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18 May 2012

The Hon. Mike Baird, MP
Level 36 Governor Macquarie Tower
1 Farrer Place
SYDNEY NSW 2000

NSW Business Chamber Submission regarding the Commission of Audit

The NSW Business Chamber is pleased to present the NSW Government with a submission regarding the *NSW Commission of Audit Interim Report on Public Sector Management*.

The NSWBC is one of Australia's largest business support groups, helping around 30,000 businesses each year. Founded in 1885, the NSWBC works with thousands of businesses, from owner operators to large corporations, from product based manufactures to service provider enterprises. The Chamber is a leading business solution provider and lobbying group with strengths in workplace management, occupational health and safety, industrial relations, human resources, international trade and improving business performance.

Operating throughout a network in metropolitan and regional NSW, NSWBC represents the needs of business at a local, State and Federal level, advocating on behalf of its members to create a better environment for industry.

The need for a Commission of Audit

Conducting a Commission of Audit was the central recommendation from our **10 Big Ideas to Grow NSW** policy campaign. We saw the Commission of Audit as a necessary precursor to drive the change necessary throughout Government to improve performance. We also believe that the Commission of Audit will create a culture of continuous improvement within government to drive productivity and produce better outcomes for citizens and businesses.

The Government's adoption of this recommendation has therefore been strongly welcomed by the NSW Business Chamber – the Commission of Audit represents an important building block in helping the NSW Government deliver better services and operate more efficiently.

The Chamber has a keen interest in ensuring that the Government gets value for money in service delivery, and looking at State Budgets in a more sophisticated way than a simple tradeoff between less services or higher taxes.

To support our thinking in this area, the NSW Business Chamber is currently finalising a research piece examining the different models of contestability and competition that might be applied in the NSW public sector, which we expect to launch in mid-June. It is hoped that this report will provide government decision makers with a toolkit to assist them with reforming government service delivery.

NSW Business Chamber Limited
140 Arthur Street
North Sydney NSW 2060

ABN 63 000 014 504

Locked Bag 938
North Sydney NSW 2059

DX 10541 North Sydney

t 13 26 96

f 1300 655 277

e navigation@
nswbusinesschamber.com.au

Regional Offices ACT, Mid North Coast, Western Sydney, Northern Rivers, Hunter, Murray/Riverina, Illawarra, Southern Sydney, Northern Sydney, Central Coast

The Schott Report

The Government tasked the audit team with examining “*public sector management and service delivery issues through case studies which illuminate specific and systemic weaknesses in management and expenditure. It will identify reform opportunities and appropriate performance objectives for public sector management and service delivery.*”

The Interim Report focussed on, and made recommendations in relation to, four fields of government operations:

- Structure and accountability;
- Financial management;
- The management of people; and
- Asset management.

Structure and accountability

Getting the structure and accountability frameworks within government right is a critical foundation on which the day to day management of government can be built. The diverse range of bodies and representatives operating within the government sector need to have clearly defined roles and responsibilities to ensure smooth operations, and activities and decisions need to be carried out in an open and transparent way to provide assurance to the community that government business is being conducted in a proper fashion.

The Schott Review makes a number of recommendations in relation to reforming structure and accountability within the NSW Government, and the NSW Business Chamber is broadly supportive of all the recommendations being put forward.

Recommendations focussed on improving clarity of roles and responsibilities for key players within clusters should be encouraged, as should recommendations for greater centralisation of service delivery within clusters. Such reforms will improve the operation of clusters and streamline support service delivery, with potential administrative savings flowing from this.

We note that recommendation 34 calls for greater integration of support services (such as human resources and finance) within clusters. While this is a useful first step, it would be even better if such streamlining could occur between clusters and not just within them. While the composition of the various clusters is fairly stable at the present time, change within these portfolios is inevitable over time as priorities change, and functions and entities are likely to be shifted from one cluster to another to match these changing expectations. Achieving the proposed streamlining between clusters would help to facilitate such transfers of responsibility.

Financial management

The activities of Governments are financed using the money of taxpayers. Every dollar wasted is either a dollar of services that the Government can no longer deliver, or an additional dollar of taxes that the Government needs to raise. In addition, failure to properly manage expenditure and revenues at a macro level will lead to an unsustainable fiscal position and spiralling government borrowings. For these reasons, it is critical that expenditure is managed carefully, and sound financial management practices are an essential prerequisite to achieving this.

The Schott Review has made a number of recommendations focussed on improving accountability, fiscal discipline and transparency of reporting. These are all admirable objectives which are supported by the NSW Business Chamber.

The Government’s financial frameworks cannot function effectively in the absence of well defined and enforced financial accountabilities. Unfortunately, the Schott Report found that “*over recent years there has*

been a systemic and pervasive failure in financial management accountabilities.”¹ Problems identified included blurred accountabilities and unclear responsibilities, a reluctance to enforce fiscal frameworks where budgets were not met, and a failure to properly empower key positions with the powers needed to fulfil their obligations (with a particular focus on hamstrung CFOs). The recommendations set out in the Schott Report designed to target these problems should be implemented as a matter of priority.

Fiscal discipline is essential to keep the NSW Budget on a sustainable footing, and improvements in financial management will assist the Government with meeting its fiscal accountability objectives. Expenses have been growing more quickly than revenues for some time, and such an approach to fiscal management is clearly unsustainable in the longer term. While the Government made some significant progress towards improving the fiscal position in the last Budget, more needs to be done and the implementation and commitment towards delivering a sound fiscal strategy is strongly supported. The NSW Business Chamber was also encouraged by the government’s decision to formally reflect its fiscal consolidation strategy by amending the *Fiscal Responsibility Act*.

While reductions on the expense side will be needed to improve the fiscal outlook, the Report correctly recognises the false economy nature of poorly targeted expenditure cuts. While the business community is of the view that all Governments could operate more efficiently, it is important that savings measures are applied carefully to areas which are underperforming, and not simply used as a blunt instrument to reduce expenditure in all areas. As the Report notes, underinvestment in financial and management support systems within the NSW Department of Health led to the Department incurring significant additional costs.

A number of recommendations focus on improving the transparency of Government financial reporting. For example, the current Budget papers lack transparency in a number of key areas, such as around reconciliation tables and understanding the impact of measures on the Budget balance. The Report also notes that under the current governance frameworks, forward estimates of costs and revenues are created using unrealistically optimistic assumptions. In the 2011-12 Budget, the Treasurer did announce that the Government would conduct a review of the presentation of Budgets, with a view to improving transparency. The NSW Business Chamber strongly welcomes this initiative, and we believe that the recommendations from the Schott review form a good starting point for this work.

The management of people

Good people management is a fundamental pillar of all successful organisations, whether they be public or private, and the lessons learnt in one sector can often be applied to the other. Getting people management right increases employee productivity and reduces absenteeism and staff turnover.

At an aggregate level, it appears that the NSW Government has done a reasonable job managing aggregate staff levels over the past 30 years. The Schott Report notes that the number of NSW public servants has remained relatively static over this period, and as a proportion of the State’s population, public sector employment fell from 7 per cent in the 1980s to 5.5 per cent in 2010.²

However, while aggregate staff numbers appear to have been well contained, at the same time there appears to have been significant bloating occurring at higher levels within public service structures - the Schott Report notes that the number of executive positions in the NSW public service increased from 3,949 positions in 1999 to 6,145 positions in 2010,³ representing an increase of more than 50 per cent. Given that the aggregate staff level has remained relatively unchanged over this period, it is unclear what driver has justified the dramatic increase in the number of senior appointments. While the Schott Report does not recommend the imposition of executive caps or employment freezes, something clearly needs to be done to arrest the growth in these positions, and while the use of a blunt instrument like a cap may not be ideal, it may be a

¹ NSW Commission of Audit Interim Report on Public Sector Management, p. 48.

² *ibid*, p. 71.

³ *ibid*, p. 77.

necessary and effective way of starting to change embedded cultural mindsets and help to start things trending in the right direction. We acknowledge that poorly managed and implemented staff freezes can have unintended consequences, such as leading to the increased use of contractors, however, this doesn't mean the underlying concept is flawed, it just means that it needs to be more carefully implemented.

Related to this issue, we also note the Commission's recommendation that: *"the Public Service Commission should undertake a remuneration comparison for NSW public sector classifications and executives."*⁴ The NSW Business Chamber strongly supports this recommendation. Completion of a benchmarking activity of this kind would help to demonstrate whether or not some of the higher salaries currently evident around middle management in the NSW public service are appropriate.

The Report identified a number of constraints to the delivery of effective people management, including inflexible position classifications and structures, poor data collection and reporting, and some capability gaps in human resources staff. A number of these constraints are the result of previous inflexible policies which were imposed on the public service. With the evidence indicating that these approaches have been unsuccessful, it is hoped that the Government can unwind many of these impediments and provide individual agencies with the flexibility necessary to properly manage their own HR affairs.

The Report identified four key challenges for people management in the NSW public service – performance management, recruitment, planning for capability gaps and mobility. The NSW Business Chamber supports the Report's recommendations in relation to these issues and in particular emphasises the importance of introducing performance management reforms to ensure that there is a link between performance, remuneration and career progression.

Asset management

The Schott Report notes that *"the pressure on the operating result to fund capital expenditure can be lessened by the disposal of assets."*⁵ While the Report notes that some progress has been made in this area (in relation to the desalination plant and the Port of Botany, it is clear that further sales will be needed to move the Budget onto a more sustainable footing and free up funding for investment. The Schott Report also recommends that a specialised unit be established within Treasury or Finance and Services to help facilitate further asset sales or leasing arrangements. The Chamber strongly supports this approach, as managing this process properly is essential to maximise the value of these asset transfers to government, which will in turn maximise the amount of infrastructure expenditure which can be financed. The Government may also wish to consider how it can tap into existing expertise (such as Tcorp) and integrate with other processes, (such as the Chief Procurement Officer) in implementing this recommendation.

The Schott report notes that *"asset-related frameworks in NSW are conceptually sound but implementation is far from assured"*.⁶ The report identifies a number of actions required to improve management of the state's asset base, including future maintenance planning and investment prioritisation. The Schott report proposes a greater focus by agencies on asset maintenance, and makes several recommendations on this issue to embed this focus within agency culture. These recommendations are supported by the NSW Business Chamber as they will help to ensure infrastructure investments stem from rigorous planning and are maintained, thereby encouraging greater transparency and ensuring better value from government investments.

The Schott report also highlights the lack of clarity of the integration of the new State Infrastructure Strategy and 5-year infrastructure plans, with other elements such as the *NSW 2021 Plan*, the fiscal strategy and other agency plans. The report notes, *"Improving the State's infrastructure planning will require better*

⁴ NSW Commission of Audit Interim Report on Public Sector Management, p. 73.

⁵ *ibid*, p. 40.

⁶ *ibid*, p.103.

*integration of whole of government infrastructure priorities with those at agency and cluster levels.*⁷ This has been a concern of the Chamber's as truly integrated planning does not seem to be occurring within the NSW Government. This needs to occur to ensure a true pipeline of infrastructure projects which reflects the social and economic priorities of NSW is being developed.

The Schott report recommends that Infrastructure NSW and Treasury should investigate toll arrangements and provide options to Government on opportunities to make the toll road network more efficient.⁸ The present charges for toll roads mostly reflect the capital cost of the road, but the Schott report recommends that adjustments to pricing may assist with managing peaks and troughs in demand through time-linked charging and recommends Sydney's toll network to be tolled on utilisation-based formulae. This would also help to make Sydney's toll system a fairer system for motorists as currently toll rates vary in amount and structure between different toll roads. The Chamber supports this recommendation and encourages INSW and Treasury to examine this proposal in a timely manner. However, to ensure motorists are not over-penalised the toll pricing structure should be capped.

The Schott report also makes some recommendations around infrastructure financing. Given the current tight fiscal environment, the NSW Government should investigate options to alleviate hurdles to private investments in infrastructure. Private investment will be necessary to get infrastructure projects off the ground in a high proportion of cases. The report recommends INSW and Treasury investigate options to enhance the design of privately financed projects (PFPs) in order to encourage the use of PFPs for future toll road projects. The report also recommends that the NSW Government should consider implementing the National Policy and Guidelines for Alliance Contracting when they become available. The Chamber strongly supports this recommendation as national harmonisation is imperative in this space, given major finance providers often operate between different jurisdictions. The Government should also implement the report's recommendation to undertake actions to improve coordination and communication of NSW's construction procurement and construction program as this will create greater certainty within industry and increase investor confidence.

Should you require further information or clarification on any of these matters, do not hesitate to contact Mr Micah Green, Economist on (02) 9458 7259 (micah.green@nswbc.com.au), or Larissa Cassidy, Infrastructure Policy Advisor on (02) 9458 7359 (larissa.cassidy@nswbc.com.au).

Yours sincerely



Paul Orton
Director, Policy and Advocacy

⁷ *ibid*, p.111.

⁸ NSW Commission of Audit Interim Report on Public Sector Management, p.132.