

**Submission
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**INQUIRY INTO NSW GOVERNMENT'S USE AND
MANAGEMENT OF CONSULTING SERVICES**

Name: Emeritus Professor Bob Walker and Dr Betty Con Walker

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Public Accountability and Works Committee
on
NSW GOVERNMENT'S USE AND MANAGEMENT OF CONSULTING SERVICES**

Emeritus Professor Bob Walker and Dr Betty Con Walker
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SUBMISSION TO INQUIRY ON

NSW GOVERNMENT'S USE AND MANAGEMENT OF CONSULTING SERVICES

1. INTRODUCTION

We welcome the Committee's invitation to make a submission to this important Inquiry, and thank the Committee for agreeing to our request for an extension of time to lodge it.

The subject of this inquiry is not surprising in view of media attention to the conduct of PwC in dealing with confidential information provided by the Australian Taxation Office.

We have a long term interest in public finance having written, spoken and (in the case of Bob Walker) designed and taught university courses in that area. Many of our writings and our book, *Privatisation: Sell off or sell out*, published by ABC Books in 2000 (reprinted in 2006 and reissued in 2008 with a New Introduction by Sydney University Press) have stood the test of time. Positions outlined in the book while regarded as anathema by some at the time, have now been accepted as orthodoxy by governments and others – even commentators. Copies will be provided to the Committee. Some of our observations in that book have been repeated below in discussion of the history of so-called 'reforms' of the public sector – 'reforms' which have contributed to the current problem with consulting services.

It should be noted that the use of consultants is merely a subset of 'contracting out' – and, this in turn is a form of privatisation of the public sector. Accordingly, the use and management of consulting services needs to be looked at in the broader context of changes over time of views about the role of the public sector.

The idea that the public sector is 'bad' and the private sector is 'good' took hold in Australia in the late 1980s. It was founded on ideology rather than evidence and analysis.

First, ideas were borrowed from overseas and, as in other areas, this has not always served Australia well. Second, there was reliance on bad data to support the use of outsiders to undertake public sector functions. Third, the public service was politicised with the wider use of short-term contracts undermining its ability to provide independent and fearless advice. Fourth, responsibilities and decision-making were devolved to individual agencies without central agencies retaining effective oversight, monitoring and maintaining standards of accountability.

This submission reviews some of that history, and reflects on our experience as observers or participants in the work of public sector agencies. Some attention is given to the source of claims that outsourcing of services can reduce agencies' expenditure by an average of 20% – claims that were always questionable.

This submission provides evidence of trends in expenditure on consultants and whether this has impacted public service staffing numbers.

One impediment to analysis of the cost structure of government agencies is the failure of management information systems (MIS) to present financial data and accompanying notes that provide an unambiguous picture of expenditure on consultants and contractors. An unkindly view of these practices is that they involve some 'creative accounting'. Correspondingly, this ambiguity, and a lack of standardisation of reporting requirements, have had a deleterious impact on governance.

The subject matter of this Inquiry can illustrate dual objectives of financial reporting. Financial reports **could** show what expenditure on consultants or contractors has been treated as an operating expense in a given year, and what has been 'capitalised' and hence treated as part of the value of an 'asset' (e.g. software) that may be subject to amortisation in later years.

A concern with 'governance' might warrant additional disclosure (via notes) of overall expenditure incurred through contracts with consultants in a given year – regardless of whether that expenditure had been 'capitalised' or 'expensed'. Refinements of such governance disclosures could be extended to refer to how the work of consultants or contractors had actually been used – focusing not just on 'costs' and resource allocation but on the quantum of services delivered and their 'effectiveness'.

2. WE HAVE A PROBLEM - HOW DID WE GET HERE?

Several decades ago, the Greiner Coalition government popularised the mantra of 'letting the managers manage' – for the 'budget sector' this was an antidote to what was seen as excessive 'controls' over spending by central agencies via the budget process (see, for example, *1988-89 Budget Speech* pp. 11-12).

But as Premier Nick Greiner said:

In the inner Budget sector, Ministers cannot abrogate responsibility for policy, nor should they.

and

Organisations which live off the public purse should be subject to Government direction (*ibid.*, p. 12).

Greiner maintained that there was a need to establish financial and performance targets for departments (and dividend targets for government businesses), coupled with performance agreements with Ministers, followed by ongoing monitoring of agency spending and activities. In short, requirements for monitoring the management of finances and performance were to continue.

But in recent years the principle of devolution of authority has apparently been interpreted as watering this down and allowing heads of agencies to assume ‘ultimate accountability for procurement’.

These developments were confirmed by statements made by Treasury’s representatives at the Committee’s hearing on 15 June 2023.

Ms Sonya Campbell, the Deputy Secretary, Commercial, NSW Treasury admitted that ultimate accountability for the use of professional services including consultants rests with heads of agencies:

New South Wales government's procurement operating framework provides all devolved agencies with government-wide laws, policies and guidelines as to how they should procure goods and services of any kind for the State of New South Wales, with ultimate accountability for those procurements being with the heads of agencies and departments, specifically in relation to the use of professional services firms, which include consultancy services (*Report on Proceedings before Public Accountability and Works Committee*, 15 June 2023, p.35).

Note the words ‘**with ultimate accountability for those procurements being with the heads of agencies and departments**’.

Worse, evidence presented to this Inquiry indicates that under a recent Coalition government, some agencies have engaged consultants **to advise on matters of policy** and other tasks which are the core of the work of the public sector.

As noted by the Deputy Auditor-General, Mr Ian Goodwin:

We have seen, through the course of our work, particularly with essential agencies such as NSW Treasury, which positions itself as a central agency around financial advice to government, the engaging of firms under consultancy where they are preparing meeting agendas, circulating minutes, arranging meetings or doing accounting advice on public sector accounting where you would think that the NSW Treasury would have the expertise and should have the expertise in public sector accounting (*ibid.*, p. 3).

Moreover, there has been an effective downgrading of the monitoring and enforcement role of central agencies. Now those activities are supplanted by agencies self-reporting to a Procurement Board which in turn is made up of agency department heads. As stated by Ms Campbell:

The Procurement Board oversees the quality of procurement in government through the accreditation scheme. ... The scheme relies on self-attestations from all agencies that are required to be submitted annually and signed off by both the chief procurement officer within the agency and the head of the department – the secretary (*ibid.*, p.35).

Mr Song Hong, Executive Director, NSW Procurement (NSW Treasury), appearing alongside Ms Campbell added:

In terms of your specific question about enforcement, I rely on the comments from Ms Campbell that there is an accreditation scheme and the agency head is ultimately accountable for that agency. We would need to get reporting from the agencies to determine what additional reviews we need to do. (*ibid.* p. 36).

And that:

... given the complexity of New South Wales government, ***we have to operate within a devolved structure and we have to rely on that devolution structure and the authorisations set by it.*** The expectation would be that the agencies comply and ultimately the agency head is responsible for what happens within that agency. If it requires escalation, it needs to be escalated to NSW Procurement or the NSW Procurement Board (*idem*, emphasis added).

With those positions taken by the very people who should be overseeing and holding other agencies accountable it can be surmised that these agencies are being reduced to toothless tigers.

Arguably, evolved decision-making processes together with lax monitoring has led to excessive reliance on consultants and other contractors – while ‘central agencies’ are no longer seen as responsible for ensuring compliance with government directives or guidelines.

The result is that the State now has a very costly problem requiring a solution not only because of the cost but also because of its impact on the erosion of public sector competence and capability.

2.1 Governments can’t do everything and nor should they try

This submission is not an advocacy for **no** private sector involvement in public sector administration. Governments cannot do everything and have long contracted the private sector to undertake some public works and services – and even provide technical advice.

Overall, public sector agencies tended to outsource activities where private sector firms had a comparative advantage, while providing services themselves where the work involved some specialist activities, or where the scale of demand could support in-house service provision.

However, if a government had established an agency to provide services to the community in a particular area, ‘core’ services were not outsourced. This was largely because governments had only become involved in some fields of service delivery – be they social services, or advice to farmers – because of ‘market failure’.

If the private sector had failed to provide adequate or comprehensive or reasonably priced services, then governments have intervened to fill the void. And of course, governments became involved in some areas of activity – assisting the aged and frail, or persons with intellectual or physical disabilities – simply because it was seen as the right thing to do. It was not a question of whether the private sector was or was not

providing services of that nature. Often a range of voluntary organisations were doing their best. But more resources were needed.

2.2 Times (and markets) change—but sometimes, the public sector doesn't

Decisions made decades ago may have been well-founded at the time. But that does not mean that those decisions should not be revisited later on.

Large and bureaucratic agencies may not be quick to change – and may not even regularly review their activities.

Changing circumstances including advances in information technology suggest the need for the public sector to re-think the way it does some things and to seek advice on how to change.

2.3 The 1980s and 1990s

The 1980s and 1990s saw much turmoil and change in the public sector. Yet there was minimal public debate about the rationale for these changes and the likely effect on the role of the public sector. There was little regard for:

What sort of things do we want our governments to do?
or

What businesses should governments be in?
or

How should our governments operate, and report on their activities?

The encouragement of greater involvement of private sector firms involved claims that:

The public sector should be smaller.

That governments should get out of activities which are 'properly' the domain of the private sector.

That privatisation was needed to reduce public sector debt.

In that period much of the actions taken echoed overseas experiences. For example, the idea that governments should be 'smaller' was articulated by former US President Ronald Reagan. The idea that governments should get out of certain activities was promoted by former British Prime Minister Margaret Thatcher. Recall that the Reagan-Bush administrations presided over the most massive blow-out in government debt in the history of the USA.

When ideas about smaller government, public sector inefficiency and debt reduction were echoed by Australian politicians, few commentators paused to consider whether these claims were actually relevant to Australian conditions – or made good financial sense.

2.4 The rhetoric of outsourcing

As with all forms of privatisation, advocates of involving the private sector in the public sector relied to a large extent on rhetoric about the alleged need for smaller government, and for competition in service delivery. Advocates of outsourcing recounted anecdotes about the high cost of internal service provision versus the cost of obtaining similar services from external suppliers.

The examples cited in these internal debates may have seemed persuasive, but could be criticised as unrepresentative, or as focusing unduly on financial considerations rather than speed and quality of service.

It is interesting to contrast the perspective of a private sector consulting firm about the efficiency of a public sector operation, with the observations of a private sector consulting firm about its own costs and fee structure. A high-flying lawyer working in mergers and acquisitions once commented about his firm's fees:

Some people say we charge a lot. But they overlook the fact that we have to keep a lot of highly qualified staff on the payroll so that when a big job comes up we can throw a team onto it, and work night and day to see it through.

So to one firm of consultants, the then government-owned engineering workshop may have been described as inefficient because of high labour costs from overmanning. To another firm of consultants, maintaining the capacity to undertake big and urgent jobs was good business.

Plainly, one needs to look at a range of financial and non-financial factors to assess whether or not government agencies can be more efficient and effective – and whether outsourcing would be even more efficient and effective?

Stories were told about the massive savings which were realised when activities previously provided by government agencies were outsourced. Yet the same evidence could often also be interpreted as pointing to poor management, or to a failure to negotiate sensibly with the workforce in order to lower costs and improve service quality.

2.5 The hit-or-miss way some governments have gone about outsourcing

It is in this climate that the late 1980s and 1990s saw a number of Australian governments painting themselves as administrative reformers. Reform meant reducing the size of the public sector, through outsourcing. It was simply *assumed* that the private sector was more efficient than the public sector, so that outsourcing would mean cost-savings.

In many cases, public sector agencies had not been monitoring the quality of services being provided in-house. Hence they were not in a good position to prepare contracts which would bind external suppliers to specified standards of service.

Little or no attention was given to more strategic questions as to likely changes in supply arrangements three, five or ten years down the track. The short-term imperative was to downsize, and to outsource.

In NSW, the most prominent advocate of private sector superiority over the public sector in the late 1980s and early 1990s was Premier Greiner. Greiner could tell rollicking yarns about inefficiencies in the public sector his review teams had unearthed.

Some of these stories were plainly exaggerated or distorted. But if any of them were true, while they may have been a cause for concern, they didn't say much about the merits of insourcing or outsourcing or hiring consultants. Rather, they pointed to poor management and possibly poorly-designed arrangements for monitoring performance within those organisations.

In any case, the trick was identifying which things should be changed, and when, and by how much. And to seek advice on how to do all this.

Greiner's enthusiasm for public sector reform was reflected in a 1991 proposal to pursue competitive tendering and, 'where appropriate', the contracting out of services currently provided in-house by government departments and authorities.

In short, the government of the day was saying to its senior managers: the onus is on you to outsource as much as possible. Then it set about checking on whether its directives were being followed by sending out questionnaires about how many activities had been contracted out.

2.6 The mythical 20% savings from outsourcing

It may be said that this enthusiasm for outsourcing was largely based on the work of the late Prof Simon Domberger.

In 1986, Domberger (in conjunction with two UK colleagues) claimed that contracting out of refuse collection services by local councils had produced savings of 'broadly 20 per cent' (*Domberger, Meadowcroft & Thompson, 1986*). The basis of those claims was a study of the costs of refuse collection of a sample of UK local councils. This study was undertaken at a time when private firms were actively lobbying the Thatcher government to make competitive tendering compulsory and were offering their services to some councils (*Paddon, 1991*).

The claim of savings of 20% per cent was inferred from data from 'a self-selecting group of Councils which were already convinced of the benefits of contracting out and favourably disposed towards its procedures' (*Paddon, 1991*). *Ganley & Grahl (1987)* pointed out that some of these contracts appeared to have been won by loss-leading behaviour, or had involved serious deterioration in the quality of services provided – citing evidence of firms seeking to increase their charges within the first year of winning tenders, of complaints from residents, or of penalties imposed by councils in response to failures to meet standards of performance.

Hodge (1996) noted that the main analysis presented in Domberger's 1986 paper did not produce any statistically significant association between contracting out and the overall cost of service provision – the main explanatory variables were the 'number of units' to which services were provided (suggesting economies of scale) and whether collections were more than once per week. Further,

Finding that the costs differences between contracting 'out' and contracted 'in' service was not statistically significant, Domberger *et al.* concluded that both resulted in cost reductions 'of around 20%'. This is the origin of the now much quoted '20% cost reduction rule' used as a basis for contracting out and competitive tendering in public sector policy (*Hodge*, 1996).

The obvious point to be made is that if roughly 20% savings could be achieved by *improving in-house performance*, then the case for contracting out was not compelling. Possibly the savings resulted from exposing these activities to competition, or the threat of contracting out; if so, possibly the same level of savings could have been achieved through better management of in-house operations.

Yet the claim of '20% savings from contracting out' was reiterated as fact – notwithstanding the existence of a series of published studies presenting conflicting evidence.

In 1992 NSW Treasury engaged Domberger as a consultant to design, perform and evaluate surveys into contracting out in the NSW public sector. Domberger carried out this work between 1992 and 1998.

Even the Federal Coalition got into the act repeating the 20% outsourcing savings claims in its 1991 *Fightback* document (with Domberger's work cited in support).

2.7 A flawed methodology

Overall, the strategy of asking agencies to develop plans and respond to surveys was not likely to produce a strong response. This was especially the case where agencies were unaware of what it was costing them to produce services or perform functions, because their internal management information systems were still essentially limited to recording cash expenditure and comparing that with 'budget'.

As the NSW Council on the Cost of Government¹ found in 1996, the NSW government's management information systems in most agencies could not provide basic data about trends in expenditure on 'line items' (like salaries and wages), let alone trends in spending on 'activities' (such as accounting, management of information technology or human resources) (*Privatisation: Sell off or sell out*, 2006, p. 157; see also various Reports of the Council of the Cost of Government).

Accordingly, sceptical readers might wonder how the respondents to Domberger's surveys could arrive at estimates of major savings from outsourcing (particularly when overall spending on departmental programs had been steadily increasing).

¹ Emeritus Professor Bob Walker served as Chairman of the Council from 1995-1999.

It seems that respondents to Domberger's NSW surveys were simply asked to provide their own estimates of savings – at a time when much publicity had been given to claims that savings of around 20% were achievable from outsourcing.

In terms of methodology, Domberger's approach was a textbook example of 'reactive research' (*Webb, Campbell, Schwartz & Sechrest, 1966*). Evidence was collected from surveys of senior public sector managers, most of whom would have been on short term contracts. Managers were asked, in effect, whether they had implemented government policies. Those managers would be unlikely to report that they had defied the government directives, or that their own efforts as managers had been less than successful.

As for the scale of savings secured by their efforts: NSW Treasury was saying that 20% was achievable, and the designer of the survey had already publicly claimed that 20% was an *average* saving. No one would be surprised if respondents to Domberger's surveys claimed savings of around 20%. But many researchers would suggest that survey responses collected in these circumstances could have been influenced by external events.

In the event, Domberger's estimates of savings were based on figures provided by a small minority of respondents and covering only 1.3% of his sample, after excluding legal aid contracts (*NSW Treasury, 1994*). The estimates were not based on data extracted from accounting records, but from respondent's recollections of questionable data. It appears that Domberger's respondents were only asked to compare annual costs of providing a specific service *before* and *after* contracting - without counting the costs of establishing and administering the contracts, or the costs associated with paying out redundant employees.

This was flimsy evidence. It was pathetically flimsy when viewed as the basis for policies which would affect the livelihoods of thousands of public sector employees and their families.

If Domberger's analysis was based on poor quality information, he was at least brave enough to recommend that existing guidelines on outsourcing should be revised to emphasise the importance of contract management and the need to establish systems for monitoring performance (*NSW Treasury, 1996*). Yet this seemed a case of 'do as I say, not what I do' (or, perhaps, 'what I have been asked to do').

A NSW Joint Parliamentary Committee report on its inquiry into *Competitive Tendering and Contracting in the NSW Public Sector* (1998) was highly sceptical about whether the analysis underpinning proposals for more extensive outsourcing was independent:

The Committee remains concerned that the government relies heavily on CTC [Competitive Tendering and Contracting] research obtained through a limited number of consultants. This trend also raises concern about bias and whether researchers have a vested interest in the outsourcing industry themselves.

The observations of this parliamentary committee only highlighted the fact that large-scale contracting out had been undertaken without effective oversight and scrutiny –

and that many decisions to outsource had been made on the basis of incomplete, partial, or poor quality information.

Much space has been given to this mythical 20% saving because it formed the basis for decisions to abandon some public sector services by outsourcing or bringing in consultants. Importantly, those decisions were based on poor quality information.

2.8 Shortcomings in public sector management information systems didn't help

Claims of 20% savings were to persevere, largely as a legacy of the public sector's use of cash-based budgeting and cash-based accounting systems. The tradition of simply counting expenditure to date and comparing it against budget only involved simple clerical tasks. Hence public sector managers neither had to be skilled in financial management, nor had any need to hire staff who had training and experience in either finance or accounting.

While public sector disclosure requirements commonly required agencies in the general government sector to report on aggregate spending against budget, and to disclose levels of spending in broad categories (salary related expenditure, depreciation, other) many agencies would have found it difficult to compile reports about *trends* in spending on individual items of expenses (such as overtime, travel, telephone or supplies).

But the real shortcomings of public sector management information systems (MIS) concerned the manner in which they failed to track patterns of spending (and other aspects of financial performance) within individual agencies and across government.

As a minimum, government agencies should have known the cost structure of their organisations: what had been spent (through wages and salaries and other direct costs such as rent and communications), and how many staff were engaged in direct service delivery and in ancillary functions. Managers of programs or regional offices should also have had information to enable them to benchmark their performance against others and to explore ways of maximising the effectiveness of the way in which resources were expended in the interests of the community.

In practice, MIS operating in government agencies fell far short of these basic requirements. Even at head office, agencies didn't monitor spending on administrative overheads as distinct from service delivery, and didn't track spending on such activities as accounting, human resources management, property management, and information technology.

As an example: when in 1996 the NSW Council on the Cost of Government (COCOG) set out to explore the source of major increases in spending during the term of office of the previous government, it found that agencies could not supply basic information about trends in spending on line items.

A survey found that, in a sample of 95 agencies, 82 operated different financial systems, using 48 different software packages (of which five were developed in-house), and that there was almost total diversity in coding expenditure on items like wages and salaries. When COCOG set out to find how much was being spent on

corporate services within the general government sector, it found that agencies could not provide this information from their accounting systems. Data had to be collected by distributing questionnaires (Council on the Cost of Government, *First Report*, June 1996, p. 24).

COCOG recommended adoption by all government agencies of a minimum standard 'chart of accounts' (accounting terminology for an index of ledger accounts), so as to standardise reporting to stakeholders and to facilitate access to consistent financial data relevant to management. Treasury advised that it was developing its own scheme to facilitate reporting to the Australian Bureau of Statistics (though it later abandoned this project, writing off previously capitalised expenditure).

Without dwelling on these events, one can understand that public sector managers were not in a good position to assess what is being spent on specific activities within agencies, or understand the cost structure of those activities, let alone assess whether those activities are being undertaken efficiently. Yet such basic costing information was necessary if governments were to be able to make informed assessments of whether it makes good sense to continue to provide services from within the public sector, or whether they should outsource services to contractors or consultants.

2.9 Failure to employ qualified people in financial management

As in the rest of the Australian public sector, the NSW public sector failed to recruit sufficient well-qualified staff in financial management positions.

Some argue that this was a legacy of the long tradition of cash-based budgeting and accounting. One did not need a university degree in accounting to work out whether total monthly cash spending was more or less than an annual budget divided by 12. In any case, such an approach disregarded seasonalities in monthly expenditure – notably in the area of health, where demand for some services increased in winter months. Hence many chief financial officers in major government agencies had minimal qualifications, and had 'learned on the job'. Many were not members of professional accounting associations (and, if they were, may have been admitted through the back door, on the basis of the seniority of their position, without ever passing an exam).

In many situations the publication of 'guidelines' served more than the provision of useful memory joggers and checklists. The guidelines were often providing basic education to unqualified staff – albeit without any obligation for neophyte financial analysts to actually study these materials in detail, or work through practical exercises, or obtain any feedback on their efforts.

This was brought home when the NSW Council on the Cost of Government prepared revised guidelines on 'service competition policy' in 1997. They were issued to outline the Carr government's policies regarding contracting out. Rather than requiring CEOs to outsource as much as possible, the guidelines required CEOs to know their costs and to operate efficiently. If market testing (through informal enquiries or formal benchmarking exercises) indicated that a particular activity was inefficient, relative to the costs of obtaining services from alternative suppliers, then CEOs were obliged to find out why, and do something about it. If these efforts failed, outsourcing was to be

considered as a live option. An appendix to the guidelines outlined issues concerning the calculation of net avoidable costs, and provided spread sheet templates which could be used to analyse those costs.

The document referred to concepts that are usually mastered by second-year undergraduate accounting students. It was therefore somewhat surprising that the chief financial officer of one agency (annual budget then in excess of \$1 billion) asked that the guidelines be reissued in a 'less technical' form.

Within the public service, in the era of short-term contracts and performance assessments, it seems reasonable to suggest that many senior managers have tried to protect themselves by hiring consultants to provide formal advice on all key decisions. In effect, they were contracting out their own jobs.

It is feared that decades later, little has changed. Not only are senior managers using consultants to protect themselves but they have failed to recruit sufficient numbers of public servants with the requisite skills to assist with the development of policy and to be in a position to assess the value of advice provided by consultants.

3. THE MAGICAL 20% SAVING MADE A REAPPEARANCE PRIOR TO THE 2019 ELECTION IN A DIFFERENT GUISE: COINCIDENCE?

It is interesting that the magic 20% savings figure of long ago described above made a reappearance with a twist in a 2019 election Coalition promise. The Coalition promised that over the four years from 1 July 2019, it would make savings in consultants' expenses of 20% each year (excluding capital-related consultancy expenses) (Parliamentary Budget Office, *Election Policy Costing*, 18 March 2019).

The PBO estimated that reducing expenditure by 20% would generate savings totalling up to \$75.1 million over the forward estimates, and \$99.6 million by 2022-23. This was based on Treasury's advice from January 2019 on the General Government Sector's recurrent consultancy expenses from 2019-20. The PBO applied the reduction of 20% for each of the year's expenses as shown in Table 1 below.

However, as also shown in the table, in the three years to 2021-22, including the first two years of the forward estimates, spending by general government agencies on consultants increased to \$399 million rather than the \$300 million promised by the Coalition.

Table 1: Coalition forecast 20% annual reduction in consultancy expenses versus actual consultancy expenses

	2019-20	2020-21	2021-22	2022-23	Forward Estimates	Total by 2022-23	Total by 2021-22
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	
Recurrent consultancy expenses	122,555	121,030	131,780	122,745	375,365	498,110	
Impact of 20% reduction	-24,511	-24,206	-26,356	-24,549	-75,073	-99,622	-75,073
Net of proposed 20% reduction	98,044	96,824	105,424				300,292
Actual consultancy expenses	121,000	147,000	131,000				399,000

Source: NSW Parliamentary Budget Office, 18 March 2019; *NSW Reports on state finances, 2020-21 and 2021-22*.

And as stated by the Auditor-General, 'NSW government agencies would need to limit spending on consultants to less than \$1 million in 2022–23 to meet the four-year savings target' (NSW Auditor-General, 2 March 2023, p. 5).

4. CURRENT MANAGEMENT INFORMATION SYSTEMS

4.1 Improvements in MIS but shortcomings remain

Although there have been changes in information systems from decades ago, there remain some shortcomings so that decisions to outsource activities or to engage consultants may still being made on the basis of inadequate information.

In the case of consultants, as noted while preparing this submission and as confirmed by the Auditor-General:

There is no single source of data that accurately captures all whole-of-government spending on consultants, despite previous commitments to improve data quality (*ibid.*, p. 4).

There are four different sources of data that contain information about spending on consultants by NSW government agencies: agency annual reports, the NSW Government's financial consolidation system (Prime), and two systems operated by NSW Procurement (the Business Advisory Services dashboard and Spend Cube). As the Auditor-General stated:

Each of these sources of data serves a different purpose, and none of the four datasets individually or collectively provides complete information on total actual spending on consultants (*idem*).

Due to the absence of a complete single source of data, the Auditor-General chose to collect information from agency annual reports since while some entities are excluded (e.g. NSW Local Health Districts) they at least disclose spending which includes capital-related expenditure on consultants. The Auditor-General notes that 'entities that were not required to report publicly, spent over \$170 million on consulting from 2017–18 to 2021–22' (*ibid.*, p. 5).

As admirable as it is for the Audit Office to go through 350 annual reports over five years to source information on consultancies, the Auditor-General should be the reviewer and assessor of information – and not a compiler of basic information which should be readily available from a centralised government source.

On the basis of this source, the Auditor-General found that between 2017–18 and 2021–22, NSW government agencies disclosed total spending of around \$1 billion on consultants across more than 10,000 engagements using more than 1,000 consulting firms (*ibid.*, p. 1).

As noted above even this figure is understated due to the fact that some entities are exempt from reporting, including LHDs, legal services secured through the legal services panel, and some IT consulting expenditure.

In preparing this submission, a similar attempt was undertaken to locate published information on consultants.

The best that can be said is that specific information on consultancies appears to exist in silos with agencies potentially using the same consultancy firms at the same time and perhaps for the same or similar tasks. This of course may suit consultants looking for work in the public sector.

Examining annual audited *NSW Reports on state finances* from 2010-11, data on consultancies and contractors were found as single line items in notes to the audited financial statements.

The data show that **from 2010-11 to 2021-22, total government spending on consultants totalled nearly \$2.6 billion dollars, with the general government sector accounting for nearly \$2.1 billion** (see Table 2 below).

Over the same period, **spending on contractors totalled \$21.2 billion with the general government sector accounting for more than half at nearly \$12.2 billion.**

This means that **government spending on consultancy and contractor fees over 12 years totalled a massive \$23.8 billion of which general government accounted for more than half at \$14.2 billion.**

While the notes to these accounts show data for consultants and contractors, there is no discussion as to the basis of the distinction between the two. Moreover, it is unclear as to whether the expenditure on consultants was expended or capitalised (e.g. treated as part of the cost of new or upgraded infrastructure).

The data for spending on consultants in the five years 2017–18 to 2021–22 totalled \$1.1 billion – which is in line with the Auditor-General's figure of 'over \$1 billion' (*ibid.*, p. 10) for the same period.

Table 2: Consultancy and Contractor Fees, 2010-11 to 2021-22

Year	Consultancy Fees		Contractor Fees		Consultancy plus Contractor Fees	
	General Government Sector \$m	Total State Sector \$m	General Government Sector \$m	Total State Sector \$m	General Government	State Sector
2010-11	170	197	157	549		
2011-12	110	160	181	616		
2012-13	158	179	410	866		
2013-14	173	197	465	1,246		
2014-15	159	180	515	1,340		
2015-16	213	240	1,981	2,619		
2016-17(a)	210	327	964	1,768		
2017-18(a)(b)	318	390	1,018	2,005		
2018-19 (c)	151	198	1,354	2,354		
2019-20	121	155	1,244	2,220		
2020-21	147	186	1,544	2,526		
2021-22	131	180	2,330	3,094		
TOTAL	2,061	2,589	12,163	21,203	14,244	23,792

Source: Notes to the Financial Accounts in various *NSW Reports on state finances*.

- (a) TAHE Capital Program Delivery expenses of \$1,206 million have been reclassified from Contractor Fees and Other Employee Expenses to 'Supplies, Services and Other' in 2017-18. In 2016-17, there was \$849 million in Contractor Fees relating to TAHE. This has been reclassified to 'Supplies, Services and Other' (Source: 2017-18 *NSW Report on state finances*.)
- (b) In 2017-18 \$235 million 'Contractor Fees' and \$132 million 'Consultancy Fees' were reclassified from 'Supplies, Services and Other' (Source: 2018-19 *NSW Report on state finances*.)
- (c) In 2018-19, \$155 million 'Contractor Fees' were reclassified from 'Consultancy Fees' in the General Government Sector and the Total state sector, and \$131 million 'Contractor Fees' were reclassified from 'Supplies, Services and Other' in the State Sector.

A number of concerns arise from these figures not only in relation to the quantum but also their classification and their outcomes.

First, the notes reveal a number of ***post-balance date (or even later) re-classifications*** of expenditure were undertaken.

The spending on TAHE exemplifies a compound change with a movement out of the General Government sector and the reclassification of spending items.

These changes make it difficult for readers to identify trends. In part, they may reveal a continuing confusion on the classification of consultants versus contractors. Accordingly, the figures on consultancy expenditure should be treated with some caution – for this reason and for reasons of shortcomings of consultancy expenditure data outlined above.

Second, ***the quantum is of continuing concern***. One would have expected increased spending in the early years of changes and improvements in management information systems particularly in the first decade of the 2000s. However, available information shows spending on consultancies in the 10 years 2000-01 to 2009-10 totalled just over \$1 billion.

This compares with the more than doubling at \$2.6 billion in the 12 years 2010-11 to 2021-22.

Third, is the concentration of spending whereby four firms accounted for 27% of total spending on consultants between 2017–18 and 2021–22 (KPMG at \$72 million; Ernst & Young at \$70 million; PwC at \$57 million; and Deloitte at \$42 million) (Auditor-General, 2 March 2023, p. 23).

Fourth, it is of great concern that little work has been undertaken in reviewing and assessing the effectiveness of advice received from these consultants. Evidence of post-engagement reviews were provided for only three of the sample of 82 consulting engagements reviewed by the Auditor-General (*ibid.*, p. 29).

The process of reliance on self-attestations for assessments of consultant performance appears to be repeating the mistakes of the past.

So what was accomplished by these consultancy services?

The **efficiency** of using consultants could be assessed by considering, e.g.:

- What would it have cost to produce a similar report ‘in house’?
(Note that part of the costs of a consultancy engagement would include not only payments to the consultant, but the cost of the time of in-house staff in retrieving and collating information that was not immediately available from accounting systems and published reports.)
- Could equivalent advice have been obtained using specialist staff from within the public service?

The **effectiveness** of the various consultancies could be assessed in various ways, e.g.:

- What knowledge and experience did the consultants bring to the task that was not available ‘in house’?
- What changes were made to public sector processes based on the consultants’ reports?
- What changes were not made – and why?

Since the subject matter and content of individual reviews was not published, one would hope that after the expenditure of \$2.6 billion on consultants in the last 12 years, more assessments would have been undertaken.

4.2 Has the massive spending on consultants and contractors impacted public sector staffing?

In view of the quantum of spending from 2011-22 on consultants (\$2.6 billion) and contractors (\$21.2 billion), one would have expected an impact on the number of public sector employees.

An effort was made to source this information first by looking at Budget Papers.

In the past, annual Budget Papers included the number of employees engaged on services provided by each service group within each agency. These staff figures represented an estimate of annual average staffing, including temporary and short term casual staffing, expressed on a full time equivalent basis. They showed forecast figures for the Budget paper year and the previous three years.

This information was included each year until the 2011-12 Budget – the first Coalition Budget after its win in the March 2011 election. These figures did not appear in the 2012-13 Budget Papers – the first full year in office of the Coalition Government. In that year, Budget Paper No. 3 which previously contained that information moved to a program-based budgeting structure.

The information on staff numbers reappeared in the 2013-14 Budget Papers and continued each year until they disappeared again in 2019-20 and have not re-appeared since. This followed an April 2019 announcement of machinery of government changes introducing eight government clusters.

Now staffing is presented in the annual reports of the NSW Public Service Commission. According to the data presented in the Commission's reports, there appears to have been little impact on public sector staffing despite the huge expenditure on consultants and contractors.

The Commission states that the NSW public sector is the largest employer in Australia. In 2022 it employed 433,890 or 363,617 full-time equivalent (FTE) employees (*Workforce Profile Report 2022*, p. 9).

As can be seen in Table 3 below, while there has been some fluctuation in numbers of public sector employees over the years since 2011, they remained broadly constant in the 390,000 to 400,00 range until 2019 in the case of total headcount and around 330,000 in the case of full time equivalents (FTEs). Moreover, in the four years from 2019 to 2022, numbers increased above this level each year both in headcount and FTEs. Some of the increase would have been expected due to COVID.

However, the data shows an increase of 39,101 or 9.9 per cent in the headcount and 33,217 or a 10 per cent increase in FTEs in 2022 over 2011.

Table 3: Public sector census headcount and census period FTE, 2011-22

Year	Census headcount	Census period FTE
2011	394,789	330,400
2012	401,703	332,555
2013	399,243	329,336
2014	396,036	328,111
2015	394,194	326,765
2016	393,442	326,706
2017	393,333	325,917
2018	396,243	329,005
2019	407,999	337,787
2020	413,567	348,508
2021	431,350	360,190
2022	433,890	363,617

Note: 'Headcount' is the total number of employees at a given time. 'FTE (Full time equivalent) workforce' describes the total number of full-time employees required to account for all ordinary time paid hours worked.

Source: NSW Public Service Commission various *WorkForce Profile Reports*.

The foregoing indicates that, contrary to the initially stated objectives of outsourcing public sector work, the expenditure on consultants and contractors since 2011 has not led to a reduction in public sector employment.

Ongoing employees accounted for the largest proportion at 74.8%, with the remainder accounted for by 'temporary' 'casual' and 'other' employees (*ibid.*, p. 23).

The Commission does not provide information on consultancies.

Confusingly, the Commission's Report presents information on what it describes as 'the contingent workforce'. It states:

Contingent labour forms part of the overall public sector workforce, with workers typically employed to meet a short-term need or address a capability gap.

And that:

NSW Procurement maintains data on contingent labour use and spend. Around two-thirds of the 2022 data was recorded on Contractor Central, the NSW Government's vendor management system. Records captured outside Contractor Central are not included in this analysis.

And that in 2022:

- Contractor Central recorded 20,531 contingent workers, a 36% increase from 2021.
- An average of 8,877 contingent workers were active at any given time, an increase of 27% from 2021. Of these, 68% had a tenure of less than a year (*ibid.*, p. 25).

Since it was unclear as to how this 'contingent workforce' differs from 'temporary' employees who are defined as non-casual employees who do not have ongoing conditions of employment or individual employment contracts, and who are employed for a specific period, a call was made to the Commission on 21 July 2023 to seek clarification.

A representative of the Public Service Commission advised that unlike temporary employees who are recruited directly and become part of the public service with certain entitlements, ***contingent employees numbering 20,531 in 2022 are regarded as consultants who generally are provided by private recruitment agencies.*** Their numbers are not included in the workforce numbers published by the Commission and nor were they identified in other published data.

This information adds another complication to the status of numbers of consultancies and contractors.

5. RECOMMENDATIONS FOR IMPROVING THE USE OF CONSULTING SERVICES

It is suggested that the Committee consider the following recommendations for inclusion in its final report.

a. Contextual Information: Profile of the Public Sector

The Public Service Commission should be asked to compile and periodically update summaries of the educational qualifications, experience, and age distribution of current public servants by agency in order to identify their skill profile and skill gaps.

b. Recruitment to the Public Sector

Agency recruitment should be focussed on filling identified gaps in the workforce.

c. Public Sector Consultancy

The government should establish an independent 'in house' Public Sector Consultancy. It should:

- consist of public sector staff of various financial and technical skills; and
- be made available to agencies as needed.

d. External Consultants to be engaged as a last resort (not as first resort)

While individual agencies are to be responsible for engaging external consultants:

- NSW Procurement should be responsible for reviewing and actively monitoring contracts, and require the submission by agencies of post-engagement reviews for all consultancies.
- Applications for appointment must provide the names and qualifications of the personnel to be engaged on a project.
- Applications must disclose all other projects undertaken in the public sector by the nominated staff and firm (where applicable) over the previous three years, including their cost, and a summary of recommendations or accomplishments.

e. Reporting of Expenditure on Consultants

- **Definition of consultants** to be reviewed and improved and more clearly differentiated from the definition for contractors so that spending on consultancies is not 'inadvertently' reported as expenditure on contractors.
- **Exemptions from the data** on consultants to be reviewed for consideration of inclusion. It is understood that spending on consultants by Local Health Districts are to be included from 1 July 2023. Consideration should be given to ensuring that consultancy spending on legal services and on IT services should in future be reported as consultancy expenditure so as to provide a more complete picture.
- **NSW Reports on state finances** should show expenses on consultants and contractors with clear information differentiating the two classifications and stating whether aggregate expenses on consultants includes capital-related expenditure.
- **Agency Annual Reports** should be required to report on details of consultants at the previous threshold of \$30,000 (up from the current \$50,000).

July 2023

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