I·C·A·C

INDEPENDENT COMMISSION
AGAINST CORRUPTION

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

POSITION PAPER

DECEMBER 2012

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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.

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Corruption prevention context

In common with many other governments around the world, NSW is shifting from in-house delivery of human services[1] to delivery through funding of non-government organisations (NGOs) and direct funding of individuals. Each year, NSW provides billions of dollars of funding to more than 2,000 organisations to service over 7,000 agreements for this purpose.

Proponents of an outsourced delivery model consider that the transfer of decision-making, resources, tasks and activities to NGOs operating at the local level will promote community partnerships that are more responsive to client or community needs. But delivery of services that are flexible and responsive to the needs of specific members of the community is a more complex undertaking than the provision of uniform service that is centrally controlled.
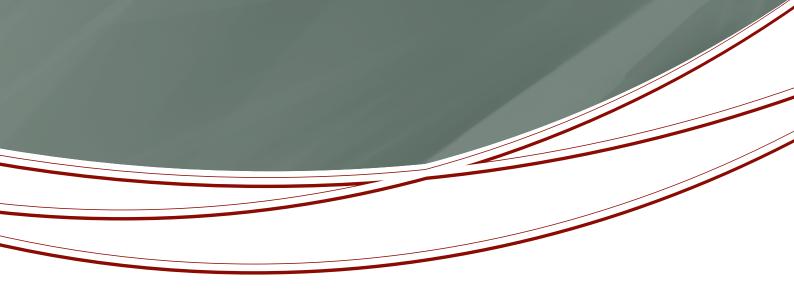
Why is the Commission involved?

As human services delivery in NSW transitions to the NGO delivery model, there will be a corresponding need to transition to organisational designs that are decentralised (where some of the decision-making authority is transferred from central offices to the regions and frontline).

Currently, the decision authority in most NSW human services agencies still sits squarely within central offices, while at the frontline the need for flexibility forces staff to work around the impediments of central directives. Central controls are becoming less effective but have not yet been replaced by a more appropriate model. With agency controls under pressure and an environment in which large numbers of funding allocations are available, the situation is conducive to corruption.

The problems and allegations that were brought to light during the research conducted by the Independent Commission Against Corruption ("the Commission") highlight the control failures in such an organisational environment. The Commission has been made aware of the following:

- NGO staff using government money and resources for their own benefit
- NGO staff using funds to deliver a different service from the one agreed on with the government agency
- NGOs obtaining funding for the same service from multiple programs, agencies and jurisdictions
- NGOs obtaining funding for capital works but delaying construction in order to bank the funds and earn interest
- government-funded assets belonging to an NGO being stolen or, in one case, used to run a business by NGO staff
- NGOs 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
- NGOs falsely reporting to the government that services have been delivered when they have not, or delivering at a lower quality than required.

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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.

The submission provided by the NSW Ombudsman to the Commission's consultation paper[2] identified "significant challenges that need to be addressed in order to provide quality assurance" as well as the need for "greater consistency in the administration of funding contracts and the systems NGOs have in place for probity checking and screening".

The NSW Auditor-General's 2012 Fraud Survey, conducted as part of the most recent audit of state finances, found that NSW Government departments identified 4,649 frauds valued at $21 million in the three years up to 30 June 2012, and that "there is a growing trend in frauds identified in outsourced functions and contracted non-government organisations".

Similar misconduct has been identified in NGOs that work with Indigenous communities. The Australian Crime Commission's National Indigenous Intelligence Taskforce (NIITF) has undertaken extensive intelligence collection over several years in relation to the nature and extent of crime in Indigenous communities. The NIITF states:

> …[it] *has identified numerous instances of potential enablers of criminal activities that impact on the use of public funds to deliver services in Indigenous communities. While it is acknowledged that a number of initiatives are being implemented to address these concerns, the NIITF continues to note potential vulnerabilities which may impact on effective delivery of services to Indigenous communities. The NIITF has identified, nationally and within NSW, a range of examples of exploitative behaviour and issues relating to financial crimes within some NGO organisations.*

A principal function of the ICAC is the revision of methods of work, practices or procedures that allow, encourage or cause the occurrence of corrupt conduct.

Specifically, section 13(l)(f) of the *Independent Commission Against Corruption Act 1988* ("the ICAC Act") 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".

While the ICAC Act is quite clear about the role of the Commission in advising public authorities about their procedures in this case, the situation is less clear about the Commission's role in overseeing funding after it has been provided to the NGOs.

If the actions of the NGO could adversely affect, either directly or indirectly, the exercise of official functions of a public official or public authority and involve matters such as fraud or theft, then it would be corrupt conduct under the ICAC Act and the Commission would have the jurisdiction to investigate.

When areas of government obligations and powers are devolved to NGOs, however, the consequences are often that the ICAC is denied jurisdiction. There is no logical pattern as regards many NGOs because officers of the NGOs concerned do not fall within the definition of public official under the ICAC Act.

A useful way of ensuring that the Commission does have jurisdiction is to legislate for the jurisdiction of the NSW Auditor-General to cover money provided to NGOs for the purposes of delivering government services. Jurisdictions that allow the auditor to examine money provided by the government to NGOs, at least to some degree, include New Zealand, Papua New Guinea, the Australian Commonwealth, Queensland, the Northern Territory, South Australia, Tasmania, Victoria and Western Australia.

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2 The consultation paper, which was released in August 2012, is available from the Commission's website at www.icac.nsw.gov.au.

Legislative change that brings all government funding provided to NGOs under the auspices of the NSW Auditor-General would provide clear external oversight of financial compliance and system performance. With the linkages between the NSW Auditor-General's legislation and the Commission's legislation, such an extension of the NSW Auditor-General's scope would also clarify the Commission's jurisdiction over NGOs in receipt of government funding. This is because the Commission has jurisdiction over public authorities and the term "public authority" is defined in the ICAC Act to include a person or body whose account of administration or working expenses is an account with respect to which the NSW Auditor-General has powers under any law.

RECOMMENDATION 1

That legislation be amended to provide the NSW Auditor-General with power to inspect, examine and audit the accounts of NGOs that have been provided with government funding.

Research and consultation

The Commission's research comprised analysis of relevant organisational arrangements evident from publically available documents and Commission holdings. Over 75 sessions were held with a broad cross section of experts, including interviews and meetings with senior managers, regional managers and frontline staff of human services agencies.
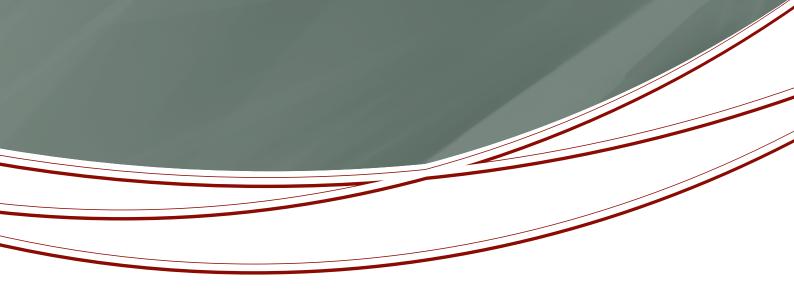
To capture the views of involved outsiders, interviews were held with some regional managers from the NSW Department of Premier and Cabinet and consulting firms that provide services to some human services agencies and NGOs. Discussions were held with NSW oversight bodies and a commonwealth intelligence agency.

Representatives of NGOs, NGO peak bodies and local government were also interviewed. To understand a different model of control within a comparable jurisdiction, discussions were held with managers from Victoria's Department of Human Services (DHS). The Commission has also considered the issues raised in the 33 submissions it received in response to its August 2012 consultation paper.

To consider the mechanisms that have been used to control decentralised decision-making in comparable jurisdictions, the Commission conducted two case studies: Victoria and Scotland. Both of these jurisdictions are considered to be leaders in the implementation of decentralised human services delivery and both are comparable to NSW. Victoria has almost 20 years experience in this area, and has learnt and evolved during that period. While change in Scotland is more recent, the approach is widely considered to be progressive and innovative.

Like NSW, both Scotland and Victoria are sub-national governments within the Westminster system. Both are similar in demographic profile, culture and legal system. All three jurisdictions spend roughly the same amount on human services delivery. Scotland and NSW provide services in remote areas, although no part of Victoria is considered remote.

Importantly, both jurisdictions adopted the same principles of control of decentralised decision-making and both have been successful in managing flexible human services delivery. The primary difference between the jurisdictions is that Scotland devolved decision authority to 32 council areas. With many more local councils, Victoria devolved decision authority to 17 local areas managed at the state level. Each of the Victorian local areas encompasses about four local council areas.

The Commission is of the view that, in the absence of significant amalgamation of local government areas, the Victorian model is more applicable to NSW than the council-based model of Scotland. Many of the recommendations made are based on this model. Key elements of the Victorian model relevant to NSW include:

- the restructuring of service delivery areas from eight regions to 17 local areas

- devolving aspects of financial authority and budgets to regions and devolving decision-making authority for local management to local areas

- strong information systems and outcome-based accountabilities

- independent accreditation of governance capabilities of NGOs

- simplified agreements and the use of lead NGOs in consortia arrangements

- strong review role for central office.

Complex reality of the NSW operational environment

Traditionally, governments have delivered human services themselves within systems designed to ensure that reliable and standardised services are provided equitably across the state. Such service outputs are well suited to management through the central command and control system that characterises many government agencies; needs are identified across the state, priorities set and programs designed. Delivery of the programs is via operational units, which are structurally distinct administrative groups organised by geographic region. Governments continue to provide many human services in this way.

Demands have increased, however, for service provision to become more flexible and innovative. Recipients and communities expect their own unique sets of complex needs to be addressed. Recipients often see the state systems as lacking innovation and being complex and slow to respond.

With government agencies designed to manage standardised and reliable services through central control, policy-makers have increasingly turned to service provision via funded NGOs, and funded individuals, to achieve these needs for flexibility and innovation. In NSW, for example, delivery of out-of-home care will soon be fully transferred to NGOs.
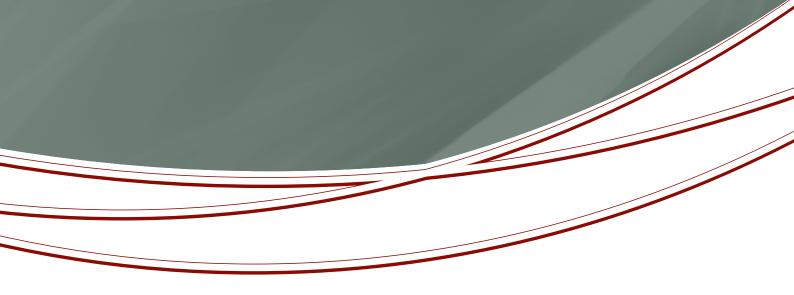
Agencies designed to control centrally in-house delivery of standard services are now in the invidious position of also having to control flexible and local delivery by third parties. No single organisational design can be suited to controlling standard and reliable outputs as well as flexible and innovative outputs.

The imperative of client responsiveness dictates that decisions must be decentralised to a point within the system where knowledge of client and community needs is most available and the local issues clearly visible. In the operating environment of the NSW Government, an empowered frontline staff would best use knowledge of the situation on the ground to manage the delivery of the services as needed. The centrally-controlled system, in contrast, is increasingly ill-equipped to achieve such objectives. The result is a transitional phase, with a system fighting against itself to achieve its mission.

This conflict between dynamic policy goals that are in step with community needs and rigid central planning makes effective control of NGO service delivery in NSW difficult.

This difficulty is worsened by the:

- need for services to be managed across large distances
- need for performance to be monitored and verified
- layers of loosely coordinated jurisdictions
- occurrence of market failures, especially in geographically-remote areas and regional NSW
- reliance on local and tacit knowledge and the experience of frontline staff
- partial funding of services by agencies within the context of a partnership between government and NGOs.

The emergence of decentralisation

The centralised and siloed agencies are poorly suited to controlling the complex interaction between frontline staff, the community, clients and other agencies. When it comes to determining needs and designing programs and controls, the work of staff at central offices cannot, ultimately, achieve both the tight control of the frontline and NGOs as well as the benefits of flexible, innovative NGO delivery.

Submissions received by the Commission in response to its consultation paper indicate tight controls imposed by central offices are limiting the ability of NGOs to deliver flexible services. Several NGOs have criticised the significant administrative burdens and red tape generated by federal and state regulations. The effect has been described as turning NGOs into government bodies.

While central office edicts limit flexibility of NGOs, the operational pressures to provide flexible service through NGOs have given rise to an embryonic, decentralised decision-making design at the frontline. Over time, agencies have evolved to cope with the needs of a more flexible and client-centred approach that has come to dominate human services. Decision-making has had to shift to the frontline to make the system work, regardless of the policies, procedures and programs; indeed, it has shifted to the frontline almost in defiance of the central directives.

Due to the overwhelming volume of often impracticable controls and material from central offices, the Commission's consultation process has revealed that regional managers are protecting their operational staff from policy overload and unnecessary directives in order to allow staff to make the necessary decisions. Regional managers do this by filtering, interpreting and communicating what they consider key policy points to operational staff.

As one respondent stated, regional managers "need to have broad shoulders" to stand between unworkable central directives and operational imperatives. The result is that some regional managers transfer as much decision-making as they can to the frontline within this informal design, and do so in direct conflict with the centralised controls. The increase in frontline discretion in this emergent structure has become, to a certain degree, detached from the formal controls of the centralised system.

From a control perspective, this is less than ideal. In effect, central policy tools that are meant to ensure probity are replaced by the informal reliance on geographically-isolated regional managers to maintain service delivery. This, in turn, creates regional silos and weakens the connection between policy formulation at head-office level and policy implementation at the local level. The probity controls that exist on paper are therefore not implemented in practice.

The decentralised operational design that has emerged informally in some human services agencies in order to cope with operational imperatives exists without official recognition or adequate systems of control. It is risky to have decentralised decision-making emerge in geographically-isolated areas. Sometimes these decisions are exercised by single individuals with end-to-end control of funding decisions, with staff allegiances to community, clients and the NGOs, and sometimes with NGOs that often lack basic governance capabilities. Some corruption is almost inevitable.

The control of decentralisation

The concern of the Commission is not the lack of compliance with the central controls, since it accepts that the high level of centralised control in the current system is not workable. The incompatibility of the central controls with the increasing shift toward NGO delivery is what has led to the emergent decentralised decision-making. The Commission is concerned, however, that the emergent decentralisation exists outside a formal organisational design.

To formally or informally decentralise decision authority, in the absence of other changes, has the potential to fuel corruption. Decentralising decision-making authority within the current system assigns largely unfettered discretion to single frontline staff; individuals often operating far from management and in their own communities. Lack of negotiation, contracting and financial skills, conflicts of interest that exist between the officer's attachment to their community and their duty to the agency, combined with end-to-end control of the funding arrangements makes such arrangements highly risky.

The recommendations made by the Commission relate to controlling decentralised NGO funding decisions rather than enforcing compliance with central directives. The experiences of Victoria and Scotland are drawn upon heavily. The recommendations address the following:

- segregation of duties and transparency of decisions within regions and local areas
- importance of adequate information and its effective management
- establishment of clear accountabilities within the system
- simplification of agency-NGO transactions
- enhanced central office oversight

- independent assurance of NGO governance capacity and service standards
- bringing funds provided by government to NGOs under the external oversight of the NSW Auditor-General and the Commission.

Local engagement – local oversight

The Commission's research identified a high degree of centralisation and prescription of service in some human services agencies that not only made it difficult to develop and deliver appropriate services but actually weakened control over the frontline and NGO activities.

To account for every contingency, an overwhelming volume of documentation emanates from head offices, yet remains disconnected from the realities on the ground. The system "works" because regional managers act as a block between head office and the frontline, allowing the frontline to make decisions as they think appropriate.

The large regions and central controls make it very difficult for the decision-makers to understand, and respond to, specific needs of individuals and communities. Both Victoria and Scotland have devolved service decisions to relatively small local areas, a change the Commission believes is appropriate for many agencies that fund NGOs in NSW.

Recently, Victoria's DHS created 17 "local areas" within four regions. These are based on geographic catchments to reflect population change and service demand across the state. The boundaries of the 17 local areas will match the boundaries of clusters of about four local councils. In effect, each service area is linked to a number of councils. As local government boundaries are universally recognised, it is anticipated that it will be easier to coordinate relevant services from different agencies regardless of each agency's individual regional boundary arrangements.

In Scotland, public services are organised by the councils themselves. Unlike NSW, Scotland has only 32 directly-elected local councils that have responsibility for providing public services, including health and social care, within each geographic area through powers conferred to them by statute. Potential council amalgamations in NSW may make the Scottish model viable in the future. At this time,

however, the difficulty in managing funding through so many local councils would provide little, if any, additional corruption control benefits.

Whether devolved to local service areas or to amalgamated councils, small service areas with clearly defined boundaries enable frontline staff close to the point of delivery to be aware of service and contract problems, as and when they arise, and to be aware of the needs of the community and individuals. Such boundaries also provide certainty and ease of identification of where service provision is contained, and can support coordination and collaboration between state agencies (such as police, health, housing, education and community services) in reaching outcomes for specific communities. Of course, it is not always possible, or necessary, to have representation of all agencies at every local service area; agencies have different concentrations of service demand in different locations.

> ## RECOMMENDATION 2
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> **That local service areas be established by agencies across NSW, where such areas are compatible with the work of the agency. These should be small enough for staff to be in touch with communities and be aware of service and contract problems as they arise. Without prior amalgamations of councils, the Commission recommends that these service areas be managed by state agencies.**

In Victoria, the commitment, collaboration and coordination between funding agencies and funded organisations are formally set out in partnership agreements, memoranda of understanding and through the Human Service Partnership Implementation Committee (HSPIC). The HSPIC is a forum of managers from the DHS and the sector, and community representatives established to govern the implementation process of service delivery. Working groups of the HSPIC regularly review and improve business processes, negotiate sector-wide funding issues, and host partnering dialogues to share learning.

The effect of the partnership agreements is to bring the frontline staff members from each agency into formal and informal groups that work to solve local problems. With multiple local agencies involved in partnership arrangements and delivery of community outcome goals, the behaviour and decisions of any single frontline staff member are visible to other staff and the community. This arrangement produces broad-based scrutiny of each funding agreement, which increases the transparency of decisions made about the funding for any one NGO and makes corrupt conduct difficult. The Commission is aware of a number of cases in NSW where the introduction of such informal communication and planning across jurisdictions and agencies has quickly identified cases of double-funding of NGOs.

RECOMMENDATION 3

That decision-making authority for local management be devolved to local service areas. Devolved decision-making would allow local staff to work together formally within partnership arrangements, and informally bring together related agencies, clients and the community to produce place-based solutions. Such arrangements would provide transparency and sharing of information that makes corrupt conduct more difficult.

Segregation of duties is a core method of corruption control. No individual should control two points in a process that together create high levels of opportunity and motivation for corruption. In the Commission's experience, contract management and financial control should be separated. Within a decentralised decision-making model it is important to segregate financial control from contract management, while keeping financial decisions close to the community. If the management of finances is transferred to the regional level, but segregated from the contract management at the frontline, the responsiveness of service delivery can be achieved without creating undue corruption risks.

The Commission is of the view that local budgets could be managed in regional offices if skilled business units were to be established at the regional level. In Victoria, funding flows from the Treasury to departmental budgets and is devolved further to the regions. The DHS' central office frames funding and resource allocation in a three-year policy and funding plan. These plans guide regional decision-making in setting activities and targets contained within service agreements. Regional decision-makers, however, have a large degree of discretion to allocate (and when necessary, to re-allocate) funding to targeted strategies. Many of the local areas will have a designated senior manager to drive and coordinate services across, for example, housing, disability and family services. According to senior managers at the DHS, this supports the principle of devolving finance and resources to its regional level and better assists in achieving community outcomes.

In parts of the NSW system, it is not possible for regional managers to move funding from one NGO to another in order to manage a problem. When funds are removed from an NGO, the money is often returned to central accounts and the funds and services may well be lost to the region. The current system creates a perverse incentive to ignore problem NGOs. Frontline staff, motivated to do the best for their region, should not face the choice of a poor service or no service.

Regional-level budgetary control retains the funding in the area. Staff are able to terminate funding of problem NGOs and contract for the service to be delivered by a different NGO. Rather than a disincentive to act, the ability to control the use of funds to produce a better local outcome for the region aligns the incentives of the staff with the goals of the agency.

The Commission's research identified a second perverse incentive to ignore the behaviour of problem NGOs; where a service must continue to be provided, such as residential care, it is difficult for central office decision-makers to maintain continuity of service while terminating an agreement with one NGO and arranging service provision by a second NGO. The central offices tend not to be aware of all the options on the ground, and are not in a good position to negotiate bridging arrangements. The agility provided by regional budgets allows temporary arrangements to be put in place while a new, permanent arrangement is made. A regional manager may hire a major NGO to temporarily deliver the service, for example, while more long-term service delivery arrangements are established.

RECOMMENDATION 4

That aspects of financial authority and budgets be devolved to the regions, so that basic service contracting and management of supplier performance (including changing providers) can be carried out by using local knowledge.

Information management in a devolved environment

Since the 1920s, it has been accepted that system measurement and information management is the foundation of controlled decentralisation. Without an effective information management system it is almost impossible to monitor and manage the thousands of decisions made about NGO funding across the state.

The current systems in NSW fall well short of what is needed to maintain control of operations. Government, or even agencies, are unable to determine what funding has been provided to which NGOs, for what purpose, and what outcomes have been achieved. Information on incidents, funding, NGO capabilities, client perceptions, complaints, expert evaluations, frontline judgments, and so on, is spread across many points of most agencies.

Where agencies do integrate information, it is often to evaluate specific programs rather than NGOs. The result is a proliferation of red tape, as NGOs provide similar information for each program and contract to the one agency. Yet, the information provided is unable to be organised in such a way as to allow an overall analysis of the reporting NGO.

Without integrated financial information about NGOs, double-funding or overcharging is almost impossible to detect. With even medium-sized NGOs having 10 or more sources of government funding, neither the frontline nor central offices are able to determine the total funding provided or the purpose of the funding. Information on under-delivery or service failures by one NGO across multiple regions or programs is often unavailable to decision-makers. A single analysis of the totality of the behaviour and performance of an NGO is difficult or impossible.

A system that integrates both formal and informal information about NGO funding and performance has greater capacity to improve the effectiveness of the funding

arrangements and to limit corruption. Corruption risks would be reduced by:

- linking each NGO to all funding sources provided by government
- bringing all information on under-delivery, financial irregularities, complaints and incidents together in such a way as to allow a comprehensive review of each NGO
- automatically triggering a review when predetermined, critical incidents occur.

The Victorian information system is not yet fully integrated, even within DHS. The information held within the main systems can, however, be assembled manually to provide an effective analysis of NGO funding arrangements, compliance and performance. A key element of financial control is the "service agreement management system" utilised by central office to review NGO financial activity. At the frontline, program and service advisers record and manage service provider relationships, supported by the "client relationship information system". Alternative processes exist for the input of data in relation to accreditation, complaints and incidents. The "funded agency channel" is a shared service utilised by NGO senior staff as a management and reporting tool. In combination, the various elements of an information management system serve to provide comprehensive support to central office and regional directors, and routinely form part of annual desktop reviews of service providers.

The Commission is of the view that, without significant improvements in information capture and management, the state will not be able to exert effective control over the funding of NGOs. Double-funding, under-delivery and financial irregularities will continue to be hard to detect, and red tape will continue to proliferate as NGOs

report on small aspects of their activities to individual funding programs. The development and implementation of information management systems may occur initially within a lead agency, but strategically would be developed in consultation with other human services agencies to allow the system to be adopted across funding bodies.

RECOMMENDATION 5

That a comprehensive information management system around NGOs be developed that captures frontline knowledge, complaints, critical incidents, accreditation and standards, program funding, audits and other information that would inform performance management and review processes.

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Creating accountabilities

The Commission's consultation process identified that the current fragmented funding arrangements made it difficult to hold NGOs accountable for their use of government money. With many NGOs contributing a small part toward a community outcome, it becomes difficult to specify the precise actions, outputs or outcomes required from any single NGO. There are communities with only a few hundred residents with 10s of NGOs and many more funded programs, some providing vague services, such as "improving foster parenting". Without clear accountabilities, and unless there is some obvious failure, wasteful or unnecessary annual funding arrangements often roll over year-after-year.

With the outcomes of small funding agreements often difficult to measure, funding is often tied to more easily measured activities instead, such as the number of clients visited. The Commission's consultation process identified concerns that some NGOs were able to check off activities against the funding without being held to account for the quality and effectiveness of their work. More broadly, concerns were raised that the funding of numerous small services by different programs and agencies often failed to deliver any tangible benefit to the individuals and communities.

A number of respondents indicated to the Commission that accountabilities are best established by linking funding to measureable higher-level outcomes. Rather than funding multiple small services, larger funding amounts are linked to the outcome that the variety of small service agreements were intended to achieve. To use a hypothetical example, small services such as employment counselling for school children in disadvantaged areas, apprenticeships for disadvantaged youth and résumé writing skills, can be bundled together. A measurable outcome, such as "a 10% increase in 16- to 20-year-olds in training or employment", can be used to hold the funded NGO accountable. Within such a bundled outcome, service activities are still specified.

> **RECOMMENDATION 6**
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> **That agreements be bundled to higher-level outcomes that are clearly measurable.**

To support outcome-based funding, Victoria has implemented the tools highlighted below, which the Commission believes can be applied to NSW.

Unit-pricing rather than tendering on price

In a model similar to Medicare, the prices of all specific service activities are set by the agency. Internal experts who understand the cost structures of NGOs set unit-prices for each specific service activity. The effect is to create competition between NGOs on what can be delivered for the set price. NGOs make submissions on how they would go about delivering services, including extra services and innovations in delivery. Competition is based on value for money and innovation rather than price. Accountability is established for the delivery of an agreed outcome at an agreed price.

This is quite different from going to market with set activities where NGOs compete on price. Price competition may be the reason for the practice of NGOs bidding below cost to win an agreement and covering costs with a second set of funds from another program. This practice normalises double-dipping and creates a significant corruption risk. Victoria has moved away from price-based tendering on agency specified services.

The price set for the delivery of the bundled outcome is the total of the unit-prices of the service activities specified within the agreement. The unit-pricing

approach allows tighter budgetary linkages between the funding provided and the outcome to be delivered. The budget-linked funding agreement limits the irregular pathways of funding from agencies to NGOs that were identified by the Commission during the consultation process. Irregular funding often consisted of additional money being deposited into NGO accounts without notice or agreement. Such loosely controlled money is potentially wasteful and creates the opportunity and motivation for corruption.

> **RECOMMENDATION 7**
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> **That the price of each service activity is fixed, and that value and innovation around delivery be contested.**

Longer agreements

To be held accountable, NGOs require sufficient time to deliver the agreed outcomes. During consultation, respondents raised concerns about the effect of short-term agreements, often for terms of only one year. The arrangements lead to uncertainty and constant searching for other funding, should one source not be renewed. Short-term funding creates incentives to seek double-funding, reduces the accountability of the NGO and increases red tape through frequent funding renewal activities. With three- to five-year funding agreements, NGOs can be held accountable against objective measures of their performance for the outcomes specified.

> **RECOMMENDATION 8**
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> **That, where feasible, agreements be set at three to five years, and funding continuity be tied to accountability for the measured outcomes.**

Frontline authority to manage agreements

Some parts of the NSW system have limited capacity to hold NGOs accountable. Often the choice is between providing capacity building assistance and total removal of funding, with no middle ground. It has been reported to the Commission that the provision of capacity building assistance is often very time consuming for agency staff and delivers mixed benefits. Frequently, efforts to build governance are centred on a single individual within a small NGO, and the benefits are lost when the individual leaves. Removing funding altogether is a dramatic step and, as noted above, there are incentives not to take such action.

Additional contract management options increase the likelihood of action being taken against problem NGOs. In Victoria, regional and frontline staff are able to negotiate with NGOs for the removal of part of the funding. If a residential care facility was problematic, for example, removal of funding for that specific service may be negotiated with the NGO while leaving intact the rest of the funding agreement.

The Commission is of the view that other intermediate performance management options also may be delegated to the regions. These options may include imposition of conditions, such as the outsourcing of the NGO's governance and financial functions to larger NGOs, either on a fee basis or through partnership arrangements. It was suggested to the Commission during the consultation process that in remote areas the business units of regional offices may provide administrative and governance services for a fee to small NGOs.

> **RECOMMENDATION 9**
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> **That, where governance or service problems develop but removal of funding is not warranted, negotiated removal of part of the funding be an option for frontline staff.**
>
> **That, if problems are detected, regional staff be provided with options to allow financial and probity functions to be outsourced from troubled NGOs.**

Reducing the complexity of the agency–NGO relationship

All transactions between an agency and NGOs carry transaction costs. These include identifying and selecting providers, agreeing on price and writing agreements. The transactions also carry additional costs related to associated risk, including resolving disputes and verifying delivery. The greater the volume and complexity of transactions, the greater the direct costs and costs related to managing risks.

Several Commission investigations have shown that a high volume of complex transactions can be conducive to corruption. Determination of need and price, verification of delivery and detection of collusion become difficult when the organisation outsources in a way that generates a large number of complex agreements with suppliers.

The current funding model for the delivery of human services consists of the provision of funding to thousands of NGOs, often for difficult-to-verify services. Many of these NGOs are receiving funds from multiple programs. Funding conditions vary across these different sources and funding agreements may be in the form of grants, contracts, partnerships or other documents. Often, the funding agreements are made in remote areas with few providers.

The Commission is of the view that boundary-spanning transactions, such as funding and granting, can be brought under tighter control by:

- reducing the number of service agreements and increasing the use of lead NGOs within consortia of NGOs or NGOs contracted as integrators of the components of service delivery

- using bundling of services to encourage entrants into weak markets

- developing single agreements per NGO with funding based on unit-priced services

- separating grants from the service delivery agreements.

Reducing transaction complexity through bundling of services

Aggregating or bundling services into a smaller number of larger outcome-based agreements based on unit-pricing directly reduces the number of agreements managed by the agency. It would not be realistic for small NGOs operating in isolation to enter into such large agreements. Larger service agreements could be used to encourage the emergence of consortia of NGOs and large NGOs acting as lead contractors or service integrators.

By contracting with lead NGOs, the complexity of managing service agreements with many providers in order to produce an outcome is removed from the agency. Responsibility for managing the complexity and risk of transactions with small NGOs is largely shifted to the lead NGO. Inefficiencies and opportunities for corruption in the transaction arrangements with the agency are reduced.

RECOMMENDATION 10

That bundled outcomes be used to reduce the number of transactions carried out by the agency.

That larger agreements be reached with consortia heads and lead NGOs acting as integrators to shift the management complexity from the agency–NGO transactions into the outcome agreements.

Encouraging entrants into weak markets

The weak markets that are particularly common in remote and regional areas can lead to complex arrangements between agency staff and potential providers. The Commission was told during the consultation process that in locations where no provider operates, the frontline staff may have to negotiate some arrangement. This arrangement can take the form of encouraging members of the community to form an NGO, and then advocating for its funding. Such activities, while noble in intent, create significant conflicts of interest for the frontline. Local staff working in their community to pull together an NGO, advocating for its funding, monitoring its performance and taking action where there are problems creates significant conflicts of interest and gives the frontline staff end-to-end control over the process.

It is the Commission's view that the bundling of agreements can also be used to encourage entrants into a market. If enough services in a particular region are bundled or the scale of the service agreement offered is large enough, larger NGOs are more likely to enter the market or new NGOs may form. Management agreements with large NGOs may also be used to develop local suppliers. By stimulating the market through service agreement bundles the current conflict of interest and end-to-end control risks are minimised.

> **RECOMMENDATION 11**
>
> **That weak markets be managed primarily through adjustments to bundling of agreements in order to create an attractive proposition to potential market entrants.**

Reducing the number of agreements through integrated contracting

The current complexity of agency-NGO transactions is partly driven by the use of multiple agreements per NGO. Each deliverable for each program generally is subject to a different agreement.

One NGO conducts a series of activities related to out-of-hours services for primary school children. While the NGO itself viewed all the activities as part of a single program, government funding treated various activities as separate. In one year, the general funding for these activities was provided by one state agency and one local council, with one federal agency providing child care rebates. The state agency and a second state agency provided funding for the "vacation care" aspect of this program. Another federal agency funded after-school activities, while an NGO established by another local council supported children with "high needs".

In submissions to the Commission, NGOs have argued that this plethora of agreements with government generates significant red tape. Different agreements are linked with different programs and agencies, requiring different or multiple information data to be provided to government. As noted earlier, despite the high level of repetitive reporting, government is unable to synthesise the information to generate an accurate and concise profile of an NGO. While there are single, broad-header agreements that are uniform across agencies, the specific service contracts are independent.

The Commission is of the view that one agreement per NGO is a realistic goal for government, by using a system of clauses and options within the single agreement. Such an approach can begin in a lead agency, such as the NSW Department of Family and Community Services (FACS), in consultation with other funding agencies that are likely to use the agreement. Over time, such an agreement may be adopted by other agencies. The red tape requirements would be reduced, while the ability of government to understand what funding is provided, to which NGO and for what purpose, is increased.

This mindset is driving reform in Victoria; the common funding agreement framework aims to simplify funding arrangements within and across all government departments. While led by the Department of Planning and Community Development, the DHS is utilising the new standardised service agreements to specify all activities funded by its divisions. Gradually, each service provider will have one standardised service agreement for all activities spread across all government departments.

> **RECOMMENDATION 12**
>
> **That the contracting approach be revised, with the goal being a system where each NGO has one standard agreement with government. If an NGO is to deliver multiple services, each set of services represents additional clauses to this agreement.**

Separating grants from service funding

Currently, one system of funding and control is frequently being used to manage two different approaches to funding: grants and service agreements. The mixing of grants with service agreements creates further complexity in the agency-NGO transactions, with grants having quite distinct risks and control requirements.

The Commission is of the view that grants should be moved outside the service delivery framework. With relatively little emphasis on deliverables, grants are not a

good funding vehicle for outcome-based service delivery. Grants are more useful for funding pilot studies, providing seed-funding, one-off capital works, and so on. Western Australia has split the management of grants from contract funding, while Victoria consciously minimises grant funding, if it uses it at all.

RECOMMENDATION 13

That the use of grants be minimised and that grants be managed separately from service-delivery funding.

Using specialists to manage capital grants

Finally, capital grants carry particular risks around the use of the funds and the ownership of the asset when problems arise. The Commission's consultation paper revealed cases where an NGO had not acted on a capital grant but simply used the interest on the granted funds as ongoing income. In another case an NGO failed but, because of the conditions under which the asset was constructed, the asset could not be used by the government. An additional degree of technical specialisation is required in managing capital grants and they should therefore be managed by those officials with that expertise.

RECOMMENDATION 14

That capital grants be managed separately from both non-capital grants and service-delivery funding.

Central control and review of system performance

The core of the concerns addressed by this paper is that current central office command and control systems within some human services agencies do not provide effective control of frontline activities. The central offices rely on highly specified programs to exert control over the activities of the frontline and the NGOs, and are often ignored. In the Commission's view, it is not practicable to attempt to exert control over the frontline using highly detailed and prescriptive service programs. Rather, the central office develops priorities and negotiates broad program outcomes, along with setting specific service outcomes. Such outcomes do not contain detailed or prescriptive directions for the frontline and NGOs.

> ### RECOMMENDATION 15
> **That highly prescriptive programs be simplified to communicate the desired broad outcomes. These outcomes would then be delivered through unit-priced service activities.**

Within a decentralised design, the challenge for central office is to control the decision-making of the regions and frontline, rather than to make the decisions for them. The control of decision-making generally has two distinct but related elements. The first effectively guides or fetters the decision-making of those in the regions, and the second monitors performance and takes remedial action as needed.

Fettering discretion

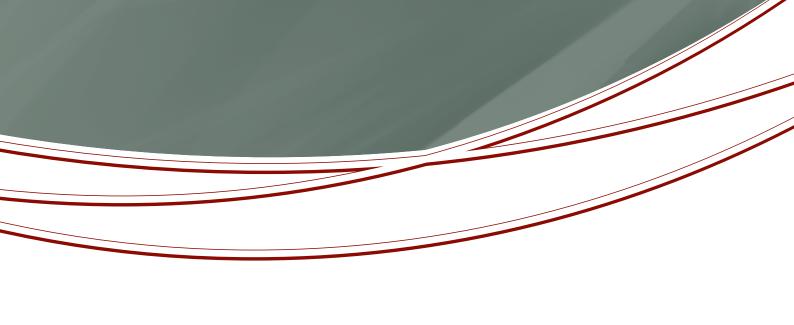Central offices have at their disposal a range of mechanisms by which the scope of frontline discretion is bound and controlled. The following mechanisms constrain the discretion of regional managers and the frontline:

- broad-based central plans
- need determination and priorities
- agreed outcomes with regions on regional level plans
- agreed specific service outcomes with the regions
- linking of regional budgets to the outcomes through unit-pricing.

Recent organisational restructuring in Victoria's DHS has consolidated the role of the central office with the aim to remove program silos and tighten control of the funding environment. The risk of corrupt behaviour in the funding system is reduced by establishing clear lines of accountability.

In Victoria, funding for government agencies is first set out in the state budget. As noted previously, every three years, it is the role of the DHS' central office to prepare a policy and funding plan for funded organisations. The plan sets out the government's policy framework, funding strategies, departmental objectives, priorities and outcomes to be achieved. It also provides an outline of divisional strategic initiatives and program budgets.

Regional budgets that are determined by central office are based on the unit-price of services to be delivered in broad program areas. It is also the role of central office to fix the unit-price of an activity based on type and level of activity as well as historical information. Unit-prices are adjusted annually to reflect indexation. The policy, funding and plan form part of the service agreement for NGOs and act as a guide to regional managers. The agreement specifies NGO compliance in terms of activities to be undertaken, performance measures, data collection process, and service standards to be met. It is the role of program and service advisers operating at the frontline to manage NGO service

agreements and any variation processes that occur. Should there be a need for regional managers to exceed their boundaries of discretion, a business case is required to be approved by central office.

Although much broader in scope and crossing jurisdictions, the same principles guide the Scottish approach. The role of the Scottish government is to set parameters for local council discretion through a framework of national objectives. These include priorities, targets and outcomes, which, in turn, determine funding allocation to support government programs and objectives at the local level. Partnership forums (community planning partnerships and community health partnerships) are essentially accountable for the decisions that are taken at a devolved level through the "single outcome agreement".

Under this model, local authorities and community partnerships are ultimately accountable to national government for their ability to link single outcome agreements to national priorities. Local authorities have a statutory duty to fund service providers and are accountable for service quality outcomes within each single outcome agreement.

RECOMMENDATION 16

That the role of designing broad policy and need determinations, along with the oversight of regions and local service areas, be retained by the central office.

Monitoring and reviewing the exercise of discretion

Central offices exert further control over decentralised decision-making through review and remedial action. Such reviews include areas such as budgets, complaints,

outcomes and desktop reviews of NGOs. They would also encompass compliance audits of key elements of the framework, such as providing money only to accredited NGOs or through some other agreed arrangement.

In Victoria, the role of the DHS' central office in reviewing NGO performance is central to maintaining adequate control of the funding system. This central office has the role of overseeing NGO annual desktop reviews. This process is to oversee all financial aspects of service delivery, incidents, complaints, performance data, external accreditation, employment checks and outcomes.

If warranted, central office will conduct a service review in partnership with regional managers and NGOs to resolve incidents or underperformance. Central office will also conduct a review of unit-prices (adjusted for indexation) and periodic reviews of program areas, such as homelessness or youth. Business units within central office are staffed with skill sets necessary to perform these functions.

In Scotland, there also exists a centralised monitoring and review function. The Accounts Commission, supported by Audit Scotland, conducts performance reviews of local authority activities. Although the 32 local councils in Scotland have significant discretion, they have, at the same time, common responsibilities that they must meet within the discretion afforded them. Through a process of internal and external review, local authorities must demonstrate that the outcome of service delivery fits within the broad policy and program set by national government.

RECOMMENDATION 17

That the role of monitoring and reviewing the performance of the regions and NGOs be retained by the central office.

Assurance of governance capacity

Part of the control of corruption, along with service control and value for money, is achieved through government assuring itself that the NGO receiving the funds has the skills and systems in place to control the funds and deliver the service.

The Commission's consultation process identified concerns about the governance capability of some NGOs in NSW, particularly smaller ones. Industry experts advised the Commission that, while many small NGOs have excellent administrative practices, others operate very basic controls.

Government agencies are aware of the risks associated with weak processes and broad oversight. Considerable effort has been put into building the capacity of these NGOs, both by the agencies and by the NGOs themselves. Unfortunately, the results are mixed, as key personnel trained in the necessary skills frequently move on, leaving the NGO back where it started. Evidence provided to the Commission indicates there are a substantial number of NGOs receiving funding from agencies while also receiving assistance from agencies to manage the concerns around governance and service capabilities.

Clearly, there are NGOs that do not have the governance capability necessary to provide assurance to the funding agency that they are capable of ensuring probity around the funding. There are some accreditation requirements, such as those related to working with children, and parts of the NSW system require some verification of governance standards as set by the agency, if accreditation the NGO has received elsewhere falls short of the standard. Overall the accreditation system is patchy in coverage and effectiveness.

The Commission is of the view that implementation of a common and systemic approach to assessing and reviewing NGO governance capacity and service quality
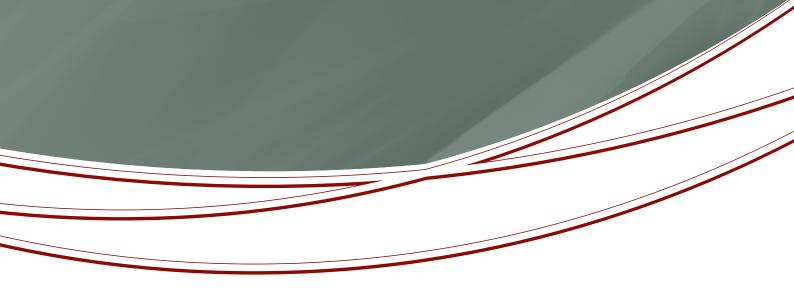
processes is necessary to provide adequate assurance to funding agencies.

Recent reform in Victoria seeks to ensure the provision of quality services, the delivery of positive client "outcomes" and the reduction of red tape by streamlining accreditation, monitoring and evaluation processes. The *DHS Standards evidence guide* supports service providers in developing systems and processes that will prepare them for participation in internal and external reviews. Service providers in Victoria must demonstrate compliance with DHS internal standards as well as the corporate and management standards of their selected independent accreditation review body.

Effective accreditation assesses relevant financial and governance skills, internal processes and service history as a type of balanced scorecard. Under the legislated accreditation model currently being implemented in Victoria, the independent accreditation organisation examines not only the paperwork provided but assesses the situation on the ground. Capacity is examined in terms of:

- governance, leadership and management
- financial competence
- human resources, including pre-employment checks for qualifications and skills, training and development, supervision and workforce
- continuous quality improvement and feedback processes
- information knowledge management
- partnerships/service coordination
- performance history.

To receive government funding, an NGO will have to be accredited by one of the government's panel of accreditation organisations.

The Commission is of the view that such a system should be adopted in NSW. A number of submissions expressed concern, however, that multiple accreditation bodies create unnecessary compliance costs, especially for small NGOs. National Disability Services advised the Commission that "meeting multiple standards from state and federal agencies can be a challenge for providers, and the compliance burden could be reduced if rationalisation of standards across human services was applied".

If such a system were adopted in NSW, and harmonised with the Victorian system and other states, mutual recognition of accreditation is feasible across jurisdictions. Mutual recognition of accreditation would result in a significant reduction in red tape for NGOs operating in both jurisdictions, and efficiencies in the provision of funding.

In NSW, it is not expected that all NGOs would meet such accreditation standards. The Commission is of the view that, where NGOs fail to achieve accreditation but meet a lower standard, they may receive government funding: through their role in a consortium; as an NGO managed by a lead or integrator NGO; in partnership with an accredited NGO; or through outsourcing the responsibility for funds management to an accredited NGO or government business unit.

Such an accreditation model rebalances the responsibility for achieving accreditation by shifting the onus more towards the NGO itself. In interviews conducted by the Commission, a common theme was that frontline staff found the demands of helping NGOs that were struggling to meet governance and service standards used up much of their available time. The demands of helping problem NGOs became a disincentive to reporting problems. In some cases reported to the Commission, this led to NGOs being assessed as low risk regardless of their governance capacity.

RECOMMENDATION 18

That NSW funding agencies move toward a standards and accreditation framework that assures service and governance capacity. This would be designed with consideration of the needs of all human services funding agencies, allowing the system to be rolled out across all agencies over time.

Eligibility to receive control of government funds would be contingent on accreditation granted by expert, independent review bodies.