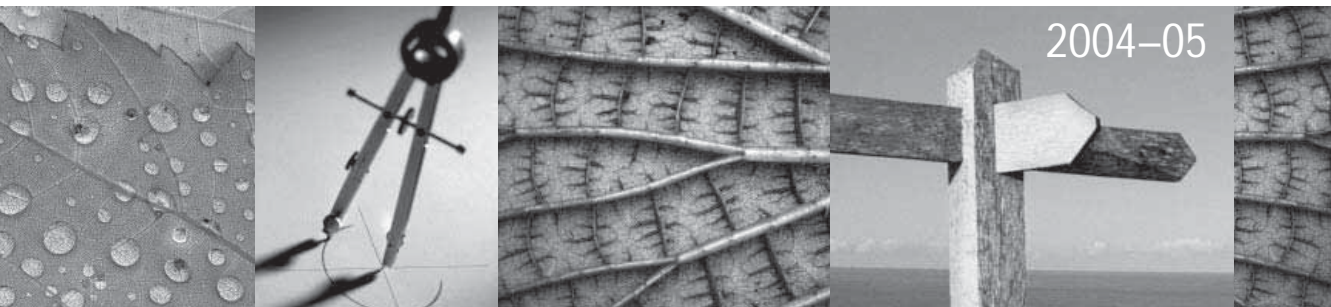




Australian Government
Australian Public Service Commission

State of the Service Report

2004-05



State of the Service Series 2004-05

Outsourced services

Outsourcing refers to an arrangement whereby an APS agency has a function or service which was previously undertaken in-house performed by a private sector provider. Outsourcing usually involves market testing through a competitive tendering and contracting process. Under these outsourced arrangements the APS agency retains overall responsibility and accountability for the function or service.

In its 2001 response to the *Review of the Whole of Government Information Technology Outsourcing Initiative*, conducted by Richard Humphry AO, the Government decided that progress with the implementation of ICT outsourcing would be monitored and reported on annually by the Commissioner in the State of the Service report. In accordance with the Government's decision, the Commission continues to ask questions of agencies about the implementation of ICT outsourcing and to report on the results. The 2005 agency survey also included questions on the outsourcing of HR services and on agencies' experiences of insourcing¹ of ICT and HR services.

Agencies are asked only to report on outsourced contracts that are worth more than \$100,000 (departmental funds) or \$5 million (administered funds) over the life of the contract.

This year's agency survey did not ask questions about contract duration and value due to the discrepancies uncovered during the drafting of last year's report. Last year an examination of some agencies' responses to the Senate Order on departmental and agency contracts² showed significant differences between the data supplied on outsourced contract duration and value in response to the agency survey and data on outsourced contracts reported in agencies' Senate Order lists for 2003–04.³

¹ 'Insourcing' occurs when an agency brings a function or service that was previously contracted out back into the agency.

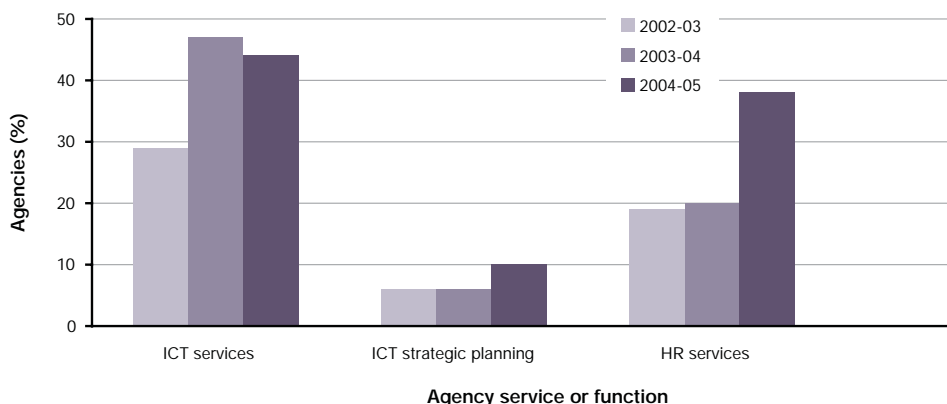
² The Senate Order requires that *Financial Management and Accountability Act 1997* agencies provide on their Internet home page a list of all contracts to the value of \$100,000 or more which have not been fully performed or which have been entered into during the previous 12 months. The Order was passed by the Senate on 20 June 2001, with subsequent amendments passed on 27 September 2001 and 26 June 2003.

³ Australian Public Service Commission, *State of the Service Report 2003–04*, 2004, <<http://www.apsc.gov.au>>

Agencies' outsourcing during 2004–05

Overall, 49 agencies (60%) reported finalising new outsourcing contracts or contract extensions in regard to at least one aspect of an ICT or HR function or service during 2004–05. Figure 12.1 shows the level of outsourcing activity in the last three years. Finalising or extending an outsourcing contract in relation to at least one aspect of ICT services occurred in 44% of agencies in 2004–05, consistent with 47% of agencies in 2003–04. However, there was a substantial increase in 2004–05 in the proportion of agencies that entered or extended an outsourcing contract in relation to at least one aspect of HR services (38% in 2004–05 compared with 20% in 2003–04). Given the limited trend data available, it is difficult to determine whether this increase is cyclical representing many agencies renewing and/or extending their outsourcing contracts for HR services in 2004–05.

Figure 12.1: Agencies' outsourcing activity, 2002–03 to 2004–05



Source: Agency survey

Outsourcing of ICT services

Thirty-six agencies (44%) reported outsourcing at least one aspect of ICT services (other than strategic planning for ICT) during 2004–05 (62% of large, 46% of medium and 31% of small agencies).

Of those agencies that reported finalising new contracts or contract extensions for outsourced ICT services during 2004–05, 8% indicated that they *wholly* outsourced ICT. The majority (92%), however, indicated that they *partially* outsourced ICT services.

Eight agencies (10%) reported outsourcing at least one aspect of strategic planning for ICT during 2004–05.

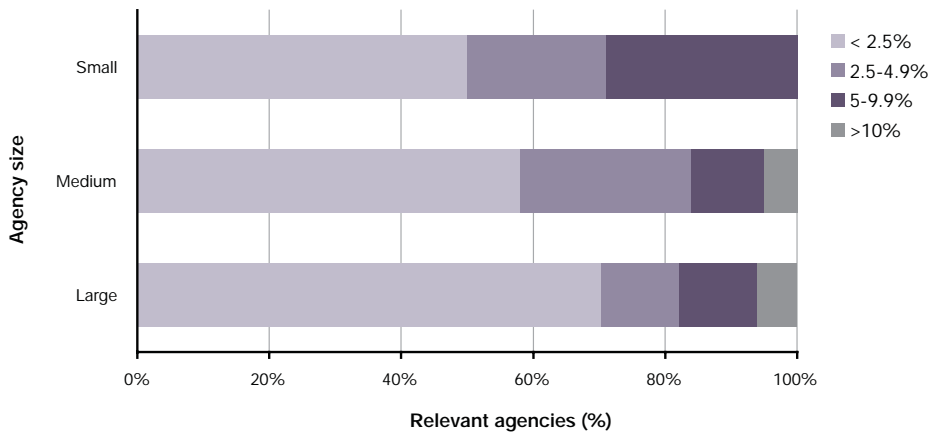
This year's survey also asked agencies to report on insourcing that had occurred during the year. Nine agencies indicated that they had insourced some aspect of ICT. The main reasons for insourcing included reducing costs and improving service delivery.

Resources used to administer ICT contracts

The agency survey asked agencies to estimate the proportion of annual resources dedicated to ICT contract management in 2004–05 as a percentage of the total cost of all outsourced ICT contracts. Agencies were asked to include human resources costs and other administrative costs in their estimates. More than half (58%) of the 60 agencies with at least one aspect of ICT services currently outsourced reported spending less than 2.5% of the total value of ICT outsourced services on managing related contracts.

This year the difference between relevant small, medium and large agencies in the proportion of annual resources they dedicated to contract management was less evident. However, as can be seen in Figure 12.2, relevant small agencies were still more likely than relevant medium and large agencies to have dedicated more than 5% of resources to contract management and less likely to have dedicated less than 2.5% of resources to contract management.

Figure 12.2: Proportion of annual resources dedicated to contract management of ICT contracts—relevant agencies, 2004–05



Source: Agency survey

A comparison of this year's data with last year's shows that overall a smaller proportion of agencies dedicated resources equivalent to more than 10% of the total contract amount to the management of ICT contracts during 2004–05 (3% of relevant agencies) than during 2003–04 (14%). Table 12.1 shows that much of the change occurred in small agencies. The proportion of relevant small agencies that spent more than 10% on contract management fell markedly to 0% in 2004–05 from 20% in 2003–04. The proportion of relevant medium agencies that spent more than 10% on contract management also fell to 5% in 2004–05 (14% in 2003–04).

Table 12.1: Proportion of annual resources dedicated to contract management of ICT contracts by size—relevant agencies, 2002–03 to 2004–05

Proportion of annual resources	Small agencies (%)			Medium agencies (%)			Large agencies (%)		
	2002–03	2003–04	2004–05	2002–03	2003–04	2004–05	2002–03	2003–04	2004–05
< 2.5%	50	40	50	63	45	58	58	65	71
2.5–4.9%	27	16	21	17	32	26	32	12	12
5–9.9%	13	24	29	13	9	11	11	18	12
> 10%	10	20	0	8	14	5	0	6	6

Source: Agency survey

Outsourcing of human resources services

This year 31 agencies (38%) reported that they had finalised new outsourcing contracts or contract extensions in regard to some aspect of HR services⁴ during 2004–05 (46% of small, 38% of medium and 24% of large agencies). This was almost double the number of agencies in 2003–04 (17 agencies) that reported that they had outsourced some aspect of HR services. As previously mentioned, it is difficult at this stage to determine whether this year’s result represents an increase in the number of agencies opting to outsource some aspect of their HR services or whether it represents a cyclical pattern.

All of the agencies that reported finalising contracts or contract extensions for HR services during 2004–05 indicated that they *partially* outsourced HR services.

Only one agency indicated that it had insourced some aspect of HR services. This agency indicated that insourcing occurred due to poor contractor performance and a change in the agency’s requirements.

Contract management

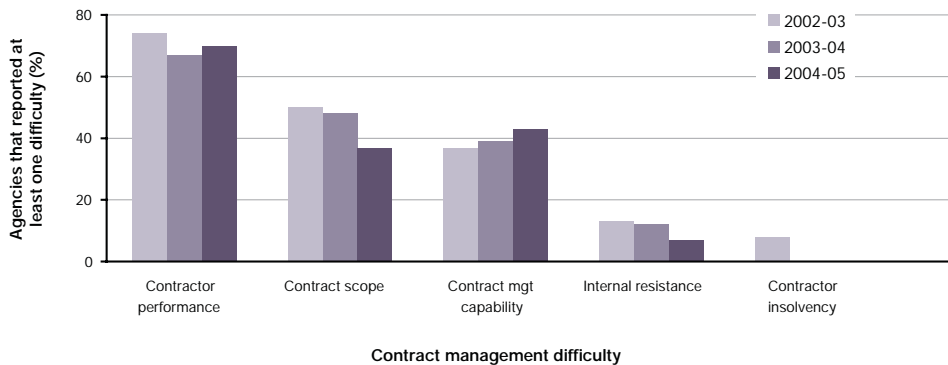
Contract management is an integral part of agency outsourcing activity. Agencies were asked questions about difficulties they experienced managing and/or overseeing outsourced contracts during 2004–05. These questions sought information about *all* outsourced contracts, not just those related to ICT and HR services. Depending on the agency, this could have included, for example, services to the agency (e.g. legal services, publishing services, security vetting services) as well as services provided to the public under outsourced arrangements.

Thirty agencies (37%) reported experiencing difficulties when managing outsourced contracts during the year; 38 agencies (46%) did not experience difficulties and 14 agencies (17%) indicated that they did not have any services outsourced. Medium agencies (46%) were more likely than large agencies (38%), who were in turn more likely than small agencies (29%), to report experiencing a difficulty.

⁴ HR services were defined in the agency survey as including payroll services, recruitment, training and development and agreement making.

The difficulties reported by agencies this year appear to be very similar to those reported in previous years. Although, as Figure 12.3 shows, contract scope and internal resistance are becoming less of a concern, agencies continue to grapple with problems surrounding contractor performance and contract management capability.

Figure 12.3: Contract management difficulties experienced by relevant agencies, 2002–03 to 2004–05



Source: Agency survey

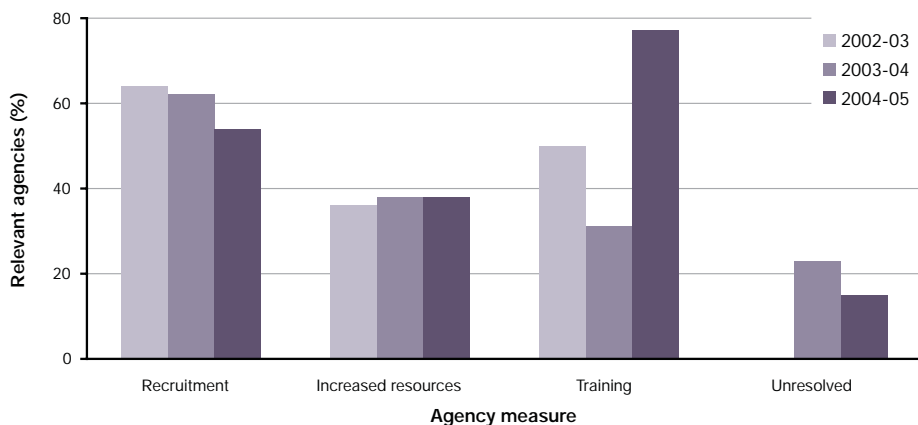
Contract management capability

The need for contract management skills in the APS has increased substantially during the last decade, reflecting the expansion of contracting out in the APS (including in relation to the provision of services to the public). Contract management skills have become an important capability for the APS.

Contract management capability was reported as a difficulty by 43% of the 30 agencies that reported experiencing a difficulty of some sort, a slight increase on last year's result. Relevant large agencies continue to be most likely to report contract management capability as a difficulty (50% in 2004–05, down from 67% of relevant large agencies in 2003–04). However, this year higher proportions of both relevant medium (42% in 2004–05 compared to 30% in 2003–04) and small (40% in 2004–05 compared to 29% in 2003–04) agencies reported contract management capability as a difficulty.

Consistent with last year, agencies reported that the strategies to address contract management capability included training staff, recruiting staff and increasing resources. As Figure 12.4 shows there appears to have been a change in the emphasis of strategies used by agencies to address the issue. This year there was a substantial increase in the proportion of relevant agencies using training as a means of improving capability in this area. This increase may be partially affected by the introduction of the new Commonwealth Procurement Guidelines in January 2005 and the associated information provided by Finance. Clearly, a key aim of agencies involved in outsourcing should be to ensure that employees who manage contracts are well equipped to deal with both the routine and more complicated issues that can arise—adequate and relevant training is a positive step in addressing this issue.

Figure 12.4: Agency measures to improve contract management capability—relevant agencies, 2002–03 to 2004–05



Source: Agency survey

The ANAO released a business support process audit, *Management of Business Support Service Contracts*, in March 2005. The audit was based around its *Better Practice Guide on Contract Management*,⁵ and was conducted with four agencies to examine the management of business support service contracts (e.g. human resources services, security services and accommodation management).⁶ One of the findings of this audit was that there was a considerable lack of training for contract managers—as a consequence, contract objectives may not be being achieved efficiently or effectively by agencies. This finding, and the resulting recommendation, further support the need for agencies to ensure that staff with contract management responsibilities are given relevant and adequate training in addition to supporting guidance from the agency, Finance and the ANAO.

Key chapter findings

Results of the agency survey show that agencies are continuing to outsource corporate services and functions, particularly ICT and HR services. During 2004–05, 44% of agencies reported finalising a new ICT outsourcing contract or contract extension, consistent with 47% of agencies in 2003–04. Furthermore, the proportion of agencies that outsourced at least one aspect of HR services almost doubled in 2004–05 (38%) compared to 2003–04 (20%).

Consistent with previous findings, it is evident that in some agencies there is still insufficient capability to manage outsourcing effectively. Although just under half of all agencies did not experience difficulties in managing outsourced contracts during the year, just over one-third reported such difficulties. Contract management capability was reported as a difficulty by 43% of agencies that experienced some sort of difficulty during the year, a slight increase on last year's result. Relevant large agencies continue

⁵ ANAO, *Better Practice Guide on Contract Management*, February 2001, <<http://www.anao.gov.au>>

⁶ ANAO, *Management of Business Support Service Contracts*, Performance Audit Report No. 37, March 2005, <<http://www.anao.gov.au>>

to be most likely to report contract management capability as a difficulty; however, this year there was an increase in both relevant medium and small agencies reporting contract management capability as a difficulty.

The most positive development in this area in 2004–05 was the substantial increase in the proportion of relevant agencies using training as a means of maintaining the required level of skilled contract managers they need to support and drive their outsourcing arrangements.