

FUNDING NGO DELIVERY
OF HUMAN SERVICES IN NSW:
A PERIOD OF TRANSITION

CONSULTATION PAPER

AUGUST 2012



FUNDING NGO DELIVERY OF HUMAN SERVICES IN NSW: A PERIOD OF TRANSITION

CONSULTATION PAPER

AUGUST 2012

© August 2012 – Copyright in this work is held by the Independent Commission Against Corruption. Part III, Division 3 of the *Copyright Act 1968* (Cwlth) recognises that limited further use of the material can occur for the purposes of "fair dealing", for example for study, research, criticism etc. However, if you wish to make use of this material other than as permitted by the *Copyright Act 1968*, please write to the Commission at GPO Box 500, Sydney NSW 2001.

ISBN: 978 1 921688 33 1

This publication and further information about the Independent Commission Against Corruption can be found on the Commission's website at www.icac.nsw.gov.au.

Public sector organisations are welcome to refer to this publication in their own publications. References to and all quotations from this publication must be fully referenced.



Level 21, 133 Castlereagh Street Sydney, NSW, Australia 2000

Postal address: GPO Box 500, Sydney, NSW, Australia 2001

T: 02 8281 5999

1800 463 909 (toll free for callers outside metropolitan Sydney)

F: 02 9264 5364

TTY: 02 8281 5773 (for hearing-impaired callers only)

E: icac@icac.nsw.gov.au www.icac.nsw.gov.au

Business hours: 9 am - 5 pm Monday to Friday

Contents

Chapter 1: Introduction	4
1.1 The purpose of the paper	4
1.2 The difficult task of controlling funds	6
Chapter 2: Government agency design	8
2.1 Internal arrangements	8
2.2 Information management systems	10
2.3 Human capabilities	11
2.4 Disincentives to report and act	12
Chapter 3: Agency–NGO interaction	14
3.1 Funding agreements	14
3.2 Value for money	18
3.3 Irregular allocation of funding	19
3.4 Oversight of services	20
Chapter 4: Broader operating environment	21
4.1 Funding coordination	21
4.2 NGO governance capabilities	23
Appendix: Questions for submissions	25

Chapter 1: Introduction

In a process repeated across many jurisdictions around the world, the NSW Government is increasingly shifting from in-house delivery of human services¹ to delivery through funding of non-government organisations (NGOs)². Every year in NSW alone, billions of dollars are provided to over 2,000 NGOs, which amounts to more than 7,000 different agreements to deliver human services on behalf of the government. Such large sums of money spent across so many agreements by so many agencies presents a formidable test of any control system.

Several reasons have been provided to the Independent Commission Against Corruption ("the Commission") as to why a government chooses to use NGOs to deliver these services, including:

- NGO delivery of services is viewed as being of lower cost to the government and, for this reason, more efficient
- NGOs are able to provide a higher quality of service than has traditionally been provided by the government
- NGOs are more flexible and responsive to clients and communities due to more dynamic internal systems and greater local knowledge.

1.1 The purpose of the paper

Efficiency, quality and responsiveness are compelling reasons for increasing the shift from government delivery to NGO delivery of human services, and it is not the intention of this paper to challenge either the reasons or the practice of funding NGOs to provide human services.

Rather, the purpose of the paper is to examine the corruption risks in the funding arrangements, in a way that is, at a minimum, compatible with the primary functions of the human services agencies and, preferably, in a way that enhances the management of the funding. Specifically, this paper is produced for the purposes of section 13(1)(f) of the *Independent Commission Against Corruption Act 1988*, which states that a principal function of the Commission is:

to advise public authorities or public officials of changes in practices or procedures compatible with the effective exercise of their functions which the Commission thinks necessary to reduce the likelihood of the occurrence of corrupt conduct.

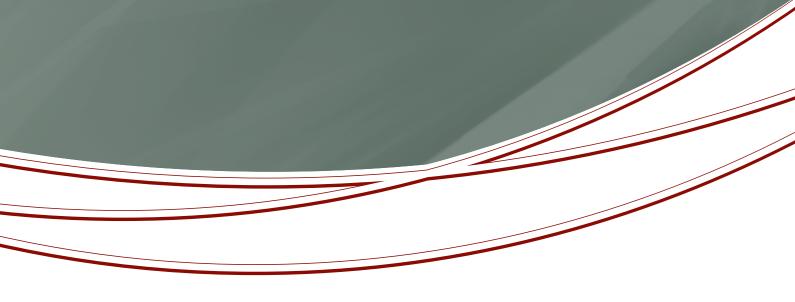
Government has the responsibility to ensure the probity of funding arrangements. Funding cannot be provided completely on trust that the recipients will use the money honestly and to best effect. Conversely, the controls on the funding cannot be so onerous as to negate the benefits derived from delivery through NGOs.

While the vast majority of NGOs and staff are dedicated to helping others, there are those that see government money as an opportunity for self-interested behaviour. The Commission is aware of a number of allegations and problems in NSW and other jurisdictions, including:

- staff using government monies and resources for their own benefit. Sometimes this evolved over time with ever-increasing salaries, cars and benefits being appropriated by NGO staff. On other occasions, there was a deliberate intention to misappropriate funds and the NGO was established for that purpose
- using funds to deliver a different service from the one agreed on with the government agency.
 While possibly done with noble intent, in reality this practice amounts to obtaining money

¹ The field of human services is broadly defined; it involves providing a range of health, welfare and social services to support the needs of individuals, families and communities.

² For example, a not-for-profit; this paper is only concerned with NGOs that receive funding from the NSW Government to deliver human services.



under false pretences and makes it difficult for government to budget or deliver services as planned

- obtaining funding for the same service from multiple programs, agencies and jurisdictions. The service can then be reported as delivered to all funding bodies but the cost to government is high. This is particularly an issue where NGO activities span borders, making it possible for an NGO to obtain funding from two states and/or the Commonwealth Government, in the knowledge that there is little coordination between NSW, other states and the federal government on specific funding agreements
- obtaining funding for capital works but delaying construction in order to bank the funds and earn interest. The interest on several million dollars can then be used as income by the NGO
- government-funded assets belonging to an NGO being stolen or, in one case, used to run a business by NGO staff
- providing services to favoured clients from the same family or community as the NGO managers
- collusion between government frontline staff and NGO staff either to obtain funding or to agree to weak or minimally-specified delivery outcomes in return for funding. In either case, the NGO income is enhanced
- falsely reporting to the government that services have been delivered when they have not, or delivering at a lower quality than required. There appear to be occasions where NGOs cover up critical client incidents to ensure continuation of funding.

A key focus of this paper is to examine the effectiveness of the control systems of the funding agencies, their interface with the NGOs and the broader operating environment. These controls can be viewed as controls over waste and mismanagement of government funds.

Efficiency, effectiveness and corruption vulnerability appear to be part of the same problem. For example, exorbitant administration costs accumulated by an NGO, or failure to commence capital works while receiving interest on the granted money, can be indicators of waste as much as corruption, and the remedies are largely the same.

A number of control issues, however, have no simple or clear solution. There are competing viewpoints on how the desired goals of control mechanisms are best achieved. The Commission seeks submissions on these matters.

The issues raised for discussion in this paper stem from a research project administered by the Commission that involved:

- discussions with interested parties including head office and frontline staff from government agencies, NGOs and peak, oversight, complaint-handling and law enforcement bodies
- reviews of relevant published reports
- examination of unpublished documents of the Commission and government agencies
- examination of the systems governing the funding of NGOs in other jurisdictions.

1.2 The difficult task of controlling funds

NSW Government agencies that deliver human services are diverse, as are the services they deliver, the arrangements by which they deliver the services, and their broader, external environments. This paper does not examine specific strengths and weaknesses of any one agency or type of funding arrangement. Rather, concerns are identified across the system as a whole, and will have varied relevance to any one agency or funding arrangement.

Government agency design

For government agencies, the shift to a contested model of delivery within a broader public service economy presents a fundamentally different control environment from the in-house delivery model. The centrally planned and directed programmatic arrangements of the in-house model do not easily coexist with controls of an outsourced model that is responsive to client or community needs.

The Commission, therefore, seeks submissions on the effectiveness of the internal arrangements of government agencies to control a flexible and outsourced delivery model. Issues that require examination include the centralisation of decision-making, funding based on program service delivery, information management systems, human capabilities and systems to manage the performance of NGOs.

Agency-NGO interaction

The transactions now occurring across organisational boundaries are quite different from the transactions that occur between an in-house service provider and their clients. For example, grants and contracts have to be established, prices have to be determined, contracts need to be oversighted and managed, and performance problems have to be addressed. These are all new

challenges for a system built to manage delivery by government staff, particularly where operational staff do not typically have contract management skills.

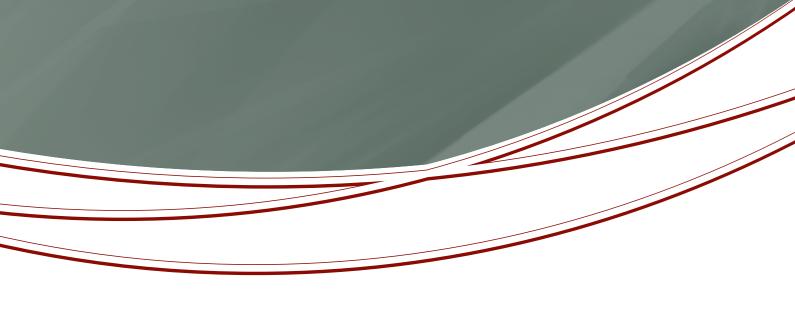
The Commission seeks submissions on the nature of the funding arrangements and the corresponding systems of control. Issues that require examination include the use of grants as opposed to contracts, the specification of deliverables, and approaches adopted to determine the price of service delivery. The Commission is also seeking views on the control of funding that occurs outside of normal channels.

Broader operating environment

Each government agency operates in a service delivery environment characterised by a tangled web of jurisdictions, funding agencies and programs. So far, the NSW Government has had limited success in coordinating the funding activities of all relevant agencies, despite the introduction of senior coordinator roles, various memoranda of understanding between government agencies, and the establishment of coordinating bodies. Where serious local problems are evident, place-based coordination is sometimes used to integrate the activities of key funding agencies. None of these approaches, however, has proven to be fully effective. Government agencies work with a large number of NGOs, many with quite limited internal governance capabilities. Funding, training, auspicing and partnering have all been used to compensate for gaps in NGO governance capability.

Call for submissions

This paper raises a number of issues for consultation. The Commission has asked those who submit responses to focus on systems of control to prevent corruption in the three broad areas of (1) government agency design, (2) the interface between agencies and NGO providers of service delivery, and (3) the broader environment in which they operate. More specifically, the Commission would like



respondents to consider strategies to integrate interdependent components of the NSW government funding system in its shift from an in-house delivery of human services to an outsourced model of service delivery.

The Commission understands that submissions will address some or all of the questions raised. Respondents, however, may make submissions that reflect a holistic analysis of the issues raised for discussion, and consider alternative solutions for the short and long terms. Refer to the appendix (page 25) for a list of the questions in full.

The Commission is seeking submissions on the issues raised in this paper to inform the publication of a future position paper. This future paper may recommend changes to improve government management of corruption risks associated with NGO delivery of human services. Submissions received will be published on the Commission's website unless their author requests otherwise.

Please submit written responses to Dr Robert Waldersee, Executive Director, Corruption Prevention Division, Independent Commission Against Corruption, by email to icac@icac.nsw.gov.au (attention: Dr Robert Waldersee) or mail at GPO Box 500, Sydney NSW 2001.

If you would like to discuss any aspect of the consultation paper while preparing your submission, contact Dr Waldersee on 02 8281 5999 or 1800 463 909 (toll free). This paper is available from the ICAC website at www.icac.nsw.gov.au.

Deadline for submissions: 5 pm, Friday 5 October 2012.

Chapter 2: Government agency design

Since the beginning of the 20th century, NSW Government agencies have primarily delivered services directly. Complex internal capabilities to control and coordinate the delivery of services have evolved, including large planning and policy areas, program-based service delivery, centralised decision-making and top-down communication. Traditionally, central offices staffed with experts in the social services have decided what services are to be provided, to whom they are provided and in what manner they are to be provided. These directives are then passed on to work units arranged by a large geographical area. These units deliver the services themselves

While in-house service delivery does continue, government agencies are increasingly being asked to control the client-centred, flexible, third-party delivery that has come to dominate human services in the western world. The system of centralised decision-making, planned services and top-down control of the delivery of predictable service offerings is now being asked to focus on meeting the unpredictable and complex needs of clients and communities.

Furthermore, the expectation is that government agencies will be agile and timely, and include contract arrangements with NGOs as part of the delivery mix. In effect, government agencies are tasked with ensuring the probity and effectiveness of two quite different methods of service delivery.

Government agencies have been undergoing a broad transition over the past 25 years, from:

- a command and control system to a system increasingly determined by local client demand
- in-house delivery to outsourced delivery through NGOs
- a standardised delivery system to a system of increasingly tailored services.

In short, the problem is that the legacy controls within some government agencies' systems are more suited to the old command and control, centrally-planned system of in-house delivery than the evolving-client demand model delivered through a nexus of funding agreements.

2.1 Internal arrangements

Flexible and agile client-centric service provision is a more complex undertaking than the delivery of centrally-planned, reliable and standardised service offerings. Many more decisions need to be made, and these tailored client decisions often use information primarily available at the point of service delivery. Shifting the point where client decisions are made inevitably alters the corruption risks associated with these decisions.

Such a client responsiveness imperative indicates that decisions be decentralised to a point in the organisation where there is good knowledge of the client and community needs. An empowered frontline uses knowledge of the situation on the ground to manage the delivery of the services as needed.

Equally compelling is the need for an agency to ensure appropriate distribution of resources across the state, determine what needs the government is willing to meet, ensure that the services provided are of a standard that is acceptable, and that value for money is achieved. Such imperatives indicate centralised decision-making. Responsibility for programs, which describe the services to be delivered to meet priority needs, policies and procedures to control behaviour at the frontline and NGO contract control, would sit firmly in central offices.

The Commission's concern is that the arrangements of decision-making and the systems of program and policy control that relate to the decision-making are not working

effectively, and that control is breaking down as a result. A lack of effective control of programs and policies creates opportunities for waste and corruption.

Although there is considerable variation, government agencies are characterised by large central offices with significant centralisation of decision-making, despite the shift to a flexible and outsourced delivery model. Agency head offices develop programs, policies and procedures that specify the design and manage service delivery that occurs at the frontline.

Policy units are generally detached from operational units and do not tend to actively manage the implementation of the programs they design. While not necessarily a problem in a top-down, in-house delivery model, the policies and programs of a centralised non-operational structure can become disconnected from the realities of flexible delivery.

A system of centralised planning and top-down communication struggles as the primary control of client-centric delivery of tailored services in complex environments. All possible contingencies need to be foreseen and controls put in place. To rely on specific programs, policies and procedures to control the delivery of services that meet the large range of client needs generates high levels of complexity. The amount of policy and program material designed to control activities becomes so large and difficult that, ultimately, these materials lose their ability to control. When control is lost in this manner, the challenge of managing corruption risks is increased.

Proliferation of policies and programs

In some cases, the sheer volume of policy-related information exceeds the cognitive limits of any person. Several frontline officers reported to the Commission that the relevant documentation on programs, policies and procedures produced by their agency exceeded tens of thousands of pages. Even if staff wanted to follow the rules and managers wanted to enforce them, it is beyond the capability of individuals to know what is expected of them and what they can provide to the clients.

It is not surprising, then, that the NSW Ombudsman has reported³ that not only health practitioners and social workers, but even some agency staff, lack knowledge about the service system. Families have to find their own way around the system. Some families in crisis receive a service, while others in similar circumstances do not.

In the face of the overwhelming volume of material emanating from central offices, a number of respondents told the Commission that the regional managers are key to making service delivery work. These managers protect operational staff from policy overload by interpreting and communicating what they consider to be key policy points to operational staff.

From a control perspective, this appears to be less than ideal. In effect, central policy as a tool that controls operational staff and probity is problematic, and is replaced by an unstated reliance on geographically-isolated regional managers to keep the system functioning. It has been

³ NSW Ombudsman, Consultations with families of children with disabilities on access to services and support, final report, June 2011, p. 3.

suggested by a number of parties that this sometimes contributes to the creation of regional silos and exacerbates the disconnect between policy formulation at head office level and policy implementation at the local level. A lack of control allows inefficiencies and waste, and increases the risk of corrupt conduct.

It is not only the policies and procedures that are unworkable at times, but the programs of delivery themselves. With program planning often distributed across multiple units within central offices and distant from operational knowledge, gaps and overlaps between programs develop. The Commission has been told by several respondents that, in some cases, the disconnect between operational needs and centralised program design puts regional managers and frontline staff in a position where they must bend or work around the program controls in order to deliver the services as needed. Given that these controls are designed to, inter alia, manage corruption risks, their repeated bypass results in increased corruption vulnerabilities.

To an extent, service delivery appears to function because of workarounds, rule bending and ignoring of controls. Complexity, policy overload and gaps in service design work against effective control of the system, which is conducive to corrupt and inappropriate behaviour. Instead, the system depends heavily on regional managers acting as an interface, block or filter to the centralised planning and control mechanisms rather than as a functionary within the planned system. The system implicitly relies on regional managers to exert some other effective control over their regions, which is often normative rather than procedural.

Questions for submissions

The Commission seeks submissions on how the internal control systems of human services agencies can best deal with the complexity of flexible service delivery through contract arrangements, while retaining state-wide consistency, equity and focus of service delivery.

- Which control decisions should be (a) centralised and (b) decentralised to the regions or lower level?
- 2. How can control be streamlined?
- 3. What are the advantages and disadvantages of the programmatic approach to service design and delivery?

2.2 Information management systems

Most probity arrangements rely to some extent on monitoring to detect wrongdoing. In the human services area, this is a particularly difficult task with thousands of NGOs and funding agreements to track, and the information located in disparate forms and locations. Audits, self acquittals, frontline knowledge, service incidents, NGO history, governance capabilities of NGOs and client feedback all play a part in the monitoring of NGO performance.

To be useful, this disparate information could be brought together into an information system that is:

- able to facilitate the gathering of all information relevant to managing the performance of NGOs
- structured around NGOs in order to better evaluate their performance and compliance with funding agreements
- available in a form that is easy to access, share and analyse
- capable of triggering action in respect of NGO failure to deliver in accordance with agreed performance.

A number of parties raised broad concerns about the effectiveness of existing information systems to bring together the wide spectrum of performance-related information, such as expected and achieved outcomes, expert evaluations of quality, service incidents and relevant responses, informal information (for example, from clients), self-report information and risk profile data.

While information on incidents, complaints, informal reports, client information, expert evaluations and so on are collected at different points of the agencies, they do not appear to be integrated within comprehensive information management systems. With well over 7,000 funding agreements and monitoring requirements related to NGO engagements in NSW, much of the information gathered is paper-based or simply an electronic copy of the paper-based information. In many cases, information gathering is limited to NGO self acquittals, and, in others, audit reports are supplied by the NGO.

While the Commission does not dispute the value and significance of reviewing audit reports, such reports are not a guarantee that financial irregularities do not exist, that services were delivered or that service quality was acceptable. While the Commission is aware that frontline officers and the agencies make efforts to ensure that client experiences are considered in performance evaluation,

overall there appears to be a reliance on paper-based information provided by the NGO itself.

The limitations of audit reports

Audit reports are not always an unbiased evaluation of NGO activities. In economically-depressed areas, the bulk of the work of auditors is often with NGOs. While professionally independent, the auditors rely on continued business from NGOs, creating a significant conflict of interest. In some cases, the independence of audit is lost completely as the auditor also takes on the role of book keeper for the NGO.

With the information that is collected, the Commission was told that it is difficult to obtain a complete picture of any NGO across all of its funding agreements and its history. Often the data are not in a form that allows access and analysis by frontline staff, regional managers and head office oversight processes.

Several senior public officials reported that the structure of the information that is collected is designed more to evaluate programs than NGOs. As the various programs have significant funding and accountabilities attached, the logic has been to collect information that allows the evaluation of program effectiveness. The difficulty of such information systems is that many NGOs are funded from multiple programs and even multiple agencies. To monitor NGO behaviour, therefore, requires systems that integrate information about NGOs across programs and, preferably, agencies.

Incompatible information

Often information is collected to evaluate program effectiveness rather than NGO effectiveness. The Commission is aware of NGOs that receive funding from two or more different programs administered by the same agency, each program with markedly different monitoring requirements. These monitoring requirements differ despite the funding from the programs being administered by the same frontline official from the agency. Such complexity is onerous for NGOs and makes it difficult for information management systems to generate a picture of the overall performance of any single NGO.

Finally, participants in the Commission's research raised the issue that without some sort of trigger mechanism, even an integrated information system may fail to generate an effective response. The concern is that, even if information is captured somewhere in the system, it is unlikely that it would automatically trigger an investigation into NGO improper conduct in other than exceptional circumstances. Triggers may include, but are not limited to, the number of incidents logged, periodic review of contract, patterns of outcome evaluations and entry of very serious complaints.

Questions for submissions

The Commission seeks submissions on how government human services agencies can improve their information management systems to better manage and control NGO delivery of services.

- 4. What would be necessary for both head office and frontline staff to have access to key performance information in a form that would facilitate monitoring of NGO issues?
- 5. How can quality information about client experience be obtained?
- 6. How can the recording of performance information be improved at frontline and head offices?
- 7. What information should trigger investigations of NGOs?
- 8. How can an information management system be balanced to evaluate government programs, regions/offices and NGOs?

2.3 Human capabilities

Generally, fundamental changes in a business model, such as the shift from a centrally-planned, in-house delivery model to a decentralised contracting model, alter the nature of the work done and consequently the skills required. The work to be done in controlling the funding of an outsourced service delivery model now includes understanding markets, developing market intelligence, engaging and negotiating with suppliers, writing funding agreements, financial monitoring, monitoring suppliers and remediating poor service delivery. These are qualitatively different skills from those utilised in the funding control of in-house delivery of services.

Effective funding control of NGOs requires a match of skills and knowledge, both in the adequacy of skills and the location of the skills at effective points of control. Together, the skill level of key individuals and the

deployment of skills at critical points of the organisation constitute a central element of funding control. A number of officials have raised concerns that the skill set is not adequate for the complex control task, and that the skills that are available are concentrated in central offices, distant from contract-management decisions. In situations where staff are inappropriately skilled to manage funding contracts, there is a high probability that contracts will be mismanaged, creating opportunities for misappropriation of funds and corrupt conduct.

It has been put to the Commission that the skill mix of central offices is not sufficiently weighted toward controlling the contract nexus model of delivery. Rather, there is a predominance of social science skills that relate much more to the planned services approach and the management of the in-house delivery model. Within the centralised decision model that dominates NSW funding, specialist staff that are available, such as financial analysts, economists, strategy or procurement experts, tend to be located in units within head offices rather than close to the point of delivery. The central offices exert influence over frontline staff through a multitude of mechanisms, such as funding agreement design, management of client demands, recording performance information and managing the payments to NGOs.

Most frontline staff are specialists in social services — the core of the work — yet are also at the point where contracts are negotiated and managed. The staff working at the frontline may be required to make decisions regarding matters such as need determination, funding continuation, detection of under delivery and negotiation of contracts. Agencies recognise the demands on frontline staff and the skill requirements, and have introduced some training.

The problem remains that specialist knowledge is in relatively short supply and distant from the actual management of contracts. The linkage between the central specialists and frontline staff primarily takes the form of procedural requirements and guidelines. Those at the point of delivery are expected to work across all the relevant skill specialisations to the extent necessary to manage contracting; that is a substantial expectation.

An alternative approach implemented in another jurisdiction is to move the specialist staff closer to the point of delivery. The roles of staff within regional units are more specialised. Rather than the NSW model of general positions at the frontline, a number of more specialised positions exist close to the service delivery point. To do this, functions such as need determination, negotiating specifications and performance management are separated from each other and located close to the point of service delivery, as are some aspects of financial management. The regional units of the agency structures have the range of positions and specialist capabilities required to

manage NGO contracting. The head office role is more related to oversight, macro budgeting, policy priorities and coordination – a different skill set.

The Commission, therefore, seeks submissions on NSW human capabilities issues. These issues include whether government agencies would consider reviewing the level and location of human capabilities in order to meet the changing demands of the NGO service delivery model.

Questions for submissions

The Commission seeks views on whether the level and location of human capabilities in public agencies are appropriate to the current service delivery model.

- 9. What are the key agency skills for the management and control of NGO funding?
- 10. What skills shortages currently exist in human services agencies?
- 11. Is it feasible to have frontline staff undertake generalist roles (for example, in social services) as well as a variety of specialist roles (for example, finance, contracting and procurement)?
- 12. What specialist skills are required by staff in the head offices of human services agencies?
- 13. What specialist skills are required by staff located near the point of service delivery?

2.4 Disincentives to report and act

Often, the processes and systems of an organisation create perverse incentives to act in a way that was unintended by the architects of the system. Reports to the Commission highlighted sets of perverse incentives within the NGO funding management system. For a variety of reasons, those within the system have good reason not to take action when they find improper NGO behaviour. A consultancy firm with extensive experience in the NGO environment described the situation as "layer upon layer of cover up".

No doubt the intent of the current systems is to identify and act upon improper NGO behaviour. The communication channels, reporting requirements, management responsibilities, training, policies and so on, exist, in part, to facilitate action against improper NGO activity. The broader environment, however, discourages reporting and action. Disincentives exist from within the NGO itself, to the frontline, the regional manager level and even central offices that work against the reporting and action that is intended.

NGO clients can be reluctant to report problems because they fear reprisals from the NGO. NGOs themselves can be unwilling to report corrupt or fraudulent actions by their own staff because of concerns that this might impact on their relationships with the funding agency and their reputations, both of which are essential to securing future funding. NGOs reportedly respond to evidence of corruption by ignoring such behaviour or fixing the problem as best they can, often by quietly easing out the problem staff member/s.

Frontline staff have reservations about reporting corruption or poor performance because they are advocates for the NGOs and the community, as well as being regulators of NGOs. Several groups of frontline staff identified the potential loss of local services as the most significant disincentive to taking strong action against improper NGO behaviour.

The relationship between action on improper behaviour and placing services in jeopardy is a disincentive to act created by the way funds are returned to the central office if an NGO is defunded. Without substantial financial delegations, regional staff are generally not able to remove funding from a problem NGO and use that money to more effectively deliver the service through a different NGO.

Rather, the fear is that if funds are taken away from a problem NGO, then the money is returned to the central budget and the service may be lost. For staff living in the community and with close ties to the NGOs, defunding a problem NGO does not necessarily produce a better outcome for the community or for those working for the NGO. Turning a blind eye to poor or corrupt services may be better than having no services at all.

At the regional manager level, the disincentives to report problem NGOs continue. Some regional managers indicated to the Commission that head offices are of the view that NGO problems are operational issues that should be dealt with at regional level. Rather than actively encouraging the upward reporting of problems, some regional managers felt that reporting NGO problems to head offices was taken as an indication of regional managers failing to manage NGO performance. The Commission heard concerns that head office may use reports of NGO problems from regional managers against them in their performance reviews.

Even at the central office level there are disincentives to act. NGOs are viewed by public officials as very skilled lobbyists. As one manager observed, when NGOs lobby a minister they "never lose". The effective lobbying and threats to go to the media are sometimes experienced by public officials as pressure to tread softly regardless of the strength of the evidence of problems.

The lobbying and pressure not to take strong action against an NGO also emanates from the service clients. As noted

above, funding removed from a problem NGO is generally returned to the central office. In some cases, the service simply stops, with a risk of significant outcry.

In more critical services, there is no real option of ceasing delivery during the period in which funding is removed from one NGO and a funding arrangement is established with a new NGO. Central offices generally are not adept at ensuring continuity of services during the period between defunding one NGO and establishing new arrangements. The inability to ensure continuity of services while dealing with a problem NGO is a significant disincentive to taking decisive action.

In summary, human services agencies have a conflict of duty: they are simultaneously responsible for awarding and maintaining funding, and monitoring quality. Although this is easily managed by segregation of duties, structural separation or similar methods, the design of most government agencies places all of these functions in a single frontline role.

In the absence of a redesign of the operational units, one approach to manage this issue is to have independent regulators with the responsibility of ensuring quality of service delivery. Some participants in research conducted by the Commission suggested that one regulator for all NGO engagements is a worthy idea, while others were of the view that, given the wide range of regulatory issues, a number of specialised regulators are required. There are already a few particular services that are monitored by an independent regulator.

Questions for submissions

The Commission seeks views on how to remove disincentives to report or act on improper NGO behaviour.

- 14. In what circumstances should defunding decisions be at a regional, head office or ministerial level?
- 15. Should the funds recovered from a defunded NGO be returned to the relevant region instead of the head office?
- 16. How can the continuation of services be maintained in a defunding situation?
- 17. Should all NGOs be subject to a government regulator or regulators and, if so, should one regulator or multiple regulators perform this role?
- 18. What other initiatives might be developed to improve reporting of improper NGO behaviour?

Chapter 3: Agency-NGO interaction

In chapter 2, the importance of government agency design was discussed. It was suggested that the systems of some agencies are more suited to a command and control, centrally planned regulation of in-house delivery rather than an outsourced, flexible, client-demand model of delivery. Several design factors, such as internal structures, information management systems, human capabilities and the existence of disincentives to report and act on corrupt behaviour, determine the capability and position of government funding agencies to interact with NGOs.

It is through the interaction between funding agencies and NGOs that market intelligence and assessment of NGO capability occurs, where the price of service delivery is determined and where funding is transferred. While almost all NGO and agency staff are committed to good service provision and value for money, the Commission has evidence to suggest that problems at the interface between agency and NGO manifest in funding agreements and controls, value for money assessments, irregular payments and mechanisms of oversight. These issues were identified as corruption risks during the research conducted by the Commission. This chapter examines each issue in turn.

The type of government funding provided to NGOs varies in description: funding can be secured through a grant, negotiated contract, agreement, deed, partnership or contribution. These terms are commonly used and often used interchangeably. But the way a grant is given and administered should be quite different from how a contract is agreed and monitored. A partnership involves a long-term, close relationship between agency and NGO, while a classic contract is more distant and short term.

Determining price and value in the funding arrangements is difficult yet, without this information, the government is vulnerable to corrupt or fraudulent overcharging in addition to the waste of taxpayer money. In many cases, the market

does not function well. In remote areas of NSW, it has taken particular efforts of agency frontline staff to assist others in setting up an NGO to deliver a service.

In many cases, the NGOs are fully funded by the government, potentially leading to devious behaviour around renewal of funding. Even where an agency is able to go to tender, some NGOs bid below the real cost of delivering a service because they are able to obtain additional funding from other agencies. Price and value determination through mechanisms other than the market appears to be sporadic across the human services system and uncertain in their effectiveness. Even where price and value are well understood, the problem remains of NGOs receiving funds from multiple sources (a process sometimes referred to as double dipping). As a result, government knows neither what it should pay nor what it does pay for the delivery of many services, a situation conducive to waste and corruption.

3.1 Funding agreements

The Commission is unclear as to the nature of funding and type of agreements negotiated between the NSW human services agencies and NGOs. Although the relationship between an agency and an NGO is complex, its core is the funding agreement. The Commission is guided by the principle that government control of funding agreements should be appropriate to the context and type of funding. For example:

The degree of uncertainty around what is being asked of the NGO is generally managed by the mechanism of funding that is adopted. At one extreme, where there is high uncertainty and turbulence in the delivery environment, holding an NGO to a well specified contract is not necessarily appropriate. Funding NGOs through grants may be appropriate. At the other extreme, where clear, specifiable, predictable and verifiable deliverables can be identified, then procurement

The type of funding arrangement should be matched with appropriate control systems. The control of grants usually relies heavily on peer or expert evaluations on matters relating to the proposal, whereas procurement control relies more heavily on ongoing contract management and verification of delivery.

contracts may be most appropriate

In practice, most of the terms used by government agencies to describe funding agreements refer to quite different instruments with different purposes, different risks and different control requirements. That the terms of grants, contract and partnerships are used interchangeably suggests the purposes, risks and controls associated with the funding are not clear or are not universally accepted by different parties to the agreements. The diversity of control instruments appears to reflect genuine confusion about the nature of the funding relationship between government and NGOs. Different parties within government have alternatively described the funding relationship as government:

- investing in the services that NGOs provide
- outsourcing services to the NGO sector
- forming a partnership with NGOs to deliver services.

A number of considerations influence the method by which funding is injected into an area, with goals as various as building the capacity of indigenous NGOs or the development of players within a quasi-market. In most cases, however, the choice of funding instrument is tied to the uncertainty and turbulence surrounding the service delivery, and the effect this has on the ability to predict,

specify and measure actions, outputs or outcomes. This includes the clarity of cause-effect relationships within the delivery environment.

Uncertainty in the delivery environment – foster parenting

In a somewhat remote NSW community there were concerns that placing Aboriginal children into non-Indigenous foster care was resulting in culturally inappropriate parenting. Money was provided to a small NGO to work with foster parents to "improve" the cultural sensitivity of their parenting.

As every foster situation is different and changes over time, the actions required to improve cultural sensitivity in parenting are hard to predict for any situation. Improvement of parenting is very difficult to specify and measure. Long-term outcomes, such as strength of the local Aboriginal culture, are unlikely to be demonstrably impacted by one small program within the milieu of other programs in the community. The cause and effect relationship is, therefore, unclear. Such a program cannot be funded as a contract, as deliverables cannot sensibly be specified. It is, therefore, better suited to a grant arrangement.

Grants

Grants are commonly used where measurement and prediction of specific and clear deliverables are difficult. The Australian Research Council (ARC), for example, uses grants to fund academic research where the results of the research are hard to predict. Organisations that administer grants, such as the ARC, the Australia Council for the Arts and the National Health and Medical

Research Council (NHMRC), are dissimilar in form to organisations that undertake procurement. The expertise, internal arrangements, assessment processes and ongoing management of funding by granting agencies is different from those undertaking procurement.

Controls on grants focus relatively more on the recipient than the services that the recipient delivers. Expert assessment and peer review of track record, capability, informal knowledge, and other attributes of the NGO are essential to a judgment of whether money should be provided as a grant. Ongoing monitoring centres on the continuation of key attributes, including governance capacity. Performance measures and monitoring still play an important role but the level of specification is markedly less than that contained in a classic contract and focuses on mechanisms such as independent expert reviews.

Grant controls in the arts

The specification of activities, outputs or outcomes is difficult in the arts. Even when completed, critics may disagree on the worth of the work produced. As with all granting bodies, the decision to provide funding relies more on the evaluation of the proposal and the attributes of the proponent and goals of the funding bodies than the enforceable specification of deliverables.

The Review of the Australia Council report (May 2012) describes a process by the board is to "take advice from across its Panels, balance this alongside its own commissioned research and the patterns it sees emerging from the peer assessment rounds, and to synthesize this information into a clear vision and priorities for action for the organisation as a whole".

With the priorities decided, "multiple relevant juries for each funding round are formed from a pool of identified peers. Peers follow the organisation's strategic directions, the eligibility criteria and their knowledge and experience of excellence to rank applications".

"Staff will identify potential peers from a pool to form juries each round. Final selection of juries will be determined by matching of available peers to the types of applications received. If a high number of applications are received, the number of juries used to assess that round will increase to ensure a manageable level of applications per jury."

In effect, the control of funding relies more on a dynamic peer and expert assessment of the reputation and capabilities of the proponents, and the degree to which the proposal fits these capabilities, than it does on specification of deliverables, price determination, tenders, contract management and verification of delivery.

Contracts

Control of a service contract, by contrast, focuses on market intelligence, price and value determination, negotiation and specification of deliverables, and monitoring and managing the contract. Specifications are drafted with clearly designed performance measures and appropriately skilled contract managers to ensure that performance measures are being met. Processes are in place to check and limit the autonomy and scope of contract managers.

Beyond the classic contract that dominates government procurement is the relational contract. A number of government agencies described the funding of NGOs as being more like a partnership. Partnership relationships are designed for circumstances where there is a common desire to achieve the same goals, and both parties trust the other's capacity to deliver. As such, controls focus on close interaction and open communication between players. In partnering situations, service standards are expected to evolve as the relationship progresses. Importantly, a partnership relationship is only viable where both parties have similar objectives. In several cases, the Commission has seen corruption occur when the government agency assumed that the contracted or regulated third party had the same goals when they did not.

In summary, the Commission's concern is that the lack of clarity around the nature of the funding arrangements creates vulnerabilities. A general approach to funding control that does not recognise the significant differences between granting, contracting and partnerships is unlikely to be robust. Staff of government agencies identified the weaknesses in control that stems from such a broad approach, including the general nature of service agreements, vague specifications of services on occasion, and absent or broad price guidelines.

Choice of funding instruments

The Commission is of the view that an improvement of the funding arrangement decisions and controls may be warranted. Three approaches have been put to the Commission, and the Commission seeks submissions on this matter. The first is to create a contingent control system within agencies appropriate to the funding arrangements. The second is to reduce or eliminate granting in human services delivery with a move to more outcome-based contracting. The third is to improve accountabilities and specification by bundling smaller grants into enforceable contracts.

Clarifying the distinction between grants, procurement and partnerships would allow human services agencies to better design control systems suited to the nature of the funding arrangement. Where grants are most appropriate, systems of expert assessment of NGO capabilities and history

would dominate. Where contracts are most appropriate, procurement systems and contract management controls would be utilised. Human services agencies would develop a number of engagement models and a framework to determine when each system should be used.

The feasibility, however, of such a complex approach to funding controls succeeding within the current arrangements – that often place a single person at the interface with the NGO – is questionable. Each agency would need to create parallel systems of control to manage different types of funding agreements; that is, one system that resembles the controls of the ARC or NHMRC, one that resembles a procurement and contract management system, and one that focuses on managing a very close interaction in a long-term and evolving relationship. Where funding controls are not appropriate, there is an increased probability that corruption will occur.

Several respondents have suggested that an alternative to such complexity is to seek specification of deliverables through outcome-based contracting. It has been argued that outcome-based contracts circumvent the problems of prediction, specification and cause-effect understanding associated with funding activities or outputs. Complex granting procedures and procurement engagement, and control systems would, therefore, not be necessary. For example, if improved school attendance was an outcome, this can more easily be specified and measured than activities such as "effectively encouraging parents to send their children to school".

Unfortunately, outcomes are often no clearer than activities or outputs and sometimes less so. The search for specifiable deliverables in complex social environments can result in the selection of somewhat meaningless outputs that are relatively simple to measure. Generally, it is easier to determine that a given service has "reached" a set number of individuals, for example, than to determine the effect that this service has had on them or the community. Contracts are written on the basis of what can be measured, not what matters.

Bundling funding arrangements

A different perspective on the problem of specification of deliverables focuses on the broader system of small grants. The Commission's research identified the fragmentation of delivery funding as a contributor to the problem of specification of deliverables. Advocates of this view claim that the difficulties in specifying outcomes stem from multiple NGOs contributing to the delivery of a single service. With many NGOs contributing a small part to an outcome in any community, it becomes difficult to specify the precise actions, outputs or contributions required by any single NGO. It, therefore, becomes very difficult to hold any service provider accountable.

Many grants but few accountabilities

In communities with severe social problems, it is more likely NGOs will be funded to play some part in solving problems. The Commission is aware of one NSW town of about 500 residents where there is a ratio of one NGO funding agreement for every 10 residents. In such an environment, it is difficult to specify precisely what each NGO is to deliver as their part of the solution or to hold any one NGO accountable for community outcomes.

It has been put to the Commission that the bundling of small funding arrangements that are hard to specify into larger contracts can allow outcomes to be specified and suppliers to be held accountable. The effect of bundling service contracts is to create a smaller number of larger contracts linked to specifiable outcomes. The need to use grant funding is, therefore, reduced or eliminated. The high level contract approach reduces the costs of control borne by the agency as the number of contracts, negotiations, monitoring and dispute resolutions are simplified, and accountabilities are strengthened.

Opponents of this service bundling strategy suggest that, while aggregated contracts may solve some of the control and accountability risks in funding agreements, they also raise a different set of risks and control complexity. The contracts would no longer be unit-based purchasing of services but the creation of relatively unique contracts suited to a specific location and problem. Delivery would involve the contracted NGO to sub-contract or auspice smaller NGOs to deliver services. These subcontracting or auspicing arrangements would, therefore, need to be detailed in the bundled contract

Furthermore, the bundled service contract resembles a relational contract. Governments, in general, have little experience with the expertise, communication and renegotiation that is necessary for effective relational contract management. The rolling annual funding arrangements of some agencies work against such contracting.

To conclude, the lack of clarity on which government funding is based – whether it be a grant, contract or partnership – indicates contingent controls are largely not in place. Attempts to either manage the complexity of different funding instruments or consolidate the funding arrangements into a system of well-specified contracts both have shortcomings.

The Commission, therefore, seeks submissions on the nature of funding arrangements, their controls, and how these can be designed to minimise their vulnerability to manipulation and waste.

Questions for submissions

The Commission seeks submissions on how the types of funding agreement and control systems can be improved.

- 19. Should a framework be developed for classifying the type of funding agreement necessary for the service being delivered?
- 20. Should grants and contracts be separated and managed accordingly and, if so, how should this be done?
- 21. In what context should government provide grants to NGOs?
- 22. How can service delivery outcomes be better specified?
- 23. In what context should "bundling" of funds occur?

3.2 Value for money

Achieving value for money is a central component of corruption prevention. Removing excess funds from the system also removes many opportunities for corrupt gains. The existence of opportunities for overcharging, over-servicing and under-delivery is incompatible with achieving value for money.

Human services agencies and government programs differ significantly in how well price and value for services are determined. Often the primary focus is on price determination for a specified service and in other cases the central focus is on value for money. Across the state, a mix of market and expert analysis is used to determine price and value.

The use of markets to determine price is particularly complex in the human services environment. Not only is the specification of contract terms complicated, but there are market distortions for some services that make it very difficult for an agency to effectively determine value for money.

First, unlike a genuinely competitive market, which assumes many buyers and sellers, smaller NGOs are often formed to carry out one type of service in one place, organised by, and fully funded by, the government. The assumption of a true market is particularly questionable in rural and regional parts of the state, where there are few NGOs able to deliver a required service.

Second, information asymmetry between the government and the NGO is a common problem that puts the government at a disadvantage. NGOs may have better information than government agencies about local need,

what is required to deliver services, what has been delivered, and what outcomes have been achieved. In fact, having local knowledge is part of the rationale for NGOs delivering the services rather than agencies. It does, however, put government agencies at a disadvantage in determining price and value.

Third, markets assume that buyers desire profit and their price reflects this. If an organisation does not intend to make a profit, the true price is obscured. The Commission has been advised that NGOs often do not intend to cover the costs of the service delivery with the price put forward to the agency. Rather, they cover their costs with additional funds obtained from other programs or sources.

Government agencies often do not intend to pay the full price of the service. The system of grants and contributions that underpins some funding arrangements is consistent with the idea that the amount transferred to the NGO does not represent a price that covers the full cost of delivering a specific service. The acceptance by agencies and NGOs that the amount transferred from the government in any one agreement does not cover costs, makes determination of the total price to the taxpayer very unclear and creates opportunities for deceptive overcharging.

Service contracting can still occur in weak, distorted or quasi-markets, despite those markets making it a less than ideal way of determining price and value. Rather, the weaknesses indicate that an approach — other than testing a market — may be a more appropriate way to determine price and value. In line with this, some programs and agencies have adopted a predetermined unit pricing for services. In another jurisdiction, the price is set by the government, and the market is used to generate competition around criteria other than price for the service being delivered. NGOs compete on the quality component of value rather than the price component of value.

Broad variation in price

Determining the unit price of a service to be delivered is complex. The difficulties were highlighted in the Boston Consulting Group (BCG) report, NSW Government Out of Home Care Review: Comparative and Historical Analysis (September 2009). BCG noted the high degree of variability, especially in intensive placements of out of home care; these costs ranged from \$67,000 to \$120,000 – a difference of around 80%. From a value for money and corruption control perspective, such a wide range given to staff to determine unit costs is undesirable and provides considerable opportunity for corrupt conduct.

Setting a unit price based on analysis of costs is not straightforward. Unit pricing under the current arrangements will differ as a function of the diversity of NGO engagements. Factors that may affect the cost of services include:

- the scale of NGOs and other services they provide (the scope of operations)
- costs associated with the geographic spread of the service
- availability of skilled labour in different parts of the state
- availability of facilities
- set up costs for new NGOs.

Assembling the evidence to conduct a financial analysis and discover the true price for service delivery is particularly challenging. The need for skilled financial analysts to determine unit pricing is related to the human capabilities issues. If unit pricing is to reflect the costs associated with different types of services in different areas, then financial and business analysis skills, and the decision-making authority, would need to be closely linked to the situational contingencies near the point of delivery.

At what price?

In one case, the Commission found a significant discrepancy between the amount of money a government agency stated it had provided to an NGO and the amount recorded in the NGO's 2010–2011 annual report. The final price paid by the agency was five times more than what the agency had understood it to be. The Commission found that the NGO had approached the agency for additional funding during the financial year, and the person responsible for administering the funds was not aware that additional funds had been granted.

Questions for submissions

The Commission seeks submissions on approaches to determining the price and quality of service delivery that ensures value for money.

- 24. How can human services agencies better use markets to determine price and value?
- 25. What reform is necessary to develop in-house agency capacity to determine the price of services?
- 26. How can direct negotiations with NGOs be managed to determine a price that reflects the actual cost of delivery?
- 27. What other steps can be taken to ensure value for money in the provision of services?

3.3 Irregular allocation of funding

Funding agreements are generally created in the context of government programs and services to be delivered. Government programs and initiatives have a number of processes to control the funding provided. In certain circumstances, however, the usual funding processes appear to be bypassed. Sometimes this is initiated by agencies that make additional payments to NGOs outside of funding agreements, and at other times NGOs successfully lobby for additional funds outside the agency's normal systems. Either way, money flows outside of the established systems and controls. Where money is not wholly accounted for, a number of opportunities for misappropriation of funds are evident.

Participants in research conducted by the Commission indicated that when government agencies have excess funds at the end of the financial year, these funds may be allocated to NGOs. Such an allocation of government funds without a clear process or purpose outside of preferred channels is a marked corruption risk, and negates efforts to control funding and achieve value for money.

End of financial year funding

Prior to the end of the financial year, one NSW government agency asked an NGO to hold millions of dollars "in trust" until an agreement was reached on the service to be provided. In other unannounced cases, government has offered to place additional funding in NGO accounts toward the end of the financial year. The risks associated with such irregular money allocations are such that one NGO peak body warned its members about the irregular nature of the payments.

A similar lack of controls is evident if funding flows outside of the main channels; for example, following an NGO effectively influencing a member of parliament or minister for grant funding. Both of these supplementary funding pathways may conflict with allocating resources on the basis of need, the effective specification of deliverables and value for money. Where agency controls are bypassed and there is no alternate framework to guide funding, there are increased opportunities for corrupt conduct, such as favouritism and misappropriation of funds.

⁴ To some extent, this can be attributed to the widespread misunderstanding of how government programs are funded, as highlighted in *Interim Report: Public Sector Management*, published by the NSW Commission of Audit, January 2012.

Questions for submissions

The Commission seeks submissions on how to ensure that funding allocated to NGOs complies with set procedures.

- 28. What can be done to minimise corruption risks associated with irregular allocation of funding?
- 29. What changes to the budget processes of human services agencies are required to reduce the practice of end-of-year distribution of surplus funds?

3.4 Oversight of services

Effective oversight of contracted service delivery depends heavily on having impartial and expert staff working in a role that presents minimal corruption risk. Dilemmas, such as advocacy for, and regulation of, NGOs increase the risk of corruption. Under the current arrangements of delivering services through numerous programs, much of the oversight of NGO performance relies on a frontline staff member who is also part of the community. This arrangement of oversight and control places frontline staff in an unreasonable position of balancing competing imperatives; for example, the needs of the community, their relationship with NGO staff and the requirements of their agency.

Frontline staff living in the communities they serve, particularly in rural and regional areas that are distant from head office, can find themselves torn between these competing imperatives, effectively facing a moral dilemma. They are primarily responsible for the process of identifying a service provider and may even play a role in forming an NGO, negotiating service specifications and price, and monitoring implementation of the services being delivered.

The Commission has evidence to indicate that some frontline staff identify closely with the goals of an NGO in their local community, form personal relationships with NGO staff during the course of business with the organisation, and have personal connections with NGO clients or their families. In some cases, there is a two-way flow of staff between the government and the NGOs. It is not surprising, then, that frontline staff are known to adopt an advocacy role, acting in the interests of NGOs rather than the interests of the funding agency.

Several frontline managers indicated to the Commission that over-identification with NGOs and clients is an ongoing and serious risk. They suggested several mechanisms for managing the risk, including:

- that potentially biased staff can be identified through management processes, team meetings and general office discussions
- that biased staff can be identified via feedback from clients and NGOs that are potential or actual competitors of the NGO being funded
- the risk of a loss of impartiality forming part of general discussions held at staff management and team meetings
- rotating the management of specific NGOs amongst different frontline staff
- being aware of any signs of "lethargy" in managing NGO engagements
- having different public officials perform monitoring and acquittal processes.

While these mechanisms are useful in densely populated areas, they are less practical in small offices and in remote parts of the state. Rotating oversight of NGOs amongst different staff members, for example, is not feasible in remote locations managed by a single staff member. Within the current structural arrangements, the problems stemming from lone staff acting in isolation are difficult to address.

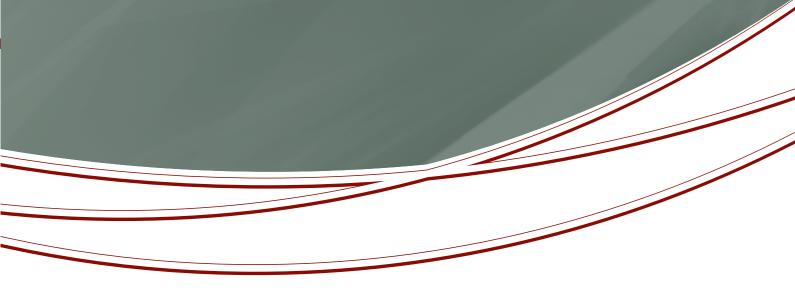
An alternative structural solution to the role-conflict problem can be found through integration of service delivery across multiple government agencies. With the integration near the point of service delivery, and with specialist support, including contract and finance roles, frontline staff carry out oversight in a multi-agency group.

The system of oversight in NSW notably contrasts with that in another jurisdiction where the risk of placing frontline staff in a conflicting role is reduced by having systems that involve multi-agency groups managing NGO contracts with integrated financial and case management systems. As a consequence, a single officer of a single agency is not acting in isolation.

Questions for submissions

The Commission seeks submissions on how to implement efficient oversight and control of services being delivered by NGOs.

- 30. How are the conflicting duties and community relationships best managed to ensure impartial and effective oversight of NGO funding?
- 31. What changes, within and across government agencies, can be made near the point of service delivery to minimise conflicts of duty and partial behaviour?



Chapter 4: Broader operating environment

Beyond the internal arrangements of government agencies and their immediate interactions with NGOs, the control of government funding is influenced by the behaviour of numerous departments and NGOs operating in the broader environment. This environment is characterised by poor coordination of funding between government bodies and poor internal governance capabilities of NGOs.

Where an NGO receives funding from multiple government agencies for similar services, it can be difficult for a specific agency to determine what "deliverables" it funds. Uncertainty over the precise purpose of funding can make drafting service specifications difficult and a NSW Auditor General report, *Performance Audit: Grants Administration* (2009), indicates that such confusion exists not just in human services grants, but grant funding more generally.

To varying degrees, the management of state funds will depend on the ability and motivation of an NGO to manage its own affairs well. Where the mission and reputation of the NGO is of great value to the NGO itself, and the NGO has good governance structures and capabilities in place, a degree of trust in the NGO may be appropriate. Conversely, there is greater risk associated with NGOs that are in existence only as a result of government funding to deliver a single service in a single location. While the majority of smaller NGOs are staffed by committed individuals, finance and management skills may be lacking as well as basic systems of management control. As a result, NGOs vary considerably in their management and governance capacity.

4.1 Funding coordination

The NGO engagement landscape is diverse and complex. There are multiple human services agencies providing funds to thousands of NGOs to service a large range of needs. An NGO may receive funding from several human services agencies, provide multiple types of services and/or provide services in different parts of the state. Moreover, different government agencies may fund very similar services.

For individuals and communities, the required services may span the programs of several agencies. Without coordination of these services, individuals are left to find their way around the various government and NGO agencies, resulting in waste and poor outcomes. Lack of coordination is also a corruption risk, reducing the ability of government to understand the full price of a service, to control double-dipping or to hold NGOs accountable for delivery of services.

The Commission was frequently informed that government funding is not well coordinated. There is often overlap in the funding across different funding agencies, different funding programs and even different jurisdictions. As a result, NGOs are sometimes able to obtain funding for the same, similar or related services from multiple sources. Only the NGO may know the total price paid by the taxpayer. Risk from weaknesses in coordination is a problem that moves beyond provision of double funding for the same service. Some NGOs also underbid on the expectation that further funding will be obtained from other programs, agencies and jurisdictions, affecting the determination of price and value, and verification of delivery.

Coordination of funding

In one case examined by the Commission, a small NGO receives approximately \$1 million in government funds per year to deliver services. This sum is made up of grants and funding from five programs spread across nine agencies and three jurisdictions. Since much of the funding is for one year only, the NGO is constantly moving to new programs and grants to maintain a constant level of funding to provide the same services in an ongoing manner. A small, constant service provided by one NGO has behind it an uncoordinated, complex and turbulent government system. The government as a whole does not know what has been funded in this case, how much was paid or what has been delivered.

Government agencies are well aware of the coordination problem. In the absence of an effective whole-of-government approach to coordination, some departments are working to integrate service delivery, at least within their own operations, including aligning the regional boundaries of the various agencies they control and developing common information systems.

Individual agencies also have added centralised coordination mechanisms within their internal arrangements. Existing executive oversight bodies have had regional coordination added to their roles. Coordination is managed centrally through a variety of mechanisms, including registries and interagency committees. Positions, such as coordinators, coordinators general, regional directors and community engagement officers, have been added.

The NSW Government operates the Regional Coordination Program, within which the Regional Coordination Management Group (RCMG) operates. This group of regional managers meets regularly to deal with the major issues within their regions. Multi-agency programs, such as Keep Them Safe, have established senior coordinating groups within which coordination can be addressed. Bilateral and multilateral memoranda of understanding are often agreed on between agencies trying to deal with specific problems or the implementation of specific programs.

Despite the good intentions and effort, most interagency coordination efforts have achieved mediocre results. The system of individual programs delivered through individual agencies has a natural tendency toward low coordination that is difficult to overcome with the addition of multiple committees and coordination roles. It appears possible that, while each coordination effort is well motivated and can potentially improve the situation, the cumulative effect is that an excess of senior level coordination initiatives paradoxically works against coordination.

Multiple coordination groups: the paradoxical effect on coordination

The NSW Keep Them Safe (KTS) program has numerous committees and working groups to coordinate and oversight implementation of its various initiatives. In 2008, the Child Protection Advisory Group (reporting to the minister and director general of the Department of Human Services) was set up to represent the interests of senior members of NGOs and peak bodies, and give advice on the implementation of the KTS program. But this advisory group was later disbanded. The KTS Implementation Group set up in 2009 by the Department of Premier and Cabinet ceased to operate in 2012.

A Senior Officers Group, comprising members of relevant government agencies and NGO peak bodies, continues to act as a steering group to oversight the KTS action plan. The KTS Evaluation Steering Committee, which was set up in 2011, meets monthly with NGOs to oversight service delivery in terms of "outcomes". In addition, individual departmental groups convene to assess the implementation of the program and its impact on their particular area of service delivery.

The plethora of implementation, steering and departmental groups does not appear to have produced effective coordination. NGO staff have indicated to the Commission that the various "funding doors" and "control points" are causing unnecessary confusion and uncertainty.

Senior-level coordination mechanisms are also hampered by their distance from the specific challenges on the ground. Much of the crucial, on-the-ground knowledge, such as the needs, preferences and history of clients and communities, cannot be effectively transmitted to central coordination decision points and back to the point of service delivery. Government agencies have recognised this problem and, in NSW, created multilateral agreements to implement place-based management of particularly problematic locations.

Such place-based mechanisms involve human services agencies agreeing to coordinate locally to deliver needed services to a specific community. Place-based models are characterised by a lead agency and several other agencies agreeing to coordinate efforts, usually to deal with serious and complex problems afflicting specific smaller communities. The approach is often based on community engagement which acts as a key guide to the coordination of services.

In effect, the place-based agreement is laid over the top of the silos of programs and agencies, rather than replacing them. Place-based interventions work against the system and are consequently expensive, relatively rare and usually short lived, despite evidence of effectiveness. A number of stakeholders have commented to the Commission that the place-based approach has been inadequate because such interventions:

- are adopted as short-term fixes in locations with complex problems. As a result, they are never part of the usual service delivery methodology but simply an attempt to improve "places" where the standard service delivery practices are deemed to have been ineffective
- are hampered by the back-of-house systems of human services agencies. Such systems are set up to support centralised, program-based delivery and are, therefore, unable to support such place-based trials to the same extent
- do not include all human services agencies in the implementation. This defeats the purpose of a place-based system because it means that this system does not coordinate all services – essentially the place-based system is just one of several programs that fund services at the "place"
- rely on one or more key individuals, such as community engagement officers or coordinators, and often fail when they leave. This reliance on individuals rather than systems may be related to the relative absence of the backend systems designed to support a placed-based approach.

Another jurisdiction has approached the coordination problem by integrating service coordination and funding control near the point of service delivery. Integrated government departments are supported by unified information and contracting systems. In effect, everywhere in the state is place-based, and there are no other siloed or programmed systems running in competition.

Questions for submissions

The Commission seeks submissions on ways to improve the coordinated control of services and their funding.

- 32. What matters should be coordinated centrally?
- 33. What matters should be coordinated near the point of service delivery?
- 34. How is coordination near the point of delivery best achieved?

4.2 NGO governance capabilities

To varying degrees, the risk of corrupt behaviour by an NGO is as much a function of the quality of governance of the NGO itself as it is of the oversight by the agency that allocates funding. Many participants in the Commission's research commented on the variable standard of NGO governance, indicating that the severity of corruption risks faced by the government agencies may differ greatly depending on the NGOs that they engage. The Commission does not intend to specify management and governance practices to NGOs. Rather, it wishes to examine the implications of variable governance capacity from a government risk-management perspective.

The funding system in NSW has created, whether deliberately intended or not, an NGO sector that is characterised by a small number of large NGOs that receive a disproportionately large amount of government funding. Meanwhile, the great majority of small NGOs rely entirely on relatively minor portions of the human services budget.

The standards of NGO governance and management practices are influenced by many factors. The size of the NGO, however, appears to be a key contributor to the governance capacity. Large NGOs tend to have a broad skills base with the capacity and motivation to understand the costs and consequences that corrupt conduct would bring to the organisation's reputation.

By contrast, NGOs that employ as few as two to three staff may have difficulty establishing and maintaining basic management practices. Skills, such as basic accounting, book-keeping and compliance management, can be absent. Industry experts advised the Commission that, while some small NGOs have excellent administrative practices, others operate very basic controls.

Governance for the small NGO

On occasion, very basic business processes are lacking. Some small NGOs use pre-signed cheques that do not require two signatures, make irregular bank reconciliations, keep a poorly maintained portable asset register, and have inadequate vetting procedures to verify staff qualifications.

An NGO governance expert told the Commission there is often a sense of entitlement amongst staff of small NGOs, which may lead to small frauds, such as individuals processing their telephone bill through the NGO account. This expert also advised the Commission that NGO boards sometimes avoid putting controls in place because it may appear as if they mistrust NGO staff.

Government agencies are aware of the risks associated with poor administration and weak board oversight of NGOs. In NSW, two broad approaches have been attempted to deal with the problem: the first was to build the governance capacity within the NGO; the second was to require the small NGO to effectively outsource finance and governance to large NGOs or other bodies.

Building NGO governance capacity is sometimes done directly by frontline staff of government agencies. Under other arrangements, additional funding is provided by agencies to specifically build capabilities in small NGOs through staff training and up-skilling. These funds can be given directly to specific NGOs or to industry peak bodies to provide training and development to the relevant NGOs.

While up-skilling the NGOs appears sensible, the outcomes are reportedly mixed. Difficulty in attracting, developing and retaining staff with the necessary skills has been a particular problem in more remote areas. Once equipped with transferable skills, there is an increased likelihood that NGO staff will seek employment opportunities elsewhere in the public, private and NGO sectors. As one senior official put it when describing capacity building followed by turnover: "you end up back at square one". The burden on frontline officers to provide assistance can be excessive and the provision of training by others, for example staff of peak bodies, is more accessible in urban areas than remote areas.

The second approach is to outsource the governance and management of small NGOs to large NGOs. In some cases, government agencies ensure that small NGOs can only enter into funding agreements if they work in partnership with a large NGO. This approach has the benefit of the small NGO providing service

delivery, with the large NGO assuming administrative functions on its behalf. In this way, the service delivery expertise of the small NGO may be utilised with less risk to government funds.

In a variation on this approach, small NGOs in remote areas have indicated a preference for some sort of government shared services or administrative centre that could deal with their management and governance requirements. In this way, small NGOs would outsource their administrative functions to a government department in the same way that one government agency might outsource its administrative functions to another.

Ultimately, it can be argued that the large number of small NGOs is a product of the way funding is carried out in NSW. The use of minor grants to totally fund these organisations is, to some extent, driving the fragmentation of the sector. The large number of small NGOs exists, in part, because of the way government funds them.

Officials from another jurisdiction suggested to the Commission that the number of NGOs being funded in NSW per head of population may be too large. Modifying funding schemes to encourage some consolidation of micro-organisations into entities that could reasonably be expected to undertake effective administration of government funds may be an option. NGOs that are unable to demonstrate management and governance capacity would be excluded from receiving government funding. Such industry consolidation would reduce the challenges to agencies of oversighting and coordinating funding, as there would be less NGOs being funded.

Questions for submissions

The Commission seeks submissions on how human services agencies should deal with the differences in NGO management and governance capabilities.

- 35. Should human services agencies specify minimum standards of administrative practice and/or governance arrangements prior to providing funding to NGOs? If so, what should these be?
- 36. Where weak administrative capability is identified, should NGOs be required to outsource their administrative functions to larger, more capable NGOs, or to shared services provided by government?
- 37. Would consolidation across NGOs improve management and governance standards?

Appendix: Questions for submissions

Chapter 2

- 1. Which control decisions should be (a) centralised and (b) decentralised to the regions or lower level?
- 2. How can control be streamlined?
- 3. What are the advantages and disadvantages of the programmatic approach to service design and delivery?
- 4. What would be necessary for both head office and frontline staff to have access to key performance information in a form that would facilitate monitoring of NGO issues?
- 5. How can quality information about client experience be obtained?
- 6. How can the recording of performance information be improved at frontline and head offices?
- 7. What information should trigger investigations of NGOs?
- 8. How can an information management system be balanced to evaluate government programs, regions/offices and NGOs?
- 9. What are the key agency skills for the management and control of NGO funding?
- 10. What skills shortages currently exist in human services agencies?
- 11. Is it feasible to have frontline staff undertake generalist roles (for example, in social services) as well as a variety of specialist roles (for example, finance, contracting and procurement)?

- 12. What specialist skills are required by staff in the head offices of human services agencies?
- 13. What specialist skills are required by staff located near the point of service delivery?
- 14. In what circumstances should defunding decisions be at a regional, head office or ministerial level?
- 15. Should the funds recovered from a defunded NGO be returned to the relevant region instead of the head office?
- 16. How can the continuation of services be maintained in a defunding situation?
- 17. Should all NGOs be subject to a government regulator or regulators and, if so, should one regulator or multiple regulators perform this role?
- 18. What other initiative might be developed to improve reporting of improper NGO behaviour?

Chapter 3

- 19. Should a framework be developed for classifying the type of funding agreement necessary for the service being delivered?
- 20. Should grants and contracts be separated and managed accordingly and, if so, how should this be done?
- 21. In what context should government provide grants to NGOs?
- 22. How can service delivery outcomes be better specified?

- 23. In what context should "bundling" of funds occur?
- 24. How can human services agencies better use markets to determine price and value?
- 25. What reform is necessary to develop in-house agency capacity to determine the price of services?
- 26. How can direct negotiations with NGOs be managed to determine a price that reflects the actual cost of delivery?
- 27. What other steps can be taken to ensure value for money in the provision of services?
- 28. What can be done to minimise corruption risks associated with irregular allocation of funding?
- 29. What changes to the budget processes of human services agencies are required to reduce the practice of end-of-year distribution of surplus funds?
- 30. How are the conflicting duties and community relationships best managed to ensure impartial and effective oversight of NGO funding?
- 31. What changes, within and across government agencies, can be made near the point of service delivery to minimise conflicts of duty and partial behaviour?

Chapter 4

- 32. What matters should be coordinated centrally?
- 33. What matters should be coordinated near the point of service delivery?
- 34. How is coordination near the point of delivery best achieved?
- 35. Should human services agencies specify minimum standards of administrative practice and/or governance arrangements prior to providing funding to NGOs? If so, what should these be?
- 36. Where weak administrative capability is identified, should NGOs be required to outsource their administrative functions to larger, more capable NGOs, or to shared services provided by government?
- 37. Would consolidation across NGOs improve management and governance standards?

I-CA-C INDEPENDENT COMMISSION AGAINST CORRUPTION Level 21, 133 Castlereagh Street Sydney, NSW, Australia 2000 Postal Address: GPO Box 500, Sydney, NSW, Australia 2001 T: 02 8281 5999 1800 463 909 (toll free for callers outside metropolitan Sydney) F: 02 9264 5364 TTY: 02 8281 5773 (for hearing-impaired callers only) E: icac@icac.nsw.gov.au www.icac.nsw.gov.au Business Hours: 9 am - 5 pm Monday to Friday