been achieved;
- risks associated with the contracts were identified and managed effectively; and
- good practice has been followed in the development, establishment and management of the contracts.

As both contracts are due to expire over the next two years, the review did not include a detailed analysis of the planning, establishment and tender processes. However, it has commented on key aspects such as IT contract management, the consortium approach, the open book and scorecard systems and the proposed new SPIRIT arrangement.

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<sup>5</sup> Love, R J – *Report to the Information Policy Council on Options for Reduction of Mainframe Computer Costs by Contracting Out*, July 1995.

### 3 INTRODUCTION (continued)

The review examined four agencies from the BIPAC contract and two from the BDMW contract. The agencies included in the review were the Department of Land Administration and Main Roads Western Australia (from BDMW) and the Department of Mineral and Petroleum Resources, the Department of Housing and Works, Office of State Revenue and the Department of Education (from BIPAC).

The methodology included:

- examining agency records to determine whether contract development, establishment and management (including risk management) had been undertaken appropriately;
- interviews with IT and end-user staff as well as management in each of the agencies selected for the review;
- examining financial records to determine contract expenditure and cost management by the agencies;
- examining the contracts and service level agreements to determine the basis and features of the contracts;
- examining agency data bases for independent data on service level performance;
- discussions with the Department of Industry and Technology about its role in the management of the contracts; and
- discussions with the contractor to obtain some additional information on the contracts.

# 4 About the Contracts

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- The BIPAC and BDMW contracts are key IT contracts both in terms of their value and the importance of the agency systems they support such as the State's taxation, land titles and electoral systems.
- Both contracts initially were mainly for mainframe services (though a wide range of IT services was available to agencies under the contracts) and are very similar in structure. The main difference between them is that agencies joined the BDMW consortium on a more voluntary basis than for BIPAC and their needs from the contract have been better aligned.
- Agencies that signed up to the contracts were allowed, and have exercised, a considerable degree of flexibility in the extent to which they have used the services provided under the contracts. In addition, the contracts have allowed agencies freedom to move in and out of them.

## Size and Importance of the Contracts

Spending on the BIPAC and BDMW contracts since they commenced has totalled about \$105 million – with current expenditure on each ranging from some \$11 million for BIPAC to about \$25 million for BDMW. They represent about 11 per cent of Western Australian government spending on IT contracting.

However, these contracts are also important because of the critical agency systems they support, including the:

- State's land titles system;
- State's mineral titles system;
- State taxation revenue collection and pensioner concession systems;
- Department of Housing and Works' housing management and rental systems;
- Department of Justice's offender management system; and
- State's electoral roll system.

## Membership and Structure of the Contracts

### Agency Membership

A major feature of the agency membership of the two consortia is the flexibility of the membership of both, with a number of agencies leaving and joining the contracts since their commencement (see Figure 1). Indeed, two agencies (the Department of Justice and the Department of Police) are currently members of both.

BDMW CONTRACT (a)		BIPAC CONTRACT (a)	
<i>Initially</i>	<i>Now</i>	<i>Initially</i>	<i>Now</i>
Department of Housing and Works (b) Department of Land Administration Main Roads Western Australia	Department of Industry and Technology (d) Department of Land Administration Main Roads Western Australian	Department of Mineral and Petroleum Resources Department of Housing and Works(f) Bureau Services Agencies: <input type="checkbox"/> Department of Education <input type="checkbox"/> Electoral Commission <input type="checkbox"/> Office of State Revenue	Department of Mineral and Petroleum Resources Department of Housing and Works Bureau Services Agencies: <input type="checkbox"/> Department of Education <input type="checkbox"/> Electoral Commission <input type="checkbox"/> Office of State Revenue
Water Corporation (c)	Department of Justice (e) Department of Police (e)	Department of Land Administration (Valuer General's Office)(h) Department of Police(h) Metrobus (i) Westrail (i)	Department of Community Development(g) Department of Justice(g)

Figure 1: Agency Membership of the BDMW and BIPAC Contracts.

*Some agencies have joined, some have left, and some take no services under each contract.*

Notes:

- (a) At November 2001.
- (b) The former Building Management Authority.
- (c) Withdrew from the contract in June 2000.
- (d) Formerly Department of Contract and Management Services. It has retained the BDMW contract with the Building Management Authority functions moving to the Department of Housing and Works.
- (e) Joined in May and August 1999 respectively for some of their administrative computing needs.
- (f) The former Homeswest.
- (g) Joined in August 1998 and June 2000 respectively.
- (h) Still signatories but do not purchase any services under the contract.
- (i) Wound down soon after contract was let.
- (j) Withdrew from the contract in October 2001.

Source: Department of Industry and Technology

In addition, the two consortia differ in the commonality of needs, attitude and approach of the agencies in them. BDMW was formed by four agencies with relatively common IT needs that believed they would benefit from joining together to outsource. In contrast, BIPAC was set up by government which selected and encouraged agencies to join the consortium. Some such as the Department of Mineral and Petroleum Resources joined reluctantly and only after receiving a financial incentive from government to encourage it to join the consortium. The differences in requirements between the agencies in each consortium are illustrated by the services selected by agencies at the start of each contract (see Figure 2).

Agency	Service <sup>(a)</sup>				
	Mainframe	Mid-Range	Wide Area Network	Local Area Network	DeskTop
<b><i>BIPAC Agencies</i></b>					
<input checked="" type="checkbox"/> Mineral & Petroleum Resources	✓	✓	✓	✓	✓
<input checked="" type="checkbox"/> Housing & Works (formerly Homeswest)	✓				
<input checked="" type="checkbox"/> Bureau Services Agencies					
<input type="checkbox"/> State Revenue	✓				
<input type="checkbox"/> Metrobus	✓		✓	✓	✓
<input type="checkbox"/> Electoral Commission	✓				
<input type="checkbox"/> Westrail	✓				
<input type="checkbox"/> Police	✓				
<input type="checkbox"/> Education	✓	✓			
<input type="checkbox"/> Valuer General	✓				
<b><i>BDMW Agencies</i></b>					
<input checked="" type="checkbox"/> Housing & Works (Building Management Authority functions)	✓				
<input checked="" type="checkbox"/> Land Administration	✓	✓			
<input checked="" type="checkbox"/> Main Roads	✓				
<input checked="" type="checkbox"/> Water Corporation	✓				

Figure 2: Services Selected by Agencies at Start of Contracts.

*BDMW agencies initially mainly took only mainframe services, while some BIPAC agencies selected a wider range of services.*

Notes:

<sup>(a)</sup> additional services that could be obtained under each contract included disaster recovery, consulting, project management and, for BIPAC only, application development.

Source: Agencies' Service Level Agreements

In summary, the BDMW agencies generally had a common need for mainframe services, while BIPAC agencies had the potential to access a broader range of IT services. Moreover, for the agencies examined, the Office of State Revenue, the Department of Education and Main Roads Western Australia have altered the type of services they selected since the contracts commenced. The Office of State Revenue and the Department of Education changed from mainframe to mid-range, while in 1998 Main Roads Western Australia added mid-range, server, wide area network and some other services to its list of services.

### Management of the Contracts Under the Consortium Approach

Under the “consortium” approach, the overall structures of the contracts were outlined in the “Head Contract” (for both contracts) and in the “Master Service Agreement” (for BIPAC). The Department of Industry and Technology is the appointed delegate under the Head Contracts to act on behalf of the government agencies.

However, the agencies involved have been able to maintain a large degree of independence both under the Head contracts and the “Service Level Agreement” each has with the contractor. The Service Level Agreements specify each agency’s particular relationship with the contractor, the types of services the agency requires, and the performance measures specified under the “Scorecard”.

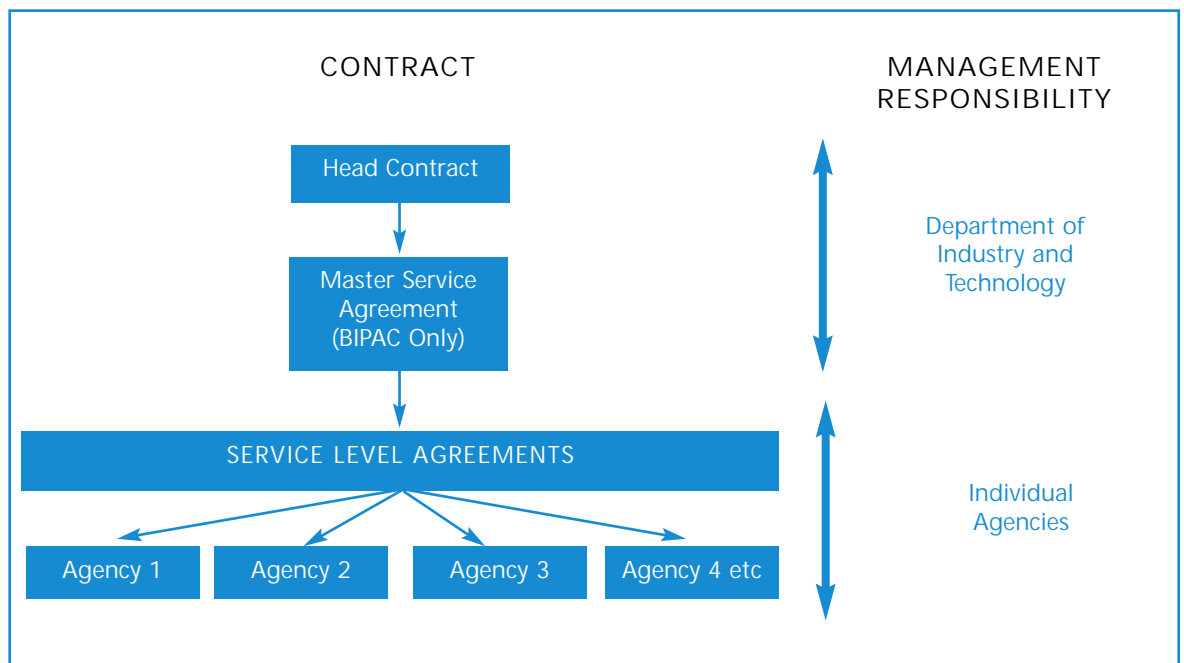


Figure 3: Contract Structure For BIPAC and BDMW.

*Common rights and requirements are specified in the Head Contract, and the Master Service Agreement (for BIPAC), while individual agency requirements are specified in their Service Level Agreements.*

Source: OAG

To cement the consortium approach, Memoranda of Understanding have been established under each contract to define the relationship between the agencies. In addition, a Partnership Agreement has been established between the agencies and the contractor.

Day-to-day management of the contracts is the responsibility of the individual agencies. However, the broad relationship is managed through a “Management Committee” comprising a representative of each of the agencies, the Department of Industry and Technology as the “delegate” and a representative of the contractor, and a higher level “Strategic Review Committee” comprising more senior representatives of each agency and the contractor.

## Key Features of the Contracts

The contracts are very similar, having both been drawn from the standard GITC (Government Information Technology Conditions Version 2) contract developed by the Commonwealth and a number of State Governments.

Some “cutting edge” features built into the two contracts at the time were:

- *Open Book Pricing* – this is essentially a “cost-plus” rather than “fixed price” approach to pricing. In each contract, the price was set as operating costs plus a margin to cover overheads (for BIPAC), a profit margin and a performance margin.
- *Scorecard System* – the Service Level Agreement for each agency contains a “scorecard” specifying the measures on which the performance of the contractor is assessed. This determines whether or not the full performance margin will be paid. The contractor provides each agency with a monthly report on its performance assessed against the measures outlined in the scorecard.
- *Incentive Approach* – the contracts provide for the contractor to receive either the full “performance margin” or a proportion of it depending on performance as determined by monthly “scorecard” measurements specified in the Service Level Agreements. In addition, the contracts specify a formula for sharing cost savings or cost overruns (from a budget set at the beginning of the year) between the agencies and the contractor.

## Flexibility in the Use of the Contracts

Under the contracts, agencies can still exercise considerable flexibility. For example, they can:

- effectively leave the contracts, either completely (as the Water Corporation did from the BDMW contract when it moved from a mainframe to mid-range computer environment) or remain a signatory to the contract while not using any services under the contract as is the case for the Department of Land Administration (Valuer General’s Office);
- alter the range of services they use under the contracts as part of their annual review of their Service Level Agreements. For example, the Office of State Revenue initially chose mainframe services, then when it returned after opting out for 12 months, selected mid-range support services;

- vary the proportion of their IT budget that they spend on each contract. The proportion of IT expenditure spent on these contracts by each of the agencies examined in this review range from as little as four per cent to as much as 51 per cent (see Figure 4);

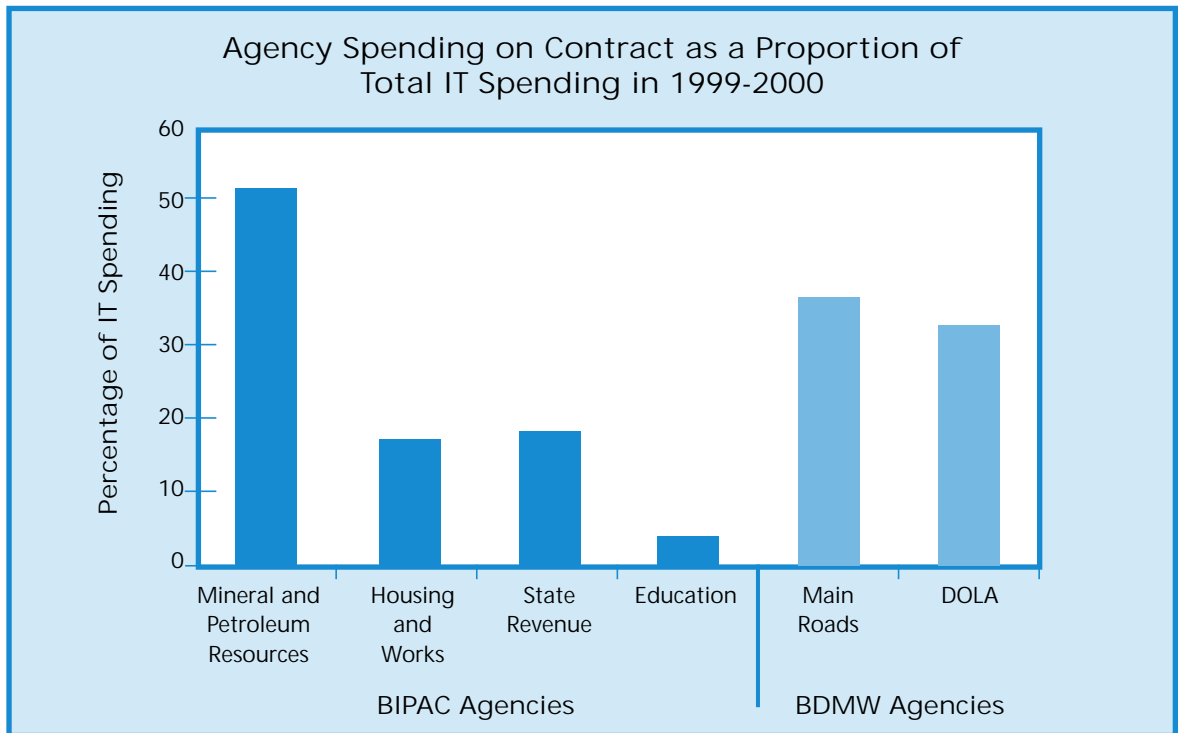


Figure 4: Agency Spending on the Contracts.

*The proportion of the IT budget spent on these contracts varies widely between the agencies.*

Source: Agencies

- alter the model under which they use services under the contract. For example, most agencies in the two contracts have transferred both equipment and staff for the contracted services to the contractor. Others have adopted a “managed labour supply” approach, retaining ownership of the equipment but contracting the staff to operate it.

## About the Contractor

While the BDMW contract was initially let to Ferntree, through a series of company takeovers, the current contractor under both contracts is CSC (Computer Sciences Corporation) Australia Pty Ltd.

CSC is a large worldwide IT company with its headquarters in North America. It has been in operation for over 42 years and offers a wide range of IT services including the full range of outsourcing services (ie business operations, data centre, desktop and applications management). CSC has operated in Australia since 1972 with its Australian headquarters in Sydney. It employs 550 people in Western Australia including over 100 working on national and international contracts.

# 5 Contract Objectives and Performance Measurement

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- The two contracts contained similar objectives such as cost (including staff) reduction, improved service levels, developing a competitive IT market place in Western Australia and greater flexibility in acquiring new technology and IT staff skills.
- In addition, BIPAC contained two whole-of-government objectives - to facilitate winding down of Bureau Services and to attract a competitor into the State for the then contractor under the BDMW contract.
- Some of the contract objectives are incidental benefits rather than targeted outcomes while others are not capable of objective measurement.
- In regard to the BIPAC whole-of-government objectives:
  - Bureau Services was wound down;
  - BIPAC was initially successful in attracting a competitor for Ferntree (the BDMW contractor at the time), but as a result of company takeovers there is now only a single contractor for the two contracts.

## What are the Objectives of the Contracts?

A number of specific objectives were listed in the two contracts. From the business case and associated government records, it was clear that BIPAC also had some whole-of-government objectives.

### Objectives in the Contracts

The objectives specified in the two contracts are:

- improved service levels;
- cost reduction;
- staff reduction;
- increased flexibility in the acquisition of new technology and associated staff skills;
- the development of a competitive market place for IT services available to the State of Western Australia; and
- increased private sector opportunities.

### Whole-Of-Government Objectives

The additional whole-of-government objectives for BIPAC were to:

- facilitate the winding down of Bureau Services ; and
- bring into the State an effective competitor for Ferntree (the BDMW contractor at the time).

## Achievement of the Objectives Specified in the Contracts

Assessment of the achievement of the objectives of improved service levels and cost reduction (including staff reduction) are provided in the following two chapters.

Of the remaining objectives, the contracts did expand the opportunity for the private sector to participate in the government's IT services. However, the other two objectives are not capable of objective measurement:

- *“increased flexibility in the acquisition of new technology and associated staff skills.”*

The available documentation did not make clear whether this was being targeted by the contracts or was merely stated as a possible advantage of outsourcing. If it was a target, it is difficult to objectively define let alone measure. However, some agencies advised that this flexibility had been a significant benefit to them.

- *“the development of a competitive market place for IT services available to the State of Western Australia.”*

Achievement of this objective is also not able to be objectively measured. To do so would entail having to define exactly what is “the market place for IT services” and to establish systems to measure the number of IT firms in the industry on an ongoing basis. Even then changes in the numbers of IT firms could not necessarily be linked to these two contracts.

## Achievement of BIPAC Whole-of-Government Objectives

In regard to the two whole-of-government objectives:

- *Winding down Bureau Services*

This objective was achieved with the transfer of the Bureau Services facility to CSC at the commencement of the BIPAC contract.

- *Competitor for the BDMW contractor*

When it was first let, BIPAC was successful in bringing in CSC as a competitor to Ferntree, the initial BDMW contractor. However, in June 1997 Ferntree was taken over by General Electric Capital Information Technology Solutions (GECITS) and in December 1999 GECITS was taken over by CSC.

As a result, both contracts now have the same contractor. There is still some broad competition for CSC in the State as Fujitsu operates payroll services for a large number of agencies. However, the direct competition generated by having two contractors under the contracts has not occurred since December 1999.

Following the CSC takeover of GECITS and resulting concerns raised by the local industry, CSC offered to provide subcontracts to local (ie Western Australian) small to medium enterprises in the industry to the value of at least 10 per cent of the revenue it receives under the two contracts.

CSC has provided two unaudited reports to government in September and December 2000 indicating that it had achieved this objective.

## Recommendations

- The Department of Industry and Technology and agencies should ensure that future contracts contain:
  - objectives that are clearly targeted outcomes and are worded in such a way as to be easily measurable; and
  - provisions to ensure that the contractor's rights under the contract cannot be reassigned in the event of takeovers, mergers, or other changes of ownership without the consent of the contracting agency/s.
- The Department of Industry and Technology should ensure that future IT contracting arrangements are structured to maximise competition among suppliers.
- The Department of Industry and Technology and agencies should assess at least annually the extent to which the objectives have been achieved.

# 6 Service Level Performance

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- Although improving service level performance was a prime objective in both contracts, only two of the six agencies examined have collected independent data to monitor service level performance.
- Only one of the agencies examined, the Department of Mineral and Petroleum Resources, collected independent service level performance data both before and after the contract commenced to enable an assessment to be made of whether service level performance has improved under the contract.
- Performance monitoring under the BIPAC contract was weakened by scorecards for a number of agencies not being reported for an extended period of time because they were “under development” or “under review”.
- Moreover, for BIPAC this monitoring responsibility was removed from the Management Committee by a variation to the contract in March 2000 reflecting the lack of review up to that time.
- The only other independent performance data collected was from a satisfaction survey by the Department of Industry and Technology of IT managers involved in the two contracts in 1999 and 2000 and a satisfaction survey of BIPAC computer users undertaken by the contractor in early 2000.

## Introduction

A primary objective in both contracts was to improve service levels. What this meant and how it was to be measured was left for each agency to determine in its Service Level Agreement. The Service Level Agreement contained a description of the services the agency required, linked to performance measures through a “scorecard”. The contractor provides all data and information for the service level performance measures included in the scorecard. These are reported in a monthly report to agencies.

In addition, the Management Committees were given the responsibility of regularly reviewing performance measures and objectives to ensure they remained relevant.

## Monitoring Service Level Performance

To check whether they are receiving “improved service levels”, agencies need relevant and useful measures. They also need a means of testing the reliability of data and information provided by the contractor.

Some agencies suggested during the review that under the partnership arrangement inherent in these contracts, they must show “trust” for the contractor. However, studies of contracting elsewhere have indicated that such monitoring is essential to ensure that the contract objectives are being achieved. This is especially so where remuneration is tied to performance as is the case for these contracts.

## Management Committee Review

For BIPAC, the responsibility for the Management Committee to scrutinise performance measures and objectives was removed by a variation to the contract in March 2000. This was understood to have been done to reflect the fact that performance objectives and measures had not been reviewed by the Management Committee up to that time.

## Checking Data Quality

In all but one of the agencies examined, the service level performance has not been monitored using independent (or audited) data:

- no evidence could be found of any agency under either contract undertaking systematic or even periodic audit of service level performance measures provided to them;
- while two BIPAC agencies collected independent performance data during the life of the contract, only one, DMPPR, collected performance data from its own system both before, and during the life of, the contract to enable measurement of improved performance;
- in one of the agencies under the BIPAC contract, only two of the monthly reports supplied by the contractor could be found on the files, while in another a copy of a monthly report for another agency was found to have been placed on that agency's files. These two examples suggest that there was little or no checking of the reports (which contain the monthly scorecards) by these agencies before they were filed; and
- the scorecards for a number of agencies under BIPAC were not reported for an extended period of time as they were "under development" or "under review". For example, one agency scorecard has been listed as "being developed" for the past three years. Moreover, in 1999, two of the seven agencies taking services under the contract had scorecards which were "suspended". In 2001, three of the eight agencies taking services had scorecards which were "being developed" or "under review". While this was the case, the contract required the full performance margin to be paid to the contractor with no means for the agencies concerned to be able to query this.

## Benchmarking

Assessment of any improvement in service level performance requires an agency to have collected performance data for a reasonable period before the contracts commenced for comparison.

For some agencies, because new mainframes have been purchased, or they have moved from mainframe to mid-range and/or networked systems since the contracts started, data collected on performance before the contracts commenced may not be directly comparable against the new systems. Ideally, these agencies should have collected data on current industry standards to enable them to assess the service level performance of the contractor.

However, only one agency collected independent data on a comparable basis both before and during the contract. No evidence could be found of agencies collecting benchmark service level performance information.

## Performance for the Department of Mineral and Petroleum Resources

Only DMPR collected independent data on service level performance before and after the BIPAC contract commenced.

DMPR has collected data from January 1996 to March 2001 for mainframe transactions, mainframe response time, the total hours the mainframe is not operating (ie outage time), problems handled by its helpdesk and support requests.

In addition, data on the total number of major outages for all services has been collected since February 1999.

As DMPR has consistently taken all services offered by the contractor since the contract commenced, the data is sufficiently comparable for the whole period. The results for mainframe services are outlined in Figure 5.

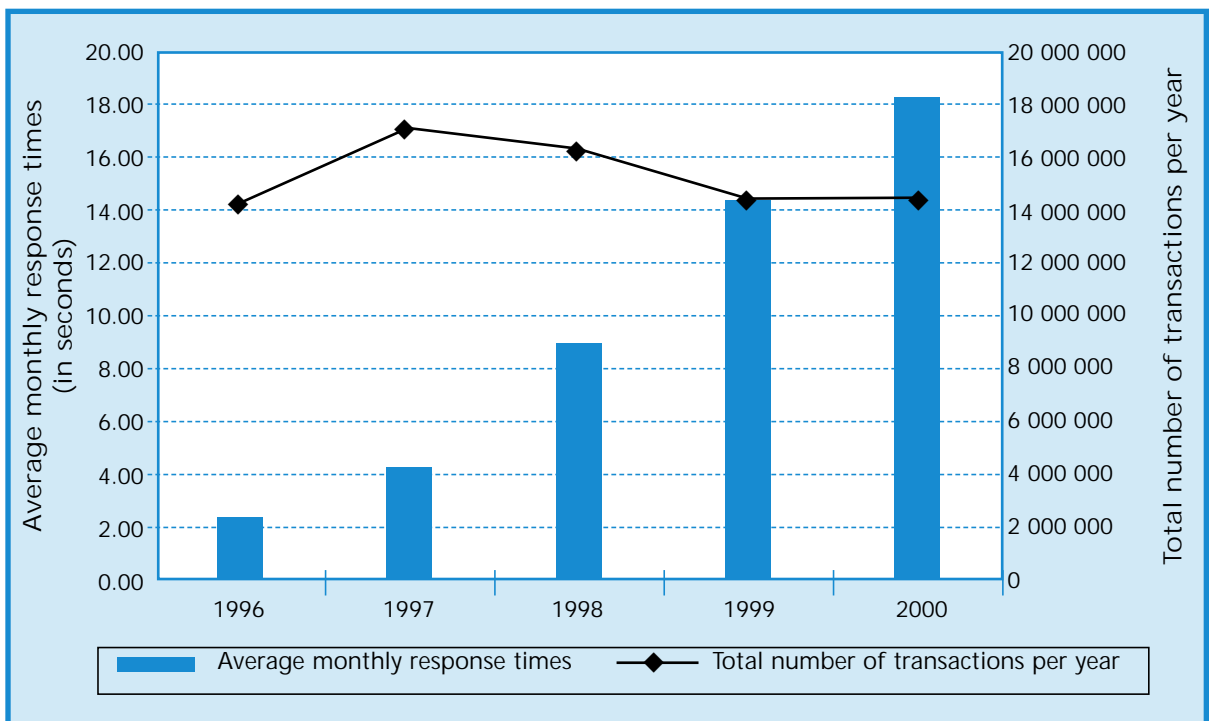


Figure 5: Mainframe Transactions and Average Response Times at DMPR.  
*Response times have increased while usage has stayed steady.*

Source: DMPR

The data (which relates to the performance of the mainframe services provided by the contractor) indicates that:

- the number of transactions through the mainframe has stayed quite steady since the contractor took over;
- the average response time of the mainframe has increased from 3.5 seconds before the contract commenced to 14.9 seconds subsequently<sup>6</sup>; and
- the total hours the mainframe is not operating (ie outage) has fallen from an average of 144.8 hours per year before the contract commenced to 63.3 hours per year since.

## Satisfaction Surveys

### Department of Industry and Technology (DOIT) Surveys

DOIT undertook surveys of the IT Managers of all the agencies involved in the two contracts in 1999 and 2000 for a report to its Minister. The results were also provided to the Strategic Review and Management Committees.

The surveys, which were developed by DOIT, measured the IT Managers' assessments of a number of aspects of responsiveness, quality of service, timeliness, communication and importance [such as management of standard services (BIPAC), achievement of cost management objectives (BDMW), content and reliability of monthly reports (both contracts)].

However, the DOIT surveys were not undertaken before 1999 (two years after BIPAC commenced and three years after BDMW started).

The results indicate that in broad terms, the BDMW agencies were generally more satisfied with the contractor than the BIPAC agencies. Moreover, "management of standard services" and "achievement of cost management objectives" were the most important issues for the BIPAC and BDMW agencies respectively. For these issues, timeliness and communication were the services with which agencies appear to have been least satisfied (though the results were still above the average).

### Contractor Survey of BIPAC Users

A survey of users in all BIPAC agencies by the contractor, in early 2000, indicated that 46 per cent (of those who expressed a view) were satisfied with the contractor's overall service.

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<sup>6</sup> The contractor has advised that this increase reflects a number of factors as well as performance, including a significant increase in the number of applications being processed and newer versions of the operating system that use more of the mainframe's processor and memory resources. It does not necessarily mean that response time to users is slower.

## Recommendations

- The Department of Industry and Technology should:
  - include provisions in contracts to ensure that performance data is independently validated; and
  - support and encourage agencies to undertake regular benchmarking of service level performance.
- Agencies need to:
  - establish service level performance measures which measure user requirements rather than technical requirements;
  - either collect independent performance data or regularly check, or audit, data provided by the contractor;
  - ensure that performance is monitored by someone who is independent of the contract manager; and
  - undertake independent benchmarking of the contractor's performance on a regular basis.

# 7 Cost Savings

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- Government was projected to save an average 10.7 per cent in expenditure on services purchased under each of the contracts.
- None of the agencies examined was able to demonstrate whether the expected cost savings had been achieved.
- Because it is not known with certainty what cost savings have been made under the contracts, agencies have limited information on which to make decisions about new contractual arrangements at the conclusion of the current contracts.

## What were the Expected Cost Savings?

One of the most important objectives of the contracts was the achievement of cost savings for both the agencies concerned and for government.

The expected cost savings from the two contracts were outlined in the business cases for the contracts using data provided by the successful tenderers after they had been selected. The estimates in the business cases informed Government's final decision to enter into the contracts.

The business cases for the two contracts suggested that savings to agencies:

- for the BIPAC contract – would be as low as 1.01 per cent of its expenditure on these services for one of the agencies and 10.7 per cent (\$4.4 million) of expenditure on these services for the whole consortium over the five years of the contract. This figure includes the savings from winding down Bureau Services; and
- for the BDMW contract – would range from 4.3 per cent to 22.4 per cent of expenditure on these services with an average saving of 10.7 per cent (\$3.3 million) for the whole consortium over the first three years of the contract.

The business case cost estimates for both contracts generally appear to have been compiled in a systematic and rigorous way, consistent with Department of Treasury and Finance guidelines that applied at the time.

## Are Cost Savings Being Achieved?

The review found that the agencies examined had failed to implement systems for monitoring the full cost of services provided under the contracts. While direct payments to the contractor can be identified, little if any information has been maintained on transition costs and on other agency management costs.

Consequently, agencies cannot demonstrate whether they are achieving the cost savings that were expected to occur with the contracts.

Had agencies annually updated the estimates in the business case, for example, of in-house cost vs outsourced cost based on services then being provided, they would now be in a position to state what cost savings had been made and would have sound information on which to make decisions about new contractual arrangements at the conclusion of the current contracts.

## 7 COST SAVINGS (continued)

In the absence of such data, this review attempted an estimate of the actual costs of the contract, as compared to those estimated in the business case.

It should be noted however that the agencies and the contractor believe that there has been growth in the volume and changes in the nature of the business, although no data was provided to support the claim about volume growth. They consider that these changes mean that the original business case estimates should be treated with caution.

They have also advised that annually, cost savings generally have been achieved by the contractor against the budget set for the year's expenditure.

The review considers that a comparison between business case and actual expenditure is appropriate, given that the business case estimates were those upon which government's final decision to enter the contract was made and given they were the source of the estimated 10.7 per cent cost savings announced at the commencement of the contracts.

It is acknowledged, however, that the resultant estimated cost savings are just that: estimates, and that estimation over a five year period is difficult in the rapidly changing IT environment. To the extent that data was available, adjustments were made to account for changes to the nature of the services, as claimed by the agencies.

The information available to the review suggests that:

- for the BIPAC contract, payments to the contractor have exceeded the original estimates by around \$1.8 million for the agencies examined<sup>7</sup>;
- for the BDMW contract, payments to the contractor have exceeded the original estimates by around \$1.7 million for the agencies examined<sup>8</sup>;
- any cost savings are likely to be eroded by the following factors:
  - the costs of managing the contracts were included in the business case for BIPAC (estimated at around \$180 000 per year for all agencies) but not for BDMW. Agencies did not collect data on this cost, but estimates obtained as part of the review suggest that for the four BIPAC agencies examined, contract management costs, at \$240 000 per year, were almost double those estimated in the business case. For BDMW, the costs for the two agencies examined are estimated to have averaged around \$150 000 per year;
  - transition costs (including contract establishment costs) at contract commencement were factored into both business cases (around \$330 000 for BDMW and \$2.5 million for BIPAC) but only one agency collected data on actual transition costs. The data for that agency indicated that its transition costs were around \$180 000 (after allowing for asset sales);

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<sup>7</sup> Measured over the four years of the contract for the Department of Mineral and Petroleum Resources and the Department of Housing and Works and two years for the Office of State Revenue and the Department of Education (to ensure comparability of the data).

<sup>8</sup> The BDMW agencies advise that they consider that cost savings have been achieved for mainframe services in the first three years of the contract (business case estimates were only available for the first three years) when the results of all the agencies in the contract are taken into account.

- ❑ adequate disaster recovery arrangements have not been made by all agencies under the contracts (see Risk Management chapter), although it should be noted that some agencies have separately made other arrangements. For the former Bureau Services agencies, disaster recovery was provided for in the pre-contract arrangements;
- ❑ for most agencies, the original staff reductions (which were factored into the business case estimates) have not been maintained though the subsequent increases may have reflected in part the changing nature of IT services in the agencies (see Figure 6);

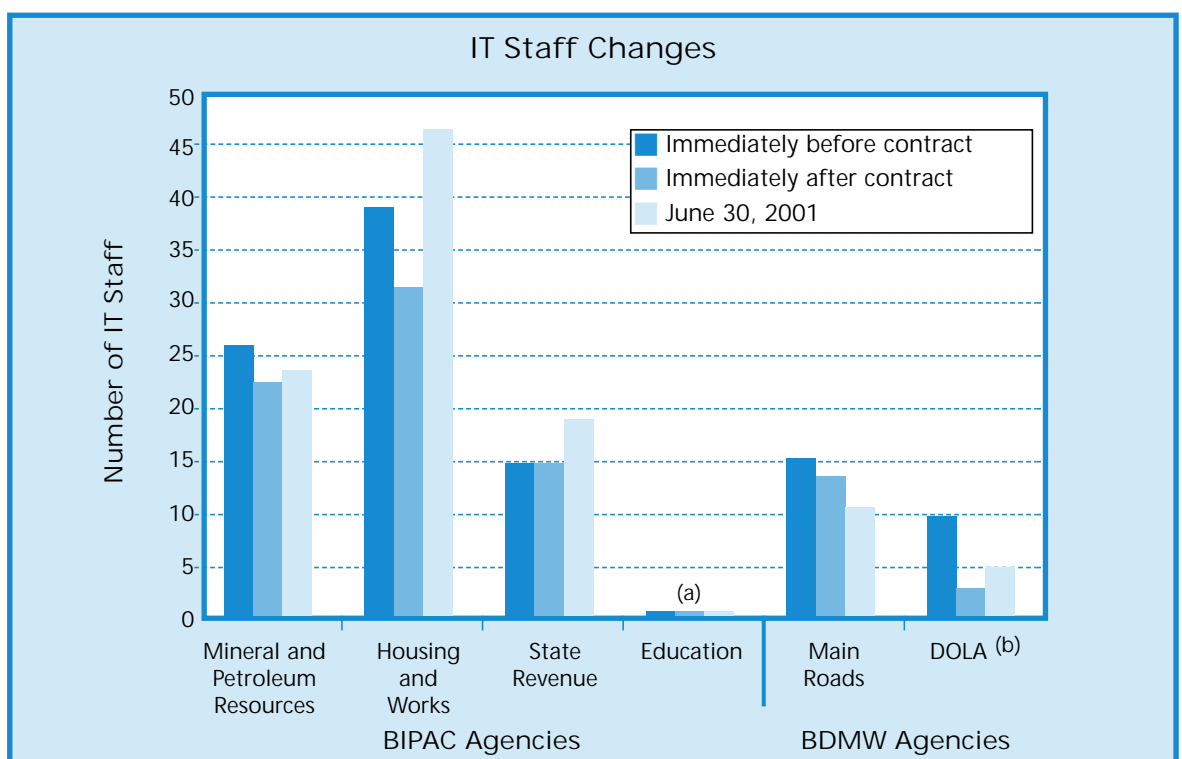


Figure 6: IT Staff Changes.

*The initial staff reductions generally have not been maintained.*

Notes:

- (a) Changes in IT staff for this agency are subject to too many other pressures in the agency to provide a meaningful indicator of what has happened under the contract.
- (b) Figures do not include application development staff as this activity has been significantly outsourced under separate contract arrangements.

Source: Agencies

- ❑ transition costs for the conclusion of the contracts of either bringing the services back in-house or transferring to another contractor have not been factored in. Estimates were provided by two agencies on the cost of bringing services back in-house. These ranged from almost \$300 000 for an agency with a small proportion outsourced to over \$1 million for an agency with a bigger proportion outsourced.

## Recommendations

- The Department of Industry and Technology should:
  - develop templates to enable agencies to establish a baseline estimate of the likely in-house costs of providing the contracted services so that they can assess the potential cost savings from continued contracting under SPIRIT and to monitor savings during the contract. These templates should be based on Treasury's 'Costing and Pricing Government Outputs – Guidelines for Use by Agencies' and incorporate all contracting costs such as transition and contract management costs; and
  - for mandated consortium, or whole-of-government contracts, monitor, and report to government on, cost savings to government on an annual basis using the information provided by agencies.
- Agencies should:
  - monitor annually the cost savings to them from outsourcing using the templates provided by the Department of Industry and Technology;
  - for whole-of-government, or mandated consortium contracts, provide the estimates to the Department of Industry and Technology to incorporate in its reports to government; and
  - establish systems to enable them to collect data on an ongoing basis on transition and contract management costs.

# 8 Use of Open Book Pricing and Scorecards

- The key features of the two contracts – open book pricing and scorecards (linked to an incentive system) – have not been used to maximise benefits to agencies from the contracts.
- The close scrutiny of contract charges required under the open book approach for the potential cost savings to be achieved has not been practised by most of the agencies examined.
- The structure of the scorecards used in these contracts has not been an effective way of monitoring, or improving, service level performance.

## Introduction

Two features of the contracts were the use of open book as the pricing system and scorecards to measure the performance of the contractor.

This chapter assesses the use of these two features in these contracts.

## Open Book Pricing

The contract uses open book pricing which is a “cost plus a margin” approach to pricing as opposed to a “fixed price” where the payment is determined in the contract. The differences are illustrated in Figure 7.

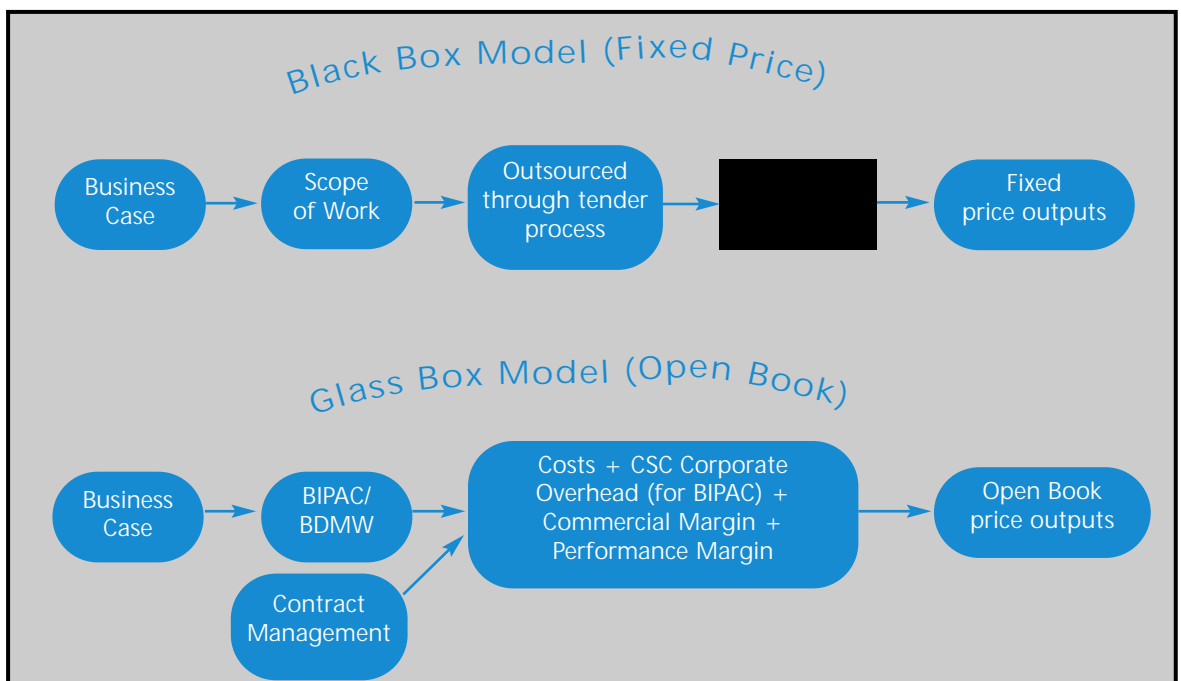


Figure 7: Open Book Model as Used in the BIPAC and BDMW Contracts.

*The structure of the contractor's costs is more open under the “open book” approach.*

Source: OAG

“Open book” refers to the requirement for the contractor to be “open” in the make-up of its costs. The approach taken in these two contracts is for the contractor to present a budget on its operating costs at the beginning of the year for scrutiny by DOIT and the agencies. The actual costs charged to each agency are then reconciled to the budget at the end of the year.

### Open Book Prices for the Two Contracts

The cost plus margin price structures under each of these contracts at present are outlined in Figure 8.

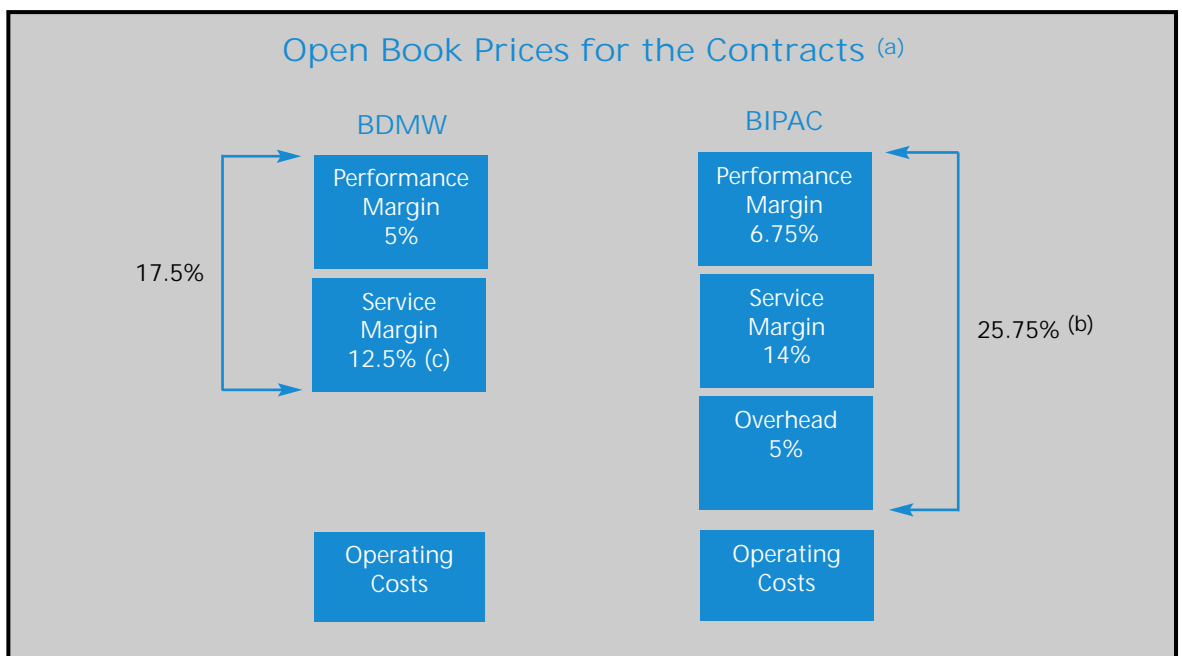


Figure 8: Open Book Prices for the Contracts.

*The open book approach requires contractors to be “open” about their costs.*

Notes:

- (a) As specified in the contracts.
- (b) On a strictly comparable basis, the BIPAC margin is 20 per cent.
- (c) Ten per cent for mainframe services.

Source: BDMW and BIPAC contracts

The review noted that, while the contract was let following a competitive tender process, a KPMG (non-financial) due diligence review on the BIPAC contractor in June 1997 found that margins in contracts elsewhere at the time which encompassed a broad range of services similar to the “end-to-end” service offered in BIPAC, were generally around 15 per cent to 20 per cent. The slightly higher BIPAC figure may, in part, have reflected the relatively small size of the IT market in Western Australia.

## Contract Management Under Open Book

The open book pricing approach can offer more opportunity than fixed prices to capture the benefits of reduced costs as technology improves. However, it requires much closer management of costs than a fixed price system. Close scrutiny of the contractor’s operating costs is needed throughout the year and especially in connection with the annual budget and reconciliation activities.

	Controls to Monitor Costs(a)	Regular Checking/ Reconciling of Invoices(a)	Regular Audits/Checks of Charges	Regular Benchmarking of Costs
BIPAC				
Mineral & Petroleum Resources	Yes	Yes	No	No
Housing & Works	No	No	No	No
State Revenue	Yes	Yes	No	No
Education	No	No	No	No
BDMW				
Main Roads	Yes	Yes	No	No
DOLA	Yes	Yes	No	No

Figure 9: Monitoring and Management of Contract Costs.

*No agencies regularly check the contractor’s charges and some do not monitor costs against monthly reports.*

Note:

(a) Monitoring and checking against monthly reports.

Source: Agencies

No agencies have undertaken regular audits, or checks, of the contractor’s charges, though some one-off checks have been undertaken by DMPR (in conjunction with the contractor). Moreover, not all agencies monitor costs and regularly check the invoices for these contracts against monthly reports provided by the contractor.

In addition, a review of the BIPAC contract in June 1999 undertaken by KPMG<sup>9</sup> for the Department of Industry and Technology indicated that the contractor ‘... complies with the “open book” arrangement and availability of agency level cost information.’ However, it noted that ‘... this was a time consuming exercise, as [the contractor] does not have a central storage facility for all invoices. Invoices may be stored in Perth or Sydney depending on the type of invoice.’ While the contractor was made aware of this concern no evidence was found in this review of this being further followed up by DOIT or the agencies.

9 KPMG – Business Information Processing Agencies Consortium: Contract Review, November 1999.

## Scorecard Approach

The scorecards are included in the Service Level Agreements and are reported on monthly by the contractor in the monthly reports prepared for each agency.

They have provided a mechanism for defining and measuring performance and establishing a linkage with the incentive system. They do this by defining the service level element being measured, the performance objective, the service level required, frequency of measurement, the method of measurement and the maximum score (reflecting the importance of the service level element to the agency's operation). To illustrate, an example from one of the agency's scorecards is provided in Figure 10.

Problem Management						
Service Level Element	Description	Performance Objective	Service Level	Measurement Interval	Method of Measurement	Score
Problem/fault management - first level help	Assistance provided by the person who answers the phone	Resolve 100% of problems	Problem resolved or referred to second level support within 30 minutes	Monthly	PABX, Help Desk records	5

Figure 10: Sample Scorecard Item.

*Scorecards define the performance objective, measurement and score for each service level element.*

Source: Agency Service Level Agreement

The scores for all of the service level elements add to 100 and the actual scores each month are used to determine whether the full performance margin (five per cent of budgeted costs for BDMW and 6.75 per cent for BIPAC) is paid to the contractor each year.

The actual performance margin paid to the contractor is determined at the end of the year on the basis of the number of months that a score of greater than 95 is achieved.

## Assessment of Scorecard Approach

The “scorecard” approach built into these two contracts ensures that each agency has agreed targets on which to measure the service level performance of the contractor. Moreover, the measures are reported monthly to the agency by the contractor. They are also linked to the contracts’ “incentive” systems (as outlined above).

However, a number of features of the scorecards and the incentive system developed under these contracts have detracted from their effective use. These include:

- *the complexity of the scorecards* – some scorecards contained a large number of individual measures, ranging up to 64 which in practice has been difficult for the contractor to report on each month and is too large to allow focus on key aspects of performance.

- *the technical nature of many of the indicators* – the indicators for most of the agencies were too focused on technical aspects rather than reflecting the requirements of users (ie outcome measures).
- *lack of incentives in the “incentive system”* – the intention was to have an “incentive system” in the pricing formula linked with the scorecard system. However, the way in which the linkage has been constructed has meant that it has worked as a “penalty” rather than a “bonus” system.
- *penalties are light for all except very poor performance* – the dollar penalties for a small slip in performance (eg only one or two months with less than 95 points) have been too light to be effective. For example, the value of penalties imposed by the one agency (under the BDMW contract) which has penalised the contractors significantly (ie more than 17 times) represented less than one per cent of its expenditure on the contract.

## Recommendations

- The Department of Industry and Technology needs to:
  - include provisions in future contracts to ensure that agencies have a clear mandate to query, check or audit contractor charges and invoices, particularly where open book pricing is used, and to require contractors to provide all relevant information, including invoices, to agencies within a reasonable timeframe;
  - explore effective bonus systems (as opposed to the penalty system contained in these two contracts) where performance measures are to be linked to an incentive system. An example is the system used in the building industry (where some of the payment can be withheld until performance is proven), the focus being to challenge the contractor to good, or better, performance.
- Agencies should:
  - ensure that the designated contract managers have the clear authority and executive support to ensure that they are receiving value for money from these contracts;
  - benchmark contract prices on a periodic basis;
  - ensure that, where scorecards are used for measuring service level performance they should:
    - include measures of user requirements, rather than technical measures; and
    - contain as few measures as is necessary to properly measure the contractor’s performance.
- The Department of Industry and Technology and agencies should ensure that when contracts are let and negotiated, their prices (and margins for open book pricing) are competitive.

# 9 Risk Management

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- The procurement and transition processes for both contracts were generally handled in a systematic, well documented and thorough way and the contracts appear to provide appropriate protection for the agencies.
- The main concerns with risk management of the two contracts are:
  - proper risk analysis was not undertaken for either contract as part of the procurement process;
  - disaster recovery arrangements have not been bedded down properly for mainframes or put in place for mid-range systems under the contracts for a number of agencies, leaving important agency systems supported by these computer services exposed;
  - effective ongoing management of the contract has not been implemented;
  - while DOIT has performed its “delegate” role under the contracts, it has not been proactive in providing support to, or clarifying its role with, the agencies. It has exacerbated this situation by introducing a charge for its services in July 2000 which is not specifically related to services it provides directly to agencies.

## Introduction

One of the main benefits of outsourcing is that it enables agencies to transfer the risks of ownership of assets to the private sector. In the case of IT services, agencies can also shift the risks of attracting and retaining appropriately skilled and experienced staff to the private sector (which has greater flexibility to provide the necessary incentives) as well as keeping up to date with the rapid technological changes which are a feature of the IT industry.

However, outsourcing does not eliminate risks. It merely substitutes one set of risks for another. Wherever contracts go wrong, the end responsibility for the performance of the service concerned still lies with the government. In this context, the main new risk faced by agencies when they outsource a service is the “loss of control”. For IT services, this might include loss of direct control over staff, which IT hardware/software is used, quality of base data, standards of confidentiality and security and timeliness of the service.

This risk can be managed by:

- selecting the right contractor (ie has the required skills, background, support, quality and is financially viable);
- establishing a contract which is fair, but provides the appropriate protection to the agencies;
- establishing meaningful and measurable indicators on which to assess performance against objectives;
- managing the contract effectively; and
- undertaking proper review of the contract before it is extended or ended.

The adequacy of the risk management for these contracts was assessed in this context. The overall framework used is outlined in Appendix 1.

## Selecting The Right Contractor

One way of minimising risks is to ensure that the process of selecting the contractor ensures that the successful contractor understands and is able to meet the needs of the agencies involved in each consortium. The selection process also needs to ensure that the contractor has the necessary skills, equipment and support; the quality systems and processes; and the financial robustness to complete the term of the contract.

### Procurement Process

The procurement process (including planning and tender specification, evaluation and selection) for both contracts was generally handled in a systematic and thorough way, though it should be noted that the tender process itself was not examined in detail.

The main concern the review found with the procurement process was the general lack of assessment of risk elements in the process and risk management strategies. An informal preliminary outsourcing risk assessment was undertaken for the BDMW contract early in the process in 1995 and the Department of Land Administration prepared its own internal risk assessment as part of its business case. However, the review found no evidence of a formal systematic risk assessment being undertaken which would have been broadly consistent with the current Standards Australia guidelines<sup>10</sup> (ie identified the risks, the likelihood of the risk and the impact of the risk). No risk assessment was found for the BIPAC contract.

### Contractor Failure

A big risk with contracting is the possibility that the private sector contractor may fail at some point leaving the agency with the option of bringing the service back in-house or having to transfer the contract to another contractor. Both of these options may be difficult and expensive, given the loss of skills and equipment, at short notice and with little market testing.

From the evidence the review found, it would appear that this risk was addressed adequately as:

- independent experts were brought in to undertake both financial and non-financial due diligence on Ferntree under the BDMW contract and CSC under the BIPAC contract. Moreover, under the BIPAC contract CSC also conducted due diligence on most of the agencies involved;
- the tender evaluations for both contracts were structured to focus on financial capability and the capacity of each tenderer to deliver the service.

### Quality Assurance

A further risk with contracting services is that the contractor does not have the processes and systems in place to provide a quality service at the standard required for the agencies' purposes.

Both the BDMW and BIPAC contracts called for the contractors to have quality certification (ie ISO 9001). All contractors under each contract have had this certification.

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<sup>10</sup> Standards Australia – *Guidelines for Managing Risk in Outsourcing, Utilising the AS/NZS 4360 Process*, Sydney, 2000.

## Contractual Protection

### The Contracts

Much of the protection for the agencies must come from the contracts as they define the relative rights of the agencies and the contractors.

Being based on the standard “Government Information Technology Conditions (GITC)” developed by the Federal and State Governments, the two contracts contain the key protective features required for the agencies.

### Confidentiality Deeds

The contracts required all contractor staff involved with them to sign “Confidentiality Deeds” to ensure continuing confidentiality of agency information. This was important given the significance and sensitivity to government of the systems in the agencies supported by the computer services provided under the contracts.

There was no evidence of agencies seeking regular assurance that confidentiality deeds were in place for all staff associated with the contracts.

The contractor provided evidence to the audit that staff who transferred to it from agencies had signed confidentiality deeds but not for other staff associated with the contracts.

### Disaster Recovery Plans

A major concern with risk management under the contract which emerged during the review was that disaster recovery arrangements have not been properly put into place in a number of agencies.

The contracts required the contractor to prepare Disaster Recovery proposals though implementation was at the discretion of each agency. Agencies wishing to implement Disaster Recovery Plans under the contract, specified this together with the basis of implementation in their service level agreements.

Disaster Recovery proposals were prepared in the early days of the contracts for each agency’s mainframe services<sup>11</sup>. According to the BIPAC contract review undertaken by KPMG on behalf of the Department of Industry and Technology in November 1999,<sup>12</sup> disaster recovery tests had been performed only once for each of the mainframes whereas the contract requires annual testing. Moreover, testing does not appear to have been completed. For example, according to the KPMG report, follow-up tests for the failed components of the disaster recovery test for one agency were not performed, while the test for another agency was only an informal, rather than a full test.

A further concern outlined in the KPMG report was that Disaster Recovery Plans for non-mainframe platforms had not been put in place. The contractor believed that the BIPAC contract did not require it to put in place plans for mid-range platforms. At the time of this review, the contractor had prepared Disaster

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<sup>11</sup> For example, the Department of Housing and Works has advised that it has had a disaster recovery plan and site (initially at its own head office, then at a Victorian site and now plans are underway to test an alternative Western Australian site) since the start of the BIPAC contract.

<sup>12</sup> KPMG – Business Information Processing Agencies Consortium: Contract Review, November 1999, P.11.

Recovery proposals for mid-range platforms for each agency under the two contracts, but only Main Roads Western Australia had implemented a plan under the contract. The Department of Land Administration has advised that it has now also agreed to implement its plan under the contract and the Department of Education has indicated that it has implemented arrangements outside the contract.

The agencies examined indicated that their reticence reflected the likely costs of the proposals. For example, one agency has estimated that it will cost almost \$300 000 a year to implement its proposals. The cost of disaster recovery is an industry-wide issue and is not peculiar to these contracts. It remains a concern, regardless of the contracts, that by not having up to date plans in place, a major failure in one of these systems could result in severe disruption to agency business functions. As indicated previously, some important government systems are supported by the computer services provided under these contracts by the one contractor.

## Managing the Transition

The transition from an in-house service to a contractor poses significant risks in terms of ensuring for:

- equipment: that all relevant equipment has been identified and valued properly; the systems of the agencies and contractors are comparable; the systems are correctly specified; and there is adequate computer capacity; and
- staff: that relevant agency staff who have a good understanding of the agency's equipment and systems transfer to the contractor to ensure the smooth transition of services.

For both contracts, substantial and detailed transition planning was undertaken including detailed lists and valuations of equipment, compatibility of equipment and systems, analysis of capacity and plans for transfer. These were set out in detailed plans and in schedules to the contracts.

## Contract Management

One of the two risks identified in the 1995 report for the Information Policy Council in the lead up to the BIPAC contract was "contract management".

Once the contractor has been selected, and the contract and measuring systems have been set-up, the contracts must still be managed actively and effectively.

Being consortium contracts, the management of the BDMW and BIPAC contracts is quite complex with DOIT being required to coordinate and manage these contracts from a whole of government perspective, and agencies being required to manage the contracts from their own viewpoint. At the same time, Management Committees were established under each contract to help ensure the required cooperation between the agencies to achieve the maximum benefits from consortium contracts.

## Contract Management by Agencies

The most important level of management of the contracts is by the agencies through their Service Level Agreements.

The evidence elsewhere in this report is that contract management has not been strong in most agencies.

The lack of monitoring of performance in achieving the contracts' objectives evident elsewhere in the report was borne out by the fact that while all agencies had clearly designated (ie in writing) managers for these contracts, the extent of contract management experience, skills, qualifications, or training of the designated managers varied between the agencies.

One issue that emerged from the review was that some agencies (particularly under the BDMW contract) had designated contract managers early in the contract who were involved in the negotiation and establishment of the contracts and, as a result, had detailed knowledge of the contracts. However, once these officers moved on their replacements did not have the same detailed knowledge of the contract. Moreover, the review found no evidence in any agency of contract manuals or any other documentation to help build up the knowledge of new contract managers, or other staff involved in the contract. DOIT has indicated that it does provide support to agencies in interpreting the contracts, but this service has not been actively used by agencies.

## Management Committees

The Management Committees were established under each contract with primarily a monitoring and coordinating role.

In practice, however, the effectiveness of the BIPAC Management Committee has been hampered by low attendance. For example, in 1999 and 2000, on average 37 per cent of agencies were absent from BIPAC meetings compared with 20 per cent of agencies for BDMW meetings. An additional issue is the presence of the contractor which means that the Committees have not provided a forum for agencies to discuss their common experiences under the contracts.

## Role of Department of Industry and Technology (DOIT)

This review did not undertake a thorough examination of how well DOIT has carried out its responsibilities as the "delegate" under the two contracts, though it was evident from the examination that it had undertaken the essential tasks of the delegate.

However, a number of issues that emerged during the review were:

- although DOIT was nominated by the Government as its "delegate" under these contracts, in July 2000 it began charging each agency \$600 per month (which yielded revenue of \$66 600 in 2000-01) for its services under the two contracts in line with government requirements. DOIT has advised that it is only charging part of the cost of the service which it estimates at \$168 000 per year (based on the Government Buying Services costing model of 2000). However, agencies are not clear on exactly what services DOIT is charging for (ie for direct services provided to them or for its overall role as the "delegate") and how the charge is calculated;

- agencies indicated during the review that they were unsure of their responsibilities compared with those of DOIT. On examining the responsibilities of DOIT as the delegate under the two contracts, potential areas of overlap do exist. Some of these are:
  - ensuring contract conditions are met;
  - ensuring expected cost benefits are delivered to the Government;
  - protecting the Government's returns on investment;
  - effectively managing the risks in the interest of the State;
  - conducting periodic benchmarking;
  - managing the key performance indicators of the contract;
  - facilitating the budget process (including the annual reconciliation process).

These are all responsibilities agencies should undertake in managing their own Service Level Agreements. In addition, while there is a role for DOIT in drawing data from the agencies to assess performance against the broad objectives of the contracts, its role in coordinating this information and how it is used needs to be clearly differentiated from the role of the agencies.

- While DOIT provides support to agencies as well as filling a mediation/facilitation role, it has not been proactive in supporting agencies in managing their Service Level Agreements.

## Recommendations

- The Department of Industry and Technology should:
  - examine ways of helping agencies to better manage contracts, including establishment of specialist contract management advice units and the development of IT contract management training programs;
  - clearly delineate its role from that of agencies in the management of consortium, or whole-of-government, contracts;
  - specify to agencies precisely what any charges it imposes on them are for. Preferably, these should be only for direct services provided to the agencies; and
  - for consortium-style contracts, establish forums which are not attended by the contractor for agencies to share their experiences and identify strategies for maximising the benefits to agencies.
- Agencies need to:
  - ensure that outsourcing decisions and procurement and transition processes are undertaken in accordance with State Supply Commission guidelines. As part of this process they should undertake a thorough risk assessment in accordance with the Standards Australia guidelines;

- ❑ ensure that appropriate disaster recovery arrangements are put in place as soon as contracts commence and are maintained thereafter;
- ❑ ensure that contractors comply fully with any confidentiality requirements;
- ❑ ensure that they have contract managers with clearly designated responsibility for these contracts;
- ❑ ensure that contract managers have skills or experience in IT and contract management and receive appropriate training so that they maintain and improve their contract management skills;
- ❑ wherever possible, provide contract managers with a career path to ensure that they can attract people with appropriate skills to these positions; and
- ❑ develop contract manuals and other succession mechanisms to protect corporate knowledge and to ensure a smooth transition when contract managers move on to other duties.

# 10 Future IT Contracting Plans – SPIRIT

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- DOIT is developing a replacement IT contracting system which will include replacements for BIPAC and BDMW when they expire in 2002 (though some BIPAC agencies have extended to 2003).
- SPIRIT appears to be a step forward in IT contracting from BDMW and BIPAC to the extent that it allows greater choice for agencies. However, to be most effective it will need to take into account the lessons learned from BIPAC and BDMW outlined in this report.

## Introduction

With both contracts due to expire towards the end of 2002 (though some BIPAC agencies have extended to 2003), the Department of Industry and Technology has been developing a replacement IT contracting system for the BIPAC and BDMW contracts, known as SPIRIT.

While the new system is initially targeted at replacing these two contracts, it is intended as a public sector wide IT contracting system.

## What is SPIRIT?

At the time of finalising this review, the exact structure of SPIRIT was still being developed.

However, DOIT has advised that the main features of SPIRIT are that:

- it will be voluntary – the aim is for agencies to be free to use SPIRIT, undertake their own contracting arrangements or provide the services in-house, unless government decides there are reasons for a particular arrangement to be mandatory. In addition, contracts will not be consortium contracts unless agencies see benefits from establishing one themselves;
- it will be essentially a common use, or panel, contract. In the first stage of the arrangement, suppliers will be registered and listed according to attributes such as the services or goods they can supply; the value of goods and services they can supply; and the level of insurance cover they can afford. Agencies will then be able to select contractor/s to supply the goods or services they are seeking by either obtaining quotes or undertaking a full tender depending on the value of the contract;
- the pricing systems (ie fixed price, open book etc) will be able to be varied from contract to contract;
- the head contract will be based on the GITC 3 contract terms and conditions, with individual agency arrangements being defined in Service Level Agreements;
- the panel of suppliers and services will be “refreshed” every few years taking into account IT trends and experience with the arrangements to that point;
- competitive tension will be facilitated by requiring suppliers to disclose information such as prices, value of sales, what services and goods are being supplied, and the agencies they are dealing with; and

- DOIT’s role will be to:
  - manage the arrangements through, for example, negotiation of terms and conditions in the head contract and refreshing the supplier panel;
  - assisting with consortium type arrangements, including pro-actively encouraging agencies to buy as a group where there are clear economies of scale;
  - encouraging agencies to buy through these arrangements; and
  - establishing standard buying rules, procurement processes, contracts and terms and conditions.

## Assessment of Current SPIRIT Proposals

SPIRIT appears to be a step forward in IT contracting from the consortium approach of BDMW and BIPAC to the extent that it provides greater choice to agencies in whether they use SPIRIT and the degree to which they use it.

It also has the potential to allow agencies access to a wide range of IT service providers, rather than just one as under the BIPAC and BDMW contracts. Moreover, SPIRIT should reduce the cost of procurement for agencies and, to the extent that information on prices and value of sales and services will be provided publicly, could facilitate greater competition between service providers. In addition regular “refreshing” of the panel of suppliers and services potentially will allow the rapid changes of the IT area to be taken into account in the contracting arrangements.

However, for SPIRIT to operate most effectively, it will need to take into account the lessons learned from the BDMW and BIPAC arrangements outlined in this report. Some particular concerns are:

- although SPIRIT has largely been developed, its objectives have not yet been clearly enunciated. For example, it is not clear whether SPIRIT is aimed at providing value for money for agencies, developing the local IT industry, or both. Whatever the objectives, the lesson from BIPAC and BDMW is that if the success of the arrangements is to be evaluated properly the objectives must be clearly targeted with measurable outcomes. The contractual arrangements of the agencies will also need to contain clear and measurable objectives so that their success can be measured;
- while “refreshing” the panel of suppliers and services will allow them to be kept up to date, it could blur the evaluation of SPIRIT. Consequently, SPIRIT should be thoroughly evaluated whenever it is “refreshed”;
- both the Department of Industry and Technology and the agencies will need to establish systems to enable them to measure value for money (ie cost savings and performance) on an ongoing basis. In addition, the contracts will need to contain provisions allowing agencies to audit, or check, charges and performance information provided by contractors, particularly if an open book pricing approach is used;

- the SPIRIT arrangements should not absolve agencies from undertaking thorough assessments of the benefits and costs of outsourcing (eg needs analysis, business cases, risk analyses etc) before they do so, especially for contracts which involve significant outlays; and
- the SPIRIT arrangements do not address the problem of the need for improved contract management skills. These will need to be built up through training and experience for the contract managers and with support from the Department of Industry and Technology regardless of SPIRIT. The recommendations on this in the Risk Management chapter will also need to be implemented.

## Recommendations

- DOIT needs to ensure that the recommendations in other parts of this report are taken into account, particularly those relating to future evaluations of the arrangements. Clear and measurable objectives need to be established up-front for the SPIRIT arrangement and in agency contracts. Moreover, whenever SPIRIT is refreshed, its success to that point will need to be properly evaluated; and
- both DOIT and the agencies will need to establish systems to enable them to measure in-house costs up-front so that cost savings can be measured under the new contracting arrangements, value for money on an ongoing basis and to ensure better management of the contracts.

# Appendix 1 – Risk Management Assessment Framework

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The risk management of these two contracts was assessed on the basis of whether:

- appropriate processes were undertaken to select the right contractor.
- appropriate protection was provided to agencies under the contract.
- the transition process was undertaken effectively.
- the contract has been managed effectively.

Proper review and evaluation of contracts should also be undertaken before contracts are renewed or ended. However, this was not considered for this exercise as the contracts have not yet expired and given the development of a new IT contracting approach to replace these contracts.

Exactly what aspects of risk were examined was based on issues identified in:

- the IT Contracting Guidelines compiled by the Information Policy Council<sup>13</sup>. These guidelines were consistent with the guidelines in the Competitive Tendering and Contracting Manual<sup>14</sup> prepared by the Public Sector Management Office and the State Supply Commission's Supply Policy Manual<sup>15</sup>.
- the "Generic Risk Identification Table for IT Outsourcing" prepared as part of the Humphry Report<sup>16</sup> on the Federal Government's IT outsourcing program. This table was derived from, and is consistent with, the Standards Australia Guidelines for Managing Risk in Outsourcing<sup>17</sup>.

## Selecting The Right Contractor

The aspects considered were:

- was the procurement process handled in a systematic and thorough way, including:
  - were the business needs of the agencies well defined, consistent with the objectives of the agencies, well documented and available to the tenderers during the tender process;
  - was the process planned and coordinated properly (ie were there extensive procurement plans, implementation plans, timetables and other planning documents; was the process coordinated well through the establishment of committees comprising all agencies; and were proper business cases prepared);
  - was the tender process undertaken properly and well documented (ie were there clear and relevant criteria, were stakeholders consulted, was value for money considered, were the Supply Commission guidelines complied with, and was the evaluation team representative and well skilled);
  - did the agencies in the consortium have sufficient independence to specify their own requirements, service levels, and performance measures;

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13 Information Policy Council – IT Contracting Guidelines for Systems Development and Systems Maintenance, Guideline No 7.7, November 1996.

14 Public Sector Management Office, *Competitive Tendering and Contracting Manual*, July 1995.

15 State Supply Commission, Western Australia – *Supply Policy Manual*, June 1996.

16 Richard Humphry – *Review of the Whole of Government Information Technology Outsourcing Initiative*, Appendix 11, December, 2000.

17 Standards Australia – *Guidelines for Managing Risk in Outsourcing Utilising the AS/NZS 4360 Process*; Sydney 2000.

- was a risk assessment of the process undertaken that would have been consistent with the Standards Australia Guidelines in that, as a minimum, they considered the risks, their likelihood, their impact and possible management measures.
- were the risks of contractor failure addressed adequately in the structure of tender evaluation criteria and was an independent and thorough due diligence undertaken on the successful tenderer.
- was the risk of the supplier not being able to provide a service of the appropriate quality (ie provide the service wanted reliably at the appropriate standard) addressed through the evaluation process, checking of references, and relevant ISO certification.

## Contractual Protection

The examination considered the following aspects of whether the contracts provided adequate protection to the agencies:

- was the standard “Government Information Technology Conditions (GITC)” contract used as a basis for the contract.
- were the following protective features built into the contract:
  - were the rights and responsibilities of the agencies and the contractors clearly defined;
  - was the contract subject to Western Australia’s laws so that any litigation would have to be in this State;
  - was there an escalating dispute resolution process;
  - were there clear expiry and rollover provisions;
  - were key aspects for IT contracts such as confidentiality and disaster recovery requirements included;
  - were the agencies protected through requirements such as the contractor having to disclose any litigation against it, provide performance and other guarantees, meet specific insurance requirements, locate source code and all services in Western Australia and provide access for the Auditor General.
- were key requirements such as insurance requirements, performance and other guarantees, confidentiality requirements and disaster recovery arrangements properly implemented.
- were agency services and business needs well defined, key performance measures identified and measurable, and minimum service levels defined in the contract or associated service level agreements.

## Transition Management

This review assessed whether:

- sufficient transition planning had been done for equipment being transferred – including whether detailed lists and valuations of equipment had been compiled, compatibility of the contractor’s and agencies’ equipment and systems had been examined, the capacity of the contractor to meet the agencies’ needs had been considered and detailed transfer plans (over an adequate period of time) had been prepared.
- staff had been kept adequately involved in the tender process and informed of what was happening and what their options and transfer benefits were. In addition, were key staff identified and encouraged to remain in agencies.
- detailed transition plans had been prepared.

## Contract Management

The review examined whether:

- measurement systems for both cost savings and service level performance were established.
- there had been independent validation of costs (particularly under the “open book” approach) and service level performance.
- there had been active management of costs and service level performance.
- there were designated contract managers with appropriate skills, experience and/or training IT contract management.
- the Management and Strategic Review Committees were effective in achieving economies of scale for the agencies.
- The Department of Industry and Technology undertook its “delegate” and agency support role effectively (though a thorough audit was not undertaken of DOIT’s role).

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