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# **Public Private Partnerships: Modernisation in the Australian Public Sector**

Linda M. English



# **Public Private Partnerships: Modernisation in the Australian Public Sector**

Linda M. English



A dissertation submitted in fulfilment of the requirements for the degree  
of Doctor of Philosophy at The University of Sydney

2008



## **CERTIFICATE OF ORIGINALITY**

This thesis contains no material which has been submitted for the award of any degree or diploma in any university, or any material previously published unless due reference to that material is made. Co-authors of published papers that contribute to the thesis have provided certification as to the extent and nature of my contribution.

Linda M. English

February, 2008



## Acknowledgements

I would like to acknowledge and thank the people who have provided guidance, assistance and support over the duration of this thesis.

To my principal supervisor, Professor James Guthrie, I would like to express my sincere gratitude for providing the motivation, confidence and academic direction necessary to bring this project to completion. His willingness to read (and reread) drafts at short notice is much appreciated, and contributed significantly to reducing the heartache frequently associated with such endeavours. Professor Guthrie's wise counsel and strategic vision have helped to propel me forward to the finishing line.

I would also like to thank Professors Jane Broadbent and Richard Laughlin for their encouragement, guidance and support. Their insights helped me to frame my research questions and to shape the thesis, notably to determine how to combine the findings in the five published papers with supplementary research undertaken to complete this project. They were always unstinting in sharing with me insights arising from their research expertise in public private partnerships, and from their experience in helping others to undertake large research projects.

In addition, I would like to thank my co-authors—Professors James Guthrie and Lee Parker; and Associate Professor Jane Baxter—for their willingness to work with me and to explore my suggestions to researching and writing up the papers we co-authored.

To my colleagues at the University of Sydney, I would like to express my thanks for the quiet words of encouragement “in the corridors”. I also wish to acknowledge and thank the University and the Discipline of Accounting for allowing me to take long service leave to complete this project. I would also like to thank Adam Weir for research and editorial assistance. Adam helped to rid the final draft of unwanted gremlins, and to ensure that the reference list was complete and accurate.

My son Phillip and my friends have been unfailingly supportive of my efforts to achieve this goal. His pride in my achievements has been extremely encouraging.

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This thesis is dedicated to my mother, Phyllis, who died far too young; and to my father, Phillip Henry Walter Jacoby, who had a great respect for education and a love of learning.



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## List of Abbreviations

ACT	Australian Capital Territory
AT	agency theory
AusCID	Australian Council for Infrastructure Development
BOO	Build Own Operate
BOOT	Build Own Operate Transfer
CAPM	capital asset pricing model
Casey	Casey Hospital
Deer Park	Metropolitan Women's Correction Centre
Fulham	Fulham Correctional Centre
GRP	Gateway Review Process
IMF	International Monetary Fund
IPP	Infrastructure Project Partners
Lara	Metropolitan Correctional Centre
Latrobe	New Latrobe Hospital
Mildura	Mildura Base Hospital
Modbury	"PPP hospital in South Australia"
NAO	National Audit Office (UK)
NHS	National Health Service (UK)
NIE	new institutional economics
NPC	net present cost
NPM	'new' public management
NPP	New Prisons Policy
NSW	New South Wales
OCSC	Office of Correctional Services Commissioner
OECD	Organisation for Economic Co-operation and Development
PAC	Parliamentary Accounts Committee
PCT	public choice theory
PFI	Private Finance Initiative
PLF	performance linked fee

PMR	public management reform
PMS	Prison Management System
Port Phillip	Port Phillip Prison
PPPs	public private partnerships
PSC	public sector comparator
PV	Partnerships Victoria
Ravenhall	Margoneet Correctional Centre
Robina	“PPP hospital in Queensland”
Royal Women’s	Royal Women’s Hospital
RTA	Road and Traffic Authority
SDOs	service delivery outcomes
TCE	transactions cost economics
VAGO	Victorian Auditor General’s Office
VDTF	Victorian Department of Treasury and Finance
VFM	value for money
VPAEC	Victorian Parliamentary Accounts and Estimates Committee
WA	Western Australia



## Abstract

Public private partnerships [PPPs] are a product of policies and processes to modernise the delivery of infrastructure-based services. An examination of the modernisation literature establishes the broad analytical frame within which this thesis investigates PPPs. The macro-level overview of the recent transformation of the Australian public sector confirms that the dominant principles underlying modernisation are grounded in new institutional economics [NIE] that are implemented through private-sector derived accounting and management implementation technologies. It highlights the contextual complexities stemming from Australia's federal system of government, explaining the decision to focus on investigating PPP experiences in Victoria.

At the conceptual level, PPPs rely on risk management and modernisation of service delivery to achieve value for money [VFM] for governments. In Victoria, 2000 signals a change in the modernisation role of PPPs. Thereafter, risk inherent in PPPs was reduced by excluding the contractor from the delivery of core social services. Also, the state began to develop a number of PPP policies to guide, aid, control and rationalise decision making in the pre-contracting stage, and to clarify objectives. Analysis of PPP contracts and the failure of one pre-2000 PPP hospital project are illustrative of the controversies identified in the literature about 'hidden' aims, the role of technologies designed provide 'objective' evidence of VFM inherent in PPPs at the time of contracting, and the 'fallacy' of risk transfer to private contractors.

An examination of prison contracts indicates the changing nature of the management and control of PPPs in the execution stage. Analysis of pre-2000 prison contracts reveals that these projects were intended to drive significant financial and non-financial modernisation reforms throughout the correctional services system. Despite problems with contractual specification of performance and payment mechanisms, and the failure of one of the three pre-2000 prisons, recent evidence suggests, contrary to conclusions in the previous literature, that sector-wide modernisation objectives are being achieved in PPP prisons.

PPPs have been criticised on the grounds that they enable governments to avoid accountability for service provision. A survey of the extent, focus and characteristics of the performance audit of PPPs confirms that little PPP auditing has been undertaken in Australia *per se*, and also that much of the performance auditing has focused on examining adherence to mandated procedures in the pre-contracting stage. However, this thesis demonstrates that the Victorian government has undertaken significant evaluation of the operation of its pre-2000 PPP prisons, and that its thinking and policy development reflect lessons learnt.

The evidence presented in this thesis challenges findings in the previous literature that modernisation has delivered less than promised. This thesis confirms the potency of longitudinal research to investigate outcomes of what is essentially an iterative process of reform and that ‘successful’ implementation of modernisation change is sensitive to the context to be reformed. In finding that the presence of goodwill trust is critical to the implementation of recent modernisation reform in the correctional services sector (including in the PPP prisons), this thesis also confirms recent critiques of the power of NIE theories to explain contracting practices in the PPP setting.

## CHAPTER ONE

### Thesis Overview: Modernisation in the Australian Public Sector

#### 1.1 Introduction

Since the 1980s, the modernisation of public services in member countries of the Organisation for Economic Co-operation and Development [OECD] has been characterised as ‘new’ public management [NPM]<sup>1</sup> (Hood, 1991; 1995). Modernisation has been implemented through accounting and management technologies (Guthrie et al, 2005; Olson et al, 1998), which have been used to provide an apparently coherent and rational means to transform the public sector (Chou et al, 2005; Lapsley, 1999; 2001a; Skaerbaek and Thorbjornsen, 2007) through making it more like the private sector (Olson et al, 1998). Public private partnerships [PPP(s)] are an example of a modern procurement technology that has been used to achieve a range of modernisation objectives (Broadbent and Laughlin, 2005). ‘Public private partnership’ is the name given to an arrangement designed to inject private-sector funds and management expertise into public-sector capital projects for the stated purpose of cost-effectively enhancing the provision of public services (Lapsley, 1999).

PPPs are time and cost-specific agreements between the state and a private consortium for infrastructure-based service provision. The consortium undertakes responsibility for financing, designing and constructing (or refurbishing) a facility, and for providing related services. The government (or users in the case of infrastructure providing user-pays services such as toll roads) pays the consortium a revenue stream that is used to repay debt, fund operations and provide a return for investors (Pollock and Price, 2004). At the rhetorical level, risks associated with financing and building the infrastructure and with service delivery are transferred to the consortium. The efficiency gains arising from the effective management of project

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<sup>1</sup> In other work, this reform movement has also been known as public management reform [PMR] Pollitt and Bouckaert (2000). Use of the term ‘modernisation’ follows Lapsley (1999, 2001a; b; c; d), Skaerbaek and Thorbjornsen (2007), and Broadbent and Guthrie (2008). In all cases it is acknowledged as an administrative doctrine influenced by new institutional economics [NIE] and implemented by private-sector derived accounting and management technologies, with the intention of producing public services more efficiently and effectively (Boston, 1995; Hood, 1991; 1995; Pollitt and Bouckaert, 2000).

risks are alleged to result in reduced whole-of-life project costs derived from superior private-sector management practices (Lapsley, 2001a), providing value for money [VFM] savings that justify the use of costly private finance. Accordingly, VFM is ostensibly the primary motivation for these projects and makes these partnership arrangements justifiable for governments.

There is no universally accepted terminology for PPPs in either the general discourse or in the scholarly literature. For example, in the UK, these types of arrangements are referred to as the Private Finance Initiative [PFI] and more recently as PPPs. In the Australian state of New South Wales [NSW], they are known as PPPs or Privately Financed Projects, and in neighbouring Victoria, PPPs are also known as Partnerships Victoria [PV] Projects. Prior to 2000, PPPs were variously known in Australia by acronyms such as Build Own Operate Transfer [BOOT] or Build Own Operate [BOO] (English and Guthrie, 2003). Whilst the PFI, PV Projects, BOOs and BOOTs can have more particular definitions attached to them, they are often used interchangeably with the term 'PPP', blurring the practical distinctions between these models. Hereafter, the term 'PPP(s)' will be used exclusively to denote the arrangements that are of interest to this thesis, namely, those PPPs that deliver social services (such as prisons and hospitals).

Overall, the conclusion of Olson et al (1998) and Humphrey et al (2005) – based on a number of national studies undertaken over a ten-year period – is that modernisation has delivered less than has been promised. According to Humphrey et al (2005, p. 2), modernisation has resulted in fundamental changes to public-sector organisations, organisational behaviour and social expectations that are too important to be left to proceed unchecked and under-researched:

[T]here is a need to subject such reforms, both in terms of their practical application and the theoretical basis on which they have spread around the world, to detailed empirical research and analysis in terms of the individual technologies applied in various nations, and the organizational contexts at national and international levels.

The motivation for this research is Humphrey et al's (2005) challenge, and also the call for longitudinal research into the outworking of modernisation in different nations (Lapsley, 2001b; d) and PPPs in particular (Broadbent et al, 2008). PPPs currently

account for about ten percent of Australian governments' investment in infrastructure (Fitzgerald, 2004). That proportion is expected to grow dramatically as significant investment in new infrastructure is required to underpin the nation's future economic development (Crowe, 2007). However, the public perception of PPPs in Australia is largely sceptical owing to concerns that they transfer wealth to private consortia (Walker, 2003); fail to deliver VFM to governments (Quiggin, 2004; Stanley and Hensher, 2004); constrain future planning and expenditure (Quiggin, 2004); and that governments have not been held sufficiently accountable for their economic and social repercussions (Andrew, 2007; Walker, 2003; Watson, 2003). Suspicions have been confirmed by various Australian governments' refusal to disclose information, even to parliaments, that could facilitate independent investigation of their outcomes (VPAEC, 2006), and by some spectacular failures (Andrew, 2007; English and Walker, 2004; Stanley and Hensher, 2004; Walker, 2003). In addition, the complexity and volume of the policies that guide and aid PPP decision-making in nine different Australian jurisdictions<sup>2</sup> adds to the difficulty of investigating their outworking (English and Guthrie, 2003). These factors also limit the scope of this research and its conclusions.

## 1.2 Thesis aims

In light of the scepticism about PPP outcomes, the objective of this 'by publication' thesis is to analyse the use of PPPs as a modern procurement technology. Explicitly, the research investigates how new institutional economics [NIE] (Hood, 1991, p. 5) and the accounting and management technologies embedded in PPP decision-making processes and procedures (Olson et al, 1998), are used to manage and control infrastructure procurement and its oversight by auditors-general.

PPPs are a product of policies and processes to modernise public services (Broadbent and Guthrie, 2008). The principles underlying modernisation are grounded in classical economic theories, which have become known as NIE when applied to the public sector (Barton, 2001). Modernisation is implemented through private-sector

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<sup>2</sup> Australia has a federal system of government comprising the Commonwealth Government, six state and two territory governments. See Chapter 3 for an explanation of the Australian political context and its relevance to PPP analysis.

accounting and management technologies that underpin public-sector modernisation in OECD nations (Guthrie et al, 2005; Olson et al, 1998). Modernisation has also changed the nature and characteristics of state audit, reorienting it to include the examination of the efficiency and effectiveness of program implementation (Pollitt et al, 1999). Questions remain, however, as to whether modernisation has achieved its intended objectives (Guthrie et al, 2005; Olson et al, 1998; Pollitt et al, 1999). Thus, this thesis has three aims, which are elucidated below.

To provide the necessary context for the analysis of PPPs and their oversight, *the first aim is to analyse the characteristics of modernisation in the Australian public sector*. Focusing on the role of accounting and management technologies in implementing modernisation change, the thesis initially analyses the history and characteristics of modernisation in the Australian public sector during the period 1998-2005.

*The second aim of this thesis is to analyse PPPs and their changing role as a modern procurement technology*. As a result of Australia's federal system of government, the nation effectively has nine governments, and potentially nine different approaches to PPP implementation (English and Guthrie, 2003). Accordingly, in investigating how PPPs have been used over time to modernise public service delivery, this study narrows its research focus to Victoria, Australia's leading PPP proponent. English and Guthrie (2003) established that PPP policies are the primary mechanisms used to manage and control PPP decision-making, and that little research has been undertaken into the underlying principles and technologies embedded in the PPP policies that guide and aid the outworking of Australian PPPs.

This thesis fills this gap by analysing Victoria's PPP policies between 1991 and 2007. The purpose of this examination is twofold. First, it provides insights into the changing use of PPPs over time. Second, this thesis focuses on how NIE and private-sector derived accounting and management technologies have been deployed to articulate and rationalise changing PPP processes and procedures over time, and to control PPP decision-making at the micro or organisational level. At the project or organisational level (Broadbent and Laughlin, 1999) the thesis examines four PPP

contracts (representing nine PPP projects) to provide insights into the changing nature of PPP use, and how the contracts reflect stated policy objectives.

***The third aim of this thesis is to analyse the oversight of PPPs by Australian auditors-general.*** Modernisation has also affected understandings of public accountability and the practice of state audit. The emphasis on performance that characterises modernisation has given rise to performance audit, which is intended to provide independent assurance that government programs have been implemented effectively and are well managed (Gendron et al, 2001). Pollitt et al (1999) have confirmed the fundamental link between the implementation of modernisation and changing performance audit practice. Although there is general agreement about the origins and distinctive characteristics of modernisation and performance audit, their development and outworking are intertwined, contested, context-dependent and change over time (Guthrie and Parker, 1999). However, performance audit has also been judged as acting to legitimate and foster modernisation (Broadbent and Laughlin, 2003; Skaerbaek and Thorbjornsen, 2007) as auditors-general also strive to provide ‘evidence’ that their own activities embody and provide an example of ‘best practice’ modernisation (Pollitt et al, 1999).

Governments’ propensity to tightly control information disclosed to the public about PPP arrangements has hindered their independent evaluation by the academic community and parliaments (Watson, 2003; 2004; VPAEC, 2006). The reluctance by executive government to provide information about the mechanics of pre-contracting decision-making, particularly as it relates to the role and calculation of the benchmarks used to determine the cost of public provision and PPP performance in the execution stage, has made the role of auditors-general in PPP oversight critical to the public’s understanding of PPPs, and to governments’ accountability for these arrangements (Heald, 2003). However, modernisation pressures on state audit to provide evidence of audit ‘success’ (in terms of number of recommendations acted on by audited bodies, for instance) may also undermine auditors-general’s ability to provide independent oversight of program implementation. This research provides evidence of the extent, focus and characteristics of auditor-general oversight of Australian PPPs in the period since their inception in the 1990s<sup>3</sup>.

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<sup>3</sup> It is difficult to establish one discrete time period that encompasses the analysis undertaken in this thesis because the published papers inevitably cover different periods. However, it is possible to state

This thesis is unique in the Australian context, and also internationally, as no previous research has examined (and disclosed details of) PPP contracts. Similarly, no Australian study has hitherto examined auditor-general oversight of extant PPPs in depth to determine the extent, focus and characteristics of their independent assessment through performance audit.

### 1.3 Overview of the five published papers

This PhD thesis contains five published papers (see Table 1.1 below) that combine to present the bulk of the analysis and empirical work undertaken to address the study's three aims. Analysis of modernisation in the Australian public sector is included because it provides insights into the changing historical context within which the study is located, and articulates linkages between international approaches to public-sector modernisation and the Australian experience. This macro-level modernisation theme is developed in the *Paper 1* [English et al (2005)], which analyses and reflects on the role of accounting and management technologies in modernising the Australian public sector. *Paper 2* [English (2006)] presents an overview of PPP deployment in Australia and introduces the PPP model of interest to this thesis. *Paper 3* [English (2005a)] contributes to the analysis of the pre-contracting processes and procedures. *Papers 2* and *3* focus on the use of PPPs to modernise the procurement of public services in the state of Victoria, the principal research site. The focus of *Paper 4* [English and Baxter (2007)] is on investigating the achievement of PPP VFM objectives in the execution stage. *Paper 4* investigates how the 1993 introduction of PPP prisons in Victoria was intended to modernise the delivery of correctional services throughout the state. The empirical investigation in *Paper 4* is based on two PPP prison contracts (representing five PPP arrangements). It is an exploration of how the examined contracts have been used to manage and control the achievement of modernisation objectives and the PPP relationship in the operating stage. *Paper 4* also examines the extent to which PPP objectives have been achieved over the period

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that the analysis of modernisation in the Australian public sector (analysed in Chapter 3) covers the period 1998-2005 (2005 being the publication date of the relevant paper, *Paper 1*). The examination of PPP policies and PPP arrangements in Chapters 4 and 5 and auditor-general oversight (Chapter 6) covers the period 1991-2007 (representing the period from the publication of Victoria's first PPP-related policy document to the time of writing this dissertation).

1996-2007. The final paper, *Paper 5* [English (2007)], analyses the effects of modernisation on the changing nature of auditor-general oversight of PPPs. An outline of these papers is presented in Table 1.1 below.

The broad objective of following six chapters is to outline findings related to the three research questions outlined above. These chapters draw together and analyse the themes and concerns of the five papers that comprise this 'by publication' thesis, and impose a consistent framework of analysis that may not be obvious from the papers themselves. Also, in the course of writing up this dissertation, some additional research has been undertaken to augment the research reported in the papers. This additional research is broadly of two types. First, the analytical framework used in this research is augmented by a themed review of additional literature, which is presented in the relevant chapters. Second, additional empirical work has been undertaken to elucidate findings contained in some of the papers. The inclusion of additional material is noted as it is reported throughout this document. In writing up the following chapters, the intention has been to introduce the contribution of each of the papers and (where relevant) to elucidate additional research and related empirical findings.

Table 1.1 (below) links the five papers with their relevant research aims and indicates the chapter in this thesis in which their findings are presented and their contribution is analysed. These papers are arranged in order at the end of this dissertation. Hereafter, these papers will be referred to as *Paper 1*, *Paper 2* and so on. References to sections or tables in these papers will also be italicised<sup>4</sup>.

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<sup>4</sup> As required by The University of Sydney's 'Theses Containing Publications' requirements, the co-authors of three of the papers have provided a signed statement outlining and attesting to my contribution.

**Table 1.1: Linkages between themes, research aims and published papers**

<b>Public-sector modernisation in the Australian context</b> <i>First aim: To analyse the characteristics of modernisation in the Australian Public Sector</i> [Chapter 3]	
<i>Paper 1</i>	English, L., J. Guthrie and L. Parker (2005) Recent Public Sector Financial Management Change in Australia: Implementing the Market Model in Guthrie, J., C. Humphrey, L. R. Jones and O. Olson [eds] <i>International Financial Management Reform: Progress, Contradictions and Challenges, A Volume in Research in Public Management</i> , Jones, L. R. and N. C. Roberts [series editors] (Greenwich Connecticut, USA: Information Age Publishing), pp. 24-55.
<b>Establishing modernisation objectives in the PPP pre-contracting stage</b> <i>Second aim: To analyse PPPs and their changing role as a modern procurement technology</i> [Chapter 4]	
<i>Paper 2</i>	English, L. (2006) Public Private Partnerships in Australia: An Overview of their Nature, Purpose, Incidence and Oversight, University of New South Wales Law Journal, Vol. 29, No. 3, pp. 250-262.
<i>Paper 3</i>	English, L. (2005a) Using Public-Private Partnerships to Deliver Social Infrastructure: The Australian Experience, in Hodge, G. and C. Greve [eds] <i>The Challenge of Public-Private Partnerships Learning from International Experience</i> (Northampton MA, USA: Edward Elgar), pp. 290-304.
<b>Using contracts to manage and control the achievement of modernisation objectives in the PPP execution stage</b> <i>Second aim: To analyse PPPs and their changing role as a modern procurement technology – PPP prison case study</i> [Chapter 5]	
<i>Paper 4</i>	English, L. and J. Baxter (2007) <i>Using Contracts to Govern Hybrid Public-Private Partnership: A Case Study of Victorian PPP Prisons</i> , Fifth Asia Pacific Interdisciplinary Research in Accounting Conference, Auckland, New Zealand, 8-10 July. Available from: <a href="http://www.mngt.waikato.ac.nz/ConferenceManager/report.asp?issue=5">http://www.mngt.waikato.ac.nz/ConferenceManager/report.asp?issue=5</a>
<b>Modernisation and the changing nature of auditor-general oversight of PPPs</b> <i>Third aim: To analyse the oversight of PPPs by Australian auditors-general</i> [Chapter 6]	
<i>Paper 5</i>	English, L. (2007) Performance Audit of Australian Public Private Partnerships: Legitimising Government Policies or Providing Independent Oversight, <i>Financial Accountability and Management Special Issue on Performance Auditing and the Modernisation of the Public Sector</i> , Vol. 23, No. 3, pp. 313-336.

## 1.4 Thesis organisation and findings

Before presenting the findings and contribution of the five papers, this dissertation provides an overview of the research approach in Chapter 2. The purpose of Chapter 2 is to outline the research method, to critically review insights from the modernisation literature, and to establish the genesis of modernisation. This literature review is the first example of additional research undertaken for this thesis. It articulates the macro-level analytical framework within which the research findings are presented and analysed. The Chapter 2 literature review also examines the nature of change in a public-sector context, and establishes that the literature has broadly concluded that, despite its appeal to technical rationality, the bulk of modernisation reform appears to have failed to achieve its objectives.

Chapters 3, 4, 5 and 6 present the empirical evidence that is the core of the contribution of this thesis. Chapter 3 addresses the first aim, Chapters 4 and 5 the second aim, and Chapter 6 the third aim.

Chapter 3 presents the findings contained in *Paper 1*. It establishes the context in which PPPs and their outworking and oversight must be considered. It analyses modernisation of public services in the Australian public sector (addressing the study's first aim) and confirms linkages between Australian and international experiences, outlining the role of accounting and management technologies in fostering modernisation. It also reports on the outcomes of modernisation at the macro (Australian public sector) level.

Chapter 4, which reports findings from *Papers 2 and 3*, has several objectives. As noted in Table 1.1 above, Chapter 4 focuses on the nature of PPP objectives and their establishment in the pre-contracting stage. Chapter 4 begins with a review of the PPP literature to provide insights into conflicting views about PPP objectives. Chapter 4 raises issues relating to the changing nature and purpose of PPPs, and examines the role of key accounting and management technologies (such as risk allocation, costing benchmarks, and VFM) that have been used to manage and control PPP decision-making in the pre-contracting stage.

The first objective of Chapter 4 is to present evidence about the incidence, cost and type of Australian PPPs, and to outline evolving PPP policies, objectives and technologies. The second objective of Chapter 4 is to chart PPP development in Victoria since 1991 through an analysis of PPP implementation, focusing on pre-contracting accounting and management appraisal technologies. Findings indicate that over the period 1991-2007 Victorian PPP models have become less complex (and less controversial) as PPP policies have, paradoxically, increasingly relied on principles derived from NIE and complex accounting and management technologies to rationalise and justify the use of PPPs. The empirical findings confirm there is a discrepancy between stated and unstated objectives of pre-2000 PPPs.

Chapter 5 (which also addresses the second aim in conjunction with Chapter 4) examines the use of contracts to manage and control the achievement of modernisation objectives in the PPP execution stage. Chapter 5 presents the contribution, analysis and findings of the case study into five Victorian PPP prisons that are presented in *Paper 4*, which are augmented by additional research. Initially, the chapter reviews the contracting literature to provide additional insights into the role played by contracts in managing and controlling the delivery of services, in responding to uncertainty, and in promoting trust between the partners. The examined prison contracts support the contention that NIE theories, such as agency theory and transactions cost economics [TCE], have influenced Victoria's approach to PPP contracting, and that, as predicted in the literature, performance specification in contracts is largely quantitative. Uniquely, this research also uncovers evidence that the pre-2000 PPP prisons were intended to drive a radical modernisation agenda throughout the Victorian correctional services sector, a key finding of this research. In its examination of the role of the pre-2000 PPP prisons in driving modernisation reform, Chapter 5 presents empirical evidence that indicates that, contrary to expectations in the PPP literature, the pre-2000 PPP contracts are capable of fostering the development of goodwill trust between the partners. Goodwill trust appears to have emerged despite punitive risk transfer arrangements embedded in the pre-2000 contracts, the failure of one PPP prison, and evidence of continuing problems at another. The findings in Chapter 5 confirm the value of longitudinal studies to examine the effectiveness of modernisation reform implementation in particular settings (Lapsley and Pong, 2000; Lapsley, 2001d; Modell et al, 2007).

Chapter 6 (which addresses the third research aim and relates to *Paper 5*) contains a number of themes and concerns. Chapter 6 reviews the performance audit literature and its relation to modernisation in the PPP setting. The literature suggests that performance audit is largely systems-based rather than substantive (Pollitt et al, 1999); and that PPP audit has largely focused on auditing adherence to PPP policies and procedures in the pre-contracting stage and, in some cases, has acted to legitimate government policy (Broadbent and Laughlin, 2003). The relative absence of PPP audits in Victoria explains why the focus of this investigation was broadened to include auditor-general audit of all Australian PPPs. Second, using Pollitt et al's (1999) framework, the characteristics of performance audits of PPPs are analysed.

The research reported in *Paper 5* confirms the linkages between the development of and changes in performance audit and public-sector modernisation over time. *Paper 5* is the first study to examine the extent, focus and characteristics of the performance audit of Australian PPPs. Using Pollitt et al's (1999) distinction between systems-based and substantive audit and an audit framework devised for this research, *Paper 5* examines the extent to which auditors-general have substantively examined the achievement of PPP objectives. Findings are analysed in the light of Power's (1999) insights into how public-sector modernisation has created 'an audit society' in which state audit appears to be increasingly more focused on checking compliance with rules and policies and in legitimating government policies and procedures, than on providing independent oversight of the implementation of those policies. This research confirms English and Guthrie's (2003) contention that Australian PPPs have been subject to inadequate independent auditor-general oversight.

Finally, Chapter 7 summarises conclusions, reflects on the contribution of this research, considers limitations, and concludes with suggestions for future research.



## CHAPTER 2

### Research Approach

#### 2.1 Introduction

Chapter 1 established the motivation, objective and aims of this research. The purpose of this chapter is twofold. The first objective is to outline the research method and approach, which occurs in sections 2.2 and 2.3. Section 2.2 introduces middle range thinking, the research method underlying the empirical investigation undertaken in this thesis, and in the five papers that comprise it. Section 2.3 discusses data sources, and links the research method with the approach adopted to guide documentary analysis.

This thesis answers calls for longitudinal research (Humphrey et al, 2005; Lapsley, 2001d; Broadbent et al, 2004a) into public-sector modernisation and its effects in different contexts over time. The focus of this research is the modernisation of public services in the Australian context. The use of PPPs as a modern infrastructure procurement technology, and the extent and characteristics of their independent oversight, cannot be understood in isolation, but must be analysed within the broader context of public-sector modernisation (Lapsley, 2001c). Accordingly, the second objective of this chapter is to establish the analytical framework that guides the interpretation of the research undertaken in this thesis. The review of the modernisation literature presented in this chapter provides additional insights into a spectrum of related ideas, ranging from new institutional economics [NIE] (Barton, 2001; English and Guthrie, 2001; Hood, 1991; English, 2005b) at the theoretical end, to the role of accounting and management implementation technologies proposed by professional consultants at the practical end (Olson et al, 1998). NIE and accounting and management technologies have been identified with the genesis and development of modernisation reform of the public sector in OECD nations (Christensen et al, 2007). This analysis takes place in section 2.4. Section 2.5 reviews critiques of the rationales for modernisation and highlights problems associated with its implementation. The drivers and nature of modernisation change are introduced in section 2.6. Section 2.7 summarises the chapter's findings.

This chapter provides insights into the broad theoretical and analytical context within which the thesis's three aims are addressed. As indicated in Chapter 1, each of the following chapters will briefly summarise the literature in the relevant papers and may also include analysis of literature and empirical findings that are not reported in the papers, but which reflect additional research that has occurred in the course of writing this thesis. Also, Chapters 3-6 include reflection on how the research approach contributes to moving the empirical analysis forward.

## 2.2 Research approach: middle range thinking

Implicit in the various approaches to empirical research are a number of critical assumptions that determine choice of approach (Crotty, 1998). Building on Burrell and Morgan (1979), Laughlin (2004, p. 263) (quoting from Laughlin, 1995, p. 66) argues that:

[A]ssumptions on being (ontology), on the role of the investigator (human nature), on perceptions of society (society), on perceptions of understanding (epistemology) and ways to investigate the world (methodology) ... provide the framework in which the discovery and discursive process, surrounding the discovery, exists and functions.

Divergent views on ontology, human nature, society and epistemology mean that choices have to be made about theory, methodology and change (Laughlin, 1995; 2004). Accordingly, it is important for researchers to articulate their research approach and the method used to undertake empirical work.

The research approach adopted in this thesis is based on Laughlin's (1995; 2004) middle range thinking. While many classifications of empirical research recognise and consider each of the key assumptions outlined in the quotation above, Laughlin (1995; 2004) suggests that these assumptions can be classified into what he terms three broad "choices" about theory, methodology and change. Laughlin (2004, p. 271) suggests that the understanding process "involves a combination of assumption sets in relation to the theoretical and methodological categories" that are mutually interdependent, implying that the change choice is separate and follows on from theory and methodology choices.

Middle range thinking recognises a reality external to the researcher, and also the subjective role of the researcher in engaging with the empirical data. Laughlin (2004, p. 268) states that “[m]iddle range thinking sets up structures around the subjective processes which recognise and accept the subject in the discovery process yet also set some limits on how that subjectivity can be operationalised”. The middle range theorist accepts that some *a priori* theorising is useful in “alerting us to the empirical points of interest with which the research will first seek to interact ... [and] gives us a language to allow us to describe and reflect on the nature of the change” (Broadbent and Laughlin, 1997, p. 627). However, the role of *a priori* theory is moderated through the recognition of the importance of context-driven formulation whereby “generalizations about reality are possible, even though not guaranteed to exist ... these will always be ‘skeletal’ requiring empirical detail to make them meaningful” (Laughlin, 1995, p. 81). Different understandings about the meaning of the data, and also of the theories guiding the data collection and analysis arise from the iterative and reflexive processes of the theory and methodology dimensions.

Laughlin (2004, p. 271) suggests that ontology is “the foundation for all other choices” and that prior theories guide choices about methodology and data collection method. The ontological and theory choices have implications for the assumed role of the researcher in the resulting empirical engagement. Laughlin’s Table 1 (1995, p. 80) and Figure 1 (2004, p. 272) outline the key features of the middle range approach. Table 1 in the 1995 paper indicates that the middle range position views theory as providing broad ‘skeletal’ understandings of the phenomena under examination, and that the primary purpose for empirical engagement is the fleshing out of the ‘skeleton’ which inevitably involves a degree of subjectivity on the part of the researcher (Laughlin, 2004, p. 274).

Laughlin (2004, p. 268) articulates the links between ‘skeletal’ theory and method, and the conclusions (the change dimension) drawn by the researcher:

There are ‘skeletal’ rather than ‘full’ or ‘no’ theories which can explain accounting in practice or, more generally, any empirical phenomena. However, these ‘skeletal’ theories need the richness of the empirical detail to make them meaningful in particular situations. There are structures that underlie social situations but not ones which fully capture the diversity and detail of these situations. For instance it is possible to say something about

different levels and pathways of organisational change ... that applies to every organisational setting. Yet such theories are not all-encompassing. They provide a language that allows researchers to interrogate the empirical site being analysed. They guide and structure the way actual organisational settings can be viewed, but they also need the detail from these settings to make these 'skeletons' live. Equally, where the empirical details do not fit the theoretical 'skeleton', the empirical data provides a basis for extending and/or reforming this framework. In this sense the 'skeletal' theory guides the discovery process but in such a way that can be reactive to the 'fit' of the detailed 'flesh' that is being added.

Also, Laughlin (2004, p. 274) indicates that the nature of the method chosen is definable, but subject to refinement in actual situations, and invariably qualitative. The data sought will be longitudinal, case-study based, heavily descriptive, empirically rich, but also analytical; and the conclusions derived will be reasonably conclusive, and tied to 'skeletal' theory (Laughlin, 1995, p. 80). Data collection methods include an examination of documents, "a wide range of forms that represent the empirical world", including public records and the media (see Figure 1 in Laughlin, 2004, p. 272).

The change dimension is separate and follows the understanding process (Laughlin, 2004, p. 271). Despite asserting that the change choice is the most important that the researcher will make, Laughlin (2004, p. 266) acknowledges that it is "the one to seemingly be made invisible" in his 1995 paper. In relation to the change dimension Laughlin (2004, p. 267) suggests:

It is only after some level of understanding is achieved, under the assumptions that follow from the theory and methodology dimensions that it is possible to decide what should be done about what is discovered ... this change dimension is of key importance for our research endeavour.

It seems clear that the change dimension stems from the researcher's efforts to make the theoretical 'skeletons' live through adding detailed 'flesh' through the empirical discovery process that can result in the researcher further explicating, extending or reformulating prior theories (Laughlin, 2004, p. 268). Arguably, the change choice remains under-explained in the 1995 and 2004 papers. However, it appears to encompass the role of research in contributing to policy debates and in changing practice as explained by Laughlin (1995, pp. 67-68):

What change means is complex and uncertain. However, in general, it refers to attitudes by the researcher concerning the worth or otherwise of maintaining the current situation that is being investigated as well as views about the necessity for actually doing something about this situation ... Those in the 'middle' ... are more strategic in their attitude towards change – open to maintaining certain aspects of current functioning but also open to challenging the status quo.

Laughlin suggests (1995, p. 68 and Table 1, p. 80) that the change dimension permits researchers to forcefully challenge the *status quo*. Indeed, this approach is adopted by some researchers who have examined PPPs in the context of the UK's National Health Service (see, for instance, Shaoul (2005a); Pollock et al (2005); and Pollock and Price (2004), the implications of which are discussed in Chapter 4).

### 2.3 Data sources and analysis

Laughlin (2004, p. 274) maintains that some data collection methods are more appropriate to the middle range approach than others. For instance, questionnaires are judged an instrument that fails to adequately capture the detail required for studies that give rise to qualitative narrative. Appropriate data collection methods include documentary analysis and interviews. With regard to documentary analysis, Laughlin is silent on the approach to analysis, merely observing (2004, p. 275) that “the actual detail extracted and the way these are analysed will differ depending on the narrative requirements and the guiding research approach”.

Yin (1994) suggests that case study is a design particularly suited to a situation in which it is impossible to separate the phenomenon's variables from their context. Therefore, case studies can provide a distinct advantage in answering the 'how' and 'why' questions implicit in the aims of this thesis. Also, the case study approach is useful to gain insights into how modernisation reforms are operationalised in the PPP and performance audit settings, and to make observations meaningful and understandable (Denzin and Lincoln, 2005). Following Yin (1989), multiple information sources are important for triangulation and enriched analysis. The sources used in this thesis include the academic literature for purposes of understanding and theory development. In addition, legislation, PPP policies and contracts, auditors-general reports, parliamentary reports, other archival records (including reports

commissioned by governments investigating PPP outcomes), press releases and media reports have been analysed.

Many of the documentary sources consist of government records. Some of these records, although available previously, are no longer accessible on government websites. Other government documents were obtained as a result of relationships developed in the course of this research. Each of these documents is “inevitably shaped by the political context in which they are produced and by the cultural and ideological assumptions that lie behind [them]” (Scott, 1990, p. 60). The approach of this thesis to analysing these documentary records is guided by an historical process designed to discover and understand how and why the approaches to, and the outworking of, the phenomena of interest to this study (e.g. modernisation, PPPs and performance audit) have changed over the period under investigation, and to understand the significance of these observed changes (Peraekylae, 2005).

Following Peraekylae (2005, p. 872), a four-stage process is adopted to guide textual analysis. The first stage is “a largely informal approach” designed to focus on the “propositional content” of the texts that tries “to pin down the assumptions and presuppositions that the texts incorporated”. In the second stage, publication dates gleaned through a historical survey of texts are used to provide important indicators of the timing of significant events that signal changes in social practices. The third stage involves textual analysis that is informed by theory, and used analytically as envisaged by Laughlin (1995; 2004). Finally, in the fourth stage, relevant texts (PPP policies, for instance) are assumed to serve as guidelines for actual social practices, or to reflect social practices (audit reports, parliamentary committee reports), permitting interpretation of motives and events.

Although multiple documentary sources support triangulation, there are cases in which aspects of practice remain unclear. In such cases, attempts have been made to clarify matters and to corroborate impressions of motive and practice through discussions with government officials and PPP consortia members. These discussions are treated as informal for two reasons. First, the impartiality of these actors is questionable due to their involvement in PPP processes and operations, and limitations on their understanding imposed by, amongst other things, time and level of

involvement. Second, given the decision to rely on documentation, the discussions were not intended to provide an additional source of evidentiary material in the triangulation process. Those with whom discussions were held were advised that they would not be quoted. Arguably, this approach did not detract from the documentary analysis; indeed, it provided insights into motives, processes and procedures, and events outlined in documents, the significance of which might otherwise have been overlooked.

In summary, the historical approach to documentary interrogation outlined by Peraekylae (2005) has much in common with the methodology of middle range thinking. Peraekylae's approach resonates with the 'structured subjectivity' of middle range thinking, which "specifies in more precise and abstracted terms what is involved in this engagement process whilst, at the same time, not trying to squeeze out the intuitive, imaginative properties of individual observers" (Laughlin, 2004, p. 274). Also, Laughlin (1995, p. 65) acknowledges the "inevitable truth that all empirical research is partial and incomplete", a sentiment echoed by Scott (1990, p. 35), who concludes that "the most that can be achieved by a researcher is an analysis which shows how the inferred internal meaning of the text opens up some possibilities for interpretation by its audience and closes off others".

In examining change in a public-sector setting, a longitudinal perspective is advocated by Pettigrew (1989) and Lapsley (2001d). Pettigrew (1989) cautions against research that provides snapshots of events from what are essentially iterative reform processes. For instance, Lapsley's (2001d) study into the introduction of budgets in publicly owned hospitals in England and Scotland (p. 88) corroborates the dangers of inference from a single episode in a continuing process. It demonstrates the need to study the wider context of proposed changes to assess their impact. Furthermore, Lapsley (2001d, p. 87) notes that the prominent view in the modernisation literature of the failure of accounting as an agent of modernisation change in public services may have been reinforced through snapshot studies, and may not always reflect long-term outcomes. Lapsley (2001d) argues that his longitudinal study resulted in the unexpected finding that in some important respects the reforms had been successful in Scotland (although not in ways envisaged by the reformers), which he attributes to the

process of reform proceeding at a gentler pace than had occurred in England, where the opposite result was observed.

Middle range thinking is the research methodology that underpins this thesis and binds the five papers that comprise it. Middle range's reflexive methodology (that is, the iterative process of fleshing out skeletal understandings through subjective empirical engagement with data (Laughlin, 2004, p. 268)) establishes the structures around the subjective processes that recognise and accept the subject in the discovery process. However, the workings of reflexivity are subtle, and remain largely hidden from the reader who, in reading the work of middle range theorists, is more aware of context and the theory and choice dimensions, than of the methodology dimension. Similarly, the analysis of documents in all papers is also reflexive (Peraekylae, 2005), and does not necessarily give rise to a structured analytical approach that is obvious in the writing up of the research.

Turning to review the modernisation literature, section 2.4 provides macro-level analysis of the modernisation of public services in OECD nations from the early 1970s to the present, identifying the theoretical and technical drivers of modernisation, its characteristics, and insights into its evaluation and achievements. Section 2.5 reviews critiques of modernisation, and section 2.6 considers the stimuli for, and nature of, modernisation change. The chapter summary follows in section 2.7.

#### **2.4 Features of modernisation**

Making the public sector more like the private sector (through a move away from an input-oriented, rules-based public service towards private-sector models of funding, management and control (Hood, 1991; 1995; VCA, 1993a; b)) remains a critical element of a series of managerial and accounting reforms introduced since the early 1970s to modernise public services in OECD nation states (see, for instance, Broadbent and Guthrie, 2008; Humphrey et al, 2005; Olson et al, 1998). Although the outworking of modernisation agendas in different countries is context dependent and changes over time (Hood, 1995; Olson et al, 1998), a number of its defining aims, rationales and features have not substantially altered (Modell et al, 2007). At the rhetorical level, the overarching goals of public service modernisation remain the

efficient, responsive and accountable delivery of public services (Chou et al, 2005). Modernisation has been justified as a theory-based, ideologically-driven, neo-liberal response to solving so called ‘crises’ (such as high levels of government debt) that are said to demand solutions in terms of ‘new’ ways of managing public services (Broadbent, 1998; Christensen et al, 2007; Laughlin and Pallot, 1998)<sup>5</sup>.

Modernisation has resulted in the introduction of a range of policies and associated practices. These include ‘Best Value’ and ‘Next Steps’ in the UK (Chou et al, 2005); new procurement arrangements such as PPPs (Broadbent and Laughlin, 1999); and the development of performance audit and other inspection techniques (Power, 1999). Modernisation predates New Labour in the UK, despite the Blair government’s adoption of modernisation as a *leitmotif* (Lapsley, 2001b, p. 331) for its public reform agenda. Similarly, modernisation in the Australian context can be traced to the introduction of a series of management reforms in the Australian public sector since the 1970s that promoted ‘managerialism’ and ‘marketisation’ (Carlin and Guthrie, 2001; English and Guthrie, 2001; Guthrie and Parker, 1998). These reforms are designed to improve the efficiency and effectiveness of public services, and to provide accountability for performance. Quantitative private-sector derived accounting methodologies are a notable feature of an array of technically rational implementation technologies utilised to achieve modernisation (Meyer, 1998).

#### 2.4.1 Theoretical drivers of modernisation

Broad understandings about what modernisation stands for, and how it should be implemented, were initially developed and advocated by ‘epistemic communities’ (Laughlin and Pallot, 1998), which have been defined as comprising an international “network of professionals with recognised expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge” (Hass, 1992, at p. 3;

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<sup>5</sup> The origins of modernisation have been traced to the political pressures arising from burgeoning government expenditures, budget deficits and rising unemployment in a period of high inflation and high taxes which caused governments to seek to radically change the way public services are delivered in modern democracies (see, for instance, Barton, 2001; Broadbent and Laughlin, 1999; English and Guthrie, 2001). Invariably, reviews of government expenditures (such as VCA, 1993a; b) emphasised inefficiency in government operations, including lack of asset, liability and expense management, resulting in the adoption of accrual accounting in the government sector (see Barton, 2002; English and Guthrie, 2001). However, the adoption of accrual accounting has received relatively little prominence in the modernisation literature, notwithstanding it being central to modernisation. The influence of accrual accounting in the PPP context is raised in Chapter 4.

quoted by Laughlin and Pallot, 1998, p. 385; see also Hood, 1995, p. 102). Modernisation is strongly supported by supra-national organisations such as the International Monetary Fund [IMF], the World Bank, and the OECD to control public debt and make the provision of public services more efficient (Stiglitz, 2000). More recently, departments of treasury have assumed primacy in its implementation within OECD nation states (English and Guthrie, 2003; Lapsley, 1999; 2001a; b; Pollitt and Bouckaert, 2000). Public-sector modernisation rests on the twin pillars of guiding principles derived from NIE, and the associated private-sector derived accounting and management technologies that have been used to implement modernisation (Hood, 1995; Modell et al, 2007).

In outlining the characteristics of modernisation, these amorphous ‘epistemic communities’ adapted NIE (Barton, 2001; Hood, 1991) to a public-sector setting to conceptualise and rationalise what has recently been seen as an agenda to modernise public services (Broadbent and Guthrie, 2008). This modernisation agenda has championed technologies identified as critical to private-sector success: control of agency problems; competitive tendering; contracting; the separation of policy making, oversight and service delivery; output and outcome specification; and an emphasis on performance management and accountability for results (Hood, 1991; 1995; VCA, 1993a; b).

At the theoretical level modernisation draws on NIE such as public choice and agency theories, and also on transactions cost economics [TCE] (Barton, 2001; Boston, 1995; Pallot, 1998). *Public choice theory* [PCT] seeks to apply conventional economic behavioural postulates to political and administrative systems, with the objective of identifying policies that will enable the public (reinvented as consumers) to choose outcomes that will best serve their interests (English, 2005b; Barton, 2001; Corbett, 1996). In relation to public-sector activities, PCT assumes that individuals have no innate preference between private (market-based) and public (by government) allocation of resources, and will choose the resource-maximising distributional or political solution (Stiglitz, 2000). It has been argued that the overriding political objective of modernisation is technical efficiency (the delivery of outcomes at lowest cost), rather than distributive or social justice which promote value-based judgements about delivery instruments and outcomes (Trebilcock, 1995). PCT assumes that all

distributional outcomes are equally acceptable, and can be efficiently determined through consumer choice in competitive markets. Also, PCT provides the rationale for the establishment of quasi-markets to underpin the modernisation of service delivery on private-sector principles (English, 2005b).

*Agency theory* [AT] strengthens the theoretical appeal of PCT by allegedly providing a blueprint for reshaping public management and control structures in the public sector to minimise agency costs. AT promotes the use of contracts to provide *ex-post* control mechanisms to manage and control the performance of agents and reduce costs (Williamson, 1981; 1991; 2005). It is assumed that contracts involving private-sector partners can be enforced to a satisfactory standard through contractually-specified (largely quantitative accounting-based) incentive mechanisms (Broadbent et al, 2008) to align the interests of private contractors with those of governments.

According to their proponents, PCT and AT have significant implications for government procurement of infrastructure and related services. PCT implies the need to replicate competitive markets within the government sector. A significant step forward for the implementation of a modernisation agenda in Australia was the 1995 adoption of National Competition Policy [NCP]<sup>6</sup> that privileged private-sector tenders through removing the relative competitive advantage of in-house (public) bids (English, 2005b).

A third major theoretical stream, TCE (Williamson, 1981; 1991; 2005), explains the role contracting plays in economic transactions and provides a means by which agency problems can be controlled and managed. TCE holds that the management and control of transactions through contracting is influenced by three considerations – namely, bounded rationality; opportunistic behaviour; and asset specificity (Williamson, 1981; 1991). First, bounded rationality (a lack of ability to anticipate and contract for all future eventualities (Broadbent et al, 2003a)) introduces uncertainty to a transaction, making it impossible, *ex ante*, to completely anticipate future complexities and changes in the transaction and its environment, resulting in contracts that are invariably ‘incomplete’ (that is, the contracting parties are required

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<sup>6</sup> NCP is supported by the *Competition Policy Reform Act 1995* (Commonwealth), parallel state legislation and Council of Australian Government Agencies agreements (between state and federal governments) and related regulations (English, 2003).

to engage in ‘gap-filling’ (Williamson, 1991, p. 278) during the execution stage). Second, opportunistic behaviour (by either party) may negatively affect the transaction, increasing the risk that self-interested and non-adaptive behaviours prevail when unforeseen events arising from uncertainty must be addressed and resolved. Third, asset specificity, which increases the bilateral dependence of contracting parties, may provide incentives for gap-filling and ease the resolution of uncertainty. Together, these three variables affect transaction costs. Problems associated with bounded rationality, opportunistic behaviour and asset specificity in long-term contracts can be mediated through the development of trust (Broadbent et al, 2003a)<sup>7</sup>.

#### *2.4.2 The technologies driving modernisation change*

On the level of practice, the modernisation of public services is characterised by the central role ascribed to accounting and management technologies such as accrual accounting, and performance management techniques (Humphrey et al, 2005; Olson et al, 1998), including techniques derived from the finance literature to cost and compare public and private provision options (Officer, 2004). These technologies have played a prominent role in defining the nature of change, in specifying performance standards and in monitoring and reporting outcomes (Humphrey et al, 2005; Lapsley, 1999; Olson et al, 1998). Also, they have been characterised as a toolbox of technically rational modernisation implementation strategies, technologies and techniques derived from private-sector practices (Meyer, 1998). Furthermore, it has been claimed that these accounting and management technologies act to legitimate the financial and control dimensions of, and rationalities for, modernisation (Meyer, 1998). Chou et al (2005, p. 291) characterise accounting and management technologies as “an extensive (but still developing) network of tools and mechanisms for restructuring, redefining, monitoring and controlling the provision of public services”.

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<sup>7</sup> Further explanations of the implications of TCE in the PPP context are explored in Chapter 5, which also includes a review of literature critical of the capacity of TCE to explain observed contracting practices in complex long-term hybrid relationships in public and private sector settings.

### *2.4.3 Changing patterns of accountability in the modern state*

In addition, modernisation has broadened the emphasis of parliamentary scrutiny and control of government expenditure from its traditional focus on inputs and appropriations to include oversight of the results arising from the provision of public services by the government and by private contractors in governments' name (Funnell and Cooper, 1998; Newberry, 2004). Performance audit is a modernisation technology developed in response to the emphasis on responsibility for performance (Guthrie and Parker, 1999), and is designed to provide assurance that program objectives have been achieved efficiently and effectively (or that value for money [VFM] has been achieved in service provision (Pollitt et al, 1999)). Performance audit<sup>8</sup> has proved controversial and highly contentious on a number of grounds. First, in most nations (and in the majority of Australian jurisdictions), it is concerned with investigating the achievement of 'effectiveness' and 'good management' of service delivery, and raises questions about the use of 'best practice' frameworks as audit criteria (Broadbent and Laughlin, 2003; Gendron et al, 2001; Pollitt et al, 1999; Skaerbaek and Thorbjornsen, 2007). Second, performance audit has become controversial and risky for auditors-general (English, 2003) as governments have increasingly resisted investigation of government policy, thereby establishing a contestable distinction between auditing policy and auditing its implementation (Gendron et al, 2001).

Modernisation has generally resulted in increased auditing activity (Power, 1999), but not necessarily in heightened public accountability. Performance audit has increasingly tended to verify adherence to prescribed processes and procedures and the reliability (and perhaps appropriateness) of performance data, rather than providing a substantive opinion on the effectiveness with which public services have been delivered, and whether programs actually achieve political objectives (Pollitt et al, 1999). For instance, in some cases, detailed analysis and conclusions about program achievements made in the course of state audit and other (internal and external) investigations remain hidden from view, and are used solely for the purposes of managerial control within the organisational hierarchy (Bowerman, 1998); they are also not available for parliamentary and public scrutiny because the relevant analytical detail is omitted for publicly available reports (including audit reports).

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<sup>8</sup> Performance audit is known as VFM audit in the UK (Sharma, 2007).

## 2.5 Critiques of modernisation

Underlying many of the critiques of modernisation and associated outcomes is the belief that many of the reforms that attempt to introduce competition into public services are not appropriate in a public-sector setting because of the fundamental differences in the objectives and operating environments of the two sectors (see Barton, 2001; 2002; 2006). For instance, in relation to the concerns of this thesis, commercial-in-confidence contracting is perceived to be inappropriate in a public-sector environment because of the need for the accountability of governments to parliaments and citizens (Watson, 2003; 2004). In addition, many commentators also believe that governments' social responsibility to provide basic public services that would not otherwise be provided by markets (because of externalities) should not, and cannot, be provided by private contractors (driven by the profit motive) in artificially created quasi-markets governed by contracts (see, for instance, Andrew, 2007; Barton, 2001; 2002; Quiggin, 2004; Shaoul, 2005a; Walker and Con Walker, 2000). Implicitly, this view questions the efficacy of the application of PCT to a public services setting. Barton (2001) argues that the shared nature (individual and social) of the benefits and costs flowing from public goods (such as the PPP hospitals and prisons examined in this thesis) makes performance outcomes difficult to measure. Attempts to capture performance in financial terms inevitably exclude the non-financial benefits and costs that also flow to individuals and society as a result of their provision, raising questions as to how such benefits and costs can be identified, specified, monitored and reported.

Other commentators have noted some paradoxes associated with the rationales and implementation of modernisation. For instance, the institutionalisation of performance audit and an emphasis on responsibility for performance (that are features of modernisation) sit uncomfortably with the observed propensity of governments to avoid disclosure on the grounds of commercial confidentiality (Barton, 2001) and the failure of proponents of modernisation to subject reforms to rigorous independent review and assessment (Olson et al, 1998), making it difficult to ascertain whether modernisation objectives have been achieved (Boston et al, 2001).

Despite its appeal to technical scientific rationality (Olson et al, 1998), the implementation of modernisation has been controversial and its achievements

challenged (Bowerman, 1998; Humphrey et al, 2005; Lapsley, 1999; 2001a; b; Olson et al, 1998; Skaerbaek and Thorbjornsen, 2007). The application of accounting and management technologies has been questioned on the grounds that they lend selective visibility (Bowerman, 1998; Lapsley, 1999; 2001a; b) to certain issues and perspectives, thereby influencing agendas and meanings. Historically, accounting and management technologies have tended to be expressed in terms of quantitative techniques that most easily specify, measure and monitor performance, with the significance of qualitative factors commensurately downplayed, privileging a technical financial and economic discourse at the expense of the social discourse that had been characteristic of the traditional public sector (Pallot, 1998). Furthermore, Newberry and Pallot (2005), in their analysis of the introduction of modernisation in New Zealand, find that the acceptance, at face value, of stated rationalisations for modernisation can be misleading because hidden agendas may mask unacknowledged objectives that are concealed in technical developments.

The relative lack of detailed assessment of the achievements of modernisation has been excused on several grounds: first, the problems associated with measuring costs and impacts; second, transitory teething problems that delay assessment (Guthrie et al, 2005; Olson et al, 1998); third, that it is too early (in the implementation of particular modernisation programs) to make any concrete judgements (Broadbent et al, 2004b); fourth, that constantly changing reforms that build on one another make it increasingly difficult to test whether the original objectives have been achieved (Carlin, 2004); and fifth, that the technical problems associated with monitoring reforms have diffuse effects (Olson et al, 1998). Also, Carlin (2004, p. 280), in his study of reforms to performance-based outcome measures in Victoria, found that “in many cases no actual data is ever reported in respect of performance indicators. Instead during the (often brief) period of their survival, the only reported data is in the form of targets.”

Olson et al (1998, p. 328) suggest that the root problem for auditors-general and others wanting to investigate modernisation outcomes is the “residing faith” that the “promised world” can be delivered only if the reform process is implemented in a better fashion. The belief that reforms based on theoretically-sound economic principles and tried technologies will result in optimal outcomes if implemented

properly may postpone and undermine investigation of the appropriateness of modernisation policies and associated implementation technologies themselves. Attempts to determine the merits of modernisation relative to what the situation might have been had there been no such initiative is seen by some (such as Olson et al, 1998) to be potentially of critical relevance, although investigation of this nature is likely to breach the constitutional boundaries that insulate government policy from scrutiny by state audit (Pollitt et al, 1999).

## 2.6 Drivers of modernisation change

In identifying PPPs and performance audit as ‘change mechanisms’, Lapsley (2001c, p. 503) suggests that it is difficult to detect patterns of modernisation change in and between countries owing to the importance of context. Indicating that the role of accounting and management technologies in the modernisation process remains a major challenge to evaluators of public-sector transformation, Lapsley (2001c, p. 503) concludes that the jury is out as to “whether the public sector is still in a state of transition or whether it has indeed been transformed into a New Public Sector”. Meyer (1998) contends that accounting and management technologies do not deliver instrumental change, but are an integral part of a rationalising and modernising transformation that has effectively produced a new public sector, implying that the mission and consequences of these implementation technologies are integral to modernisation itself, and permeate and mould the institutions that comprise the modern public sector.

Recent work by Lapsley (2001c; 2001d) and Modell et al (2007) confirms that implementation of hard-edged NIE-based reforms through the imposition of private-sector derived accounting and management technologies has had mixed success at the micro (organisational) level (see also Guthrie et al, 2005; Olson et al, 1998). However, these studies demonstrate that modernisation reform can be ‘successful’, albeit not necessarily as initially intended (Lapsley, 2001d). Lapsley (2001c; d) and Modell et al (2007) suggest that successful implementation of reforms in different contexts has a number of common features. First, it is evolutionary and builds on previous reform experiences (also see Jacobs et al, 2007). Second, success is derived from organisational memory (Lapsley, 2001c; d) and “the potency of past experience”

(Modell et al, 2007, p. 471), which causes subsequent acceptance and adaptation of that which has previously been rejected. Third, in contrast to the NIE approach, successful implementation is sensitive to the context to be reformed. Fourth, 'success' has involved adaptations and innovations at the organisational level, albeit within a broad NIE-oriented policy framework at the macro level (Lapsley, 2001d; Modell et al, 2007). Fifth, detecting success requires longitudinal research that examines "the gap between strategic intent and operational implementation" (Lapsley, 2001d, p. 88 (quoting Pettigrew, 1989)).

Lapsley (2001c; d) claims that reform driven by relentless modernising reformers who are insensitive to the complexities of the organisations they are trying to reform (Brunsson, 1989; Brunsson and Olsen, 1993) has a strong correspondence to public-sector transformation advanced by the epistemic communities advocating reforms driven by NIE theories and applied in practice through private-sector derived accounting and management technologies (Christensen et al, 2007). Lapsley (2001d) notes that the majority of studies of reforms to the UK's NHS have reported failure. In identifying one example of 'successful' implementation, Lapsley (2001d, p. 106) attributes his findings to differences in the implementation process and to the longitudinal research method adopted. In trying to understand why implementation was unsuccessful in England, Lapsley (2001d, p. 106) noted:

[T]he contrasting experience of the implementation process in England and Scotland ... In England the process of implementation is captured by the ideas of the institutional theorists ... who depict reformers as relentless modernizers, insensitive to the subtleties of hospital life, with the consequent failure of such initiatives'. From this perspective reformers are seen as driven, as being inculcated with beliefs about the benefits of modernization and insensitive to the operation of decoupled organization structures which contrast with their favoured unitary form of organizational structure. Scrutiny of the processes of reform in English captures this belief in rationalistic procedures both from the perspective of the government (which initiated these reforms) and hospital management (which was prevailed upon by government to implement these reforms). In Scotland, the process of reform has proceeded at a gentler pace and, while success was not immediate it is, nevertheless, demonstrable.

The work by Modell et al (2007) is based on the notion of 'path dependencies'. Confirming findings in Lapsley (2001d), Modell et al (2007) suggest that reforms driven by NIE and private-sector derived accounting and management technologies may have had less impact than many commentators (such as Meyer (1998)) believe.

Modell et al (2007, p. 471) distinguish between the policy level of government (which retains a preference for the NIE-based objective of managing for results) and successful implementation at agency level. Modell et al (2007, p. 471) found that the examined organisation (the Swedish Tax Agency) selectively adopted (and adapted) reforms that seemed consistent with the objectives of the performance orientation of the NIE model, concluding that this “supports the prediction that the ongoing re-interpretation of current reform initiatives by individual ‘grass-roots’ organisations may resolve seemingly ‘irreconcilable’ performance management logics”.

Accordingly, the work by Lapsley (2001d) and Modell et al (2007) appears to suggest that although central agencies (such as departments of treasuries and finance) at the macro level may continue to embrace the theoretical and applied precepts of NIE, recent reforms instigated by line agencies at the micro (organisational/project) level, while congruent with the broad objectives of NIE, may take different (and softer) approaches to implementing change that are responsive to context. The observed flexibility at the micro level raises questions about the role of accounting and management technologies in the change process. Meyer (1998) has suggested that the public sector has been transformed, and that quantitative accounting and management technologies are an integral part of the rationalising and modernising transformation that has produced a new public sector. However, the work by Lapsley (2001d) and Modell et al (2007) raises questions about the dominance (at the micro level) of these technologies as change mechanisms, and also indicates that the modernisation process is still in a state of transition.

## 2.7 Chapter summary

As outlined above, the research method guiding analysis and reflection in this thesis (and in the five papers comprising it) is Laughlin’s (1995; 2004) middle range thinking. The documentary data that provides the source of the empirical evidence in this thesis has been interrogated using an historical data analysis methodology that is compatible with the middle range thinking research approach and method.

There is broad agreement about the initial drivers and macro-level features of the modernisation of public services in OECD nations. NIE and private-sector derived

quantitative accounting and management technologies have redefined public services and associated delivery mechanisms, purportedly making them more efficient, effective and responsive to ‘customer’ needs. However, these technologies have been implicated in legitimating modernisation, and also in perceived modernisation failures, such as making invisible non-financial objectives and outcomes. Problems associated with specifying, monitoring and reporting on modernisation’s achievements have largely been sheeted home to the private-sector accounting and management technologies used to drive efficient and effective outcomes. There is also agreement that modernisation has tangibly transformed public services delivery in OECD nations, and is probably irreversible, although changing iteratively over time (Broadbent and Guthrie, 2008; Lapsley, 2001b; Meyer, 1998). Modernisation has also affected public accountability and state audit, having given rise to performance audit, which is intended to assess the achievement of modernisation objectives.

A number of common themes and concerns in the modernisation literature suggest that its implementation, although founded on supposedly technically rational theories and technologies, has frequently not resulted in the achievement of stated objectives. Some, such as Newberry and Pallot (2005), suggest that the divergence between espoused objectives and observed outcomes could result from unstated objectives, which explain the sometimes unexpected outworking of modernisation. Also, the propensity of modernisation to reinvent itself and to give rise to a rolling wave of reforms (Carlin, 2004; Lapsley, 2001b) has made oversight problematic and reduced the possibility of ascertaining whether or not modern procurement actually provides VFM in comparison with traditional public service delivery.

Observed differences in modernisation in different national contexts over time (Guthrie et al, 2005; Hood, 1995; Lapsley, 2001a; Olson et al, 1998) provide a motivation for this research. Case-based analysis of the outworking of modernisation projects suggests a gap between the claims made for modernisation and its practice (Vignoni, 2005), although Lapsley (2001d) cautions against drawing conclusions on the basis of a methodology that provides snapshots of reform processes and outcomes. Indeed, Lapsley’s (2001d, p. 106) research in the context of reform of the UK’s NHS suggests that, despite the failure of the initial reform (management budgeting) and of a subsequent reform (resource management), a variant of the initial reform had taken

hold at both research sites (in England and in Scotland) with some degree of success. Lapsley (2001a; b; d) and others have regularly called for longitudinal case-based research into modernisation and its effects in different contexts and national settings. This thesis responds to these challenges.

As would be expected, there is considerable overlap between the themes and concerns in the modernisation, PPP and performance audit literatures. As indicated earlier, these literatures will be further explored in the following chapters in which the three research aims are addressed, and the major findings of each of the five papers comprising this thesis are presented and analysed.

## CHAPTER 3

### Public-Sector Modernisation in the Australian Context

#### 3.1 Introduction

The purpose of this chapter is to address the first aim of this research, *to analyse the characteristics of modernisation in the Australian public sector*. *Paper 1*<sup>9</sup> identifies and analyses and the macro-level features of modernisation in an Australian context, and raises some implementation issues relevant to PPPs. As a counterpoint, an alternative perspective to the hard-edged NIE-based approach that dominates Australian public services modernisation is also canvassed in this chapter. It examines a European model designed to foster co-operation and consensus between stakeholders, potentially providing insights into the reasons underlying difficulties in achieving anticipated outcomes in the PPP execution stage. *Paper 1* and additional material from English and Skellern (2005) introduced in this chapter contributes to skeletal theory development that began in Chapter 2. Also, Chapter 3 begins the iterative reflexive process of applying the richness of the empirical detail to expand the skeletal theory to make it more meaningful in the context of this research (Laughlin, 1995; 2004).

The purpose of *Paper 1* is to provide contemporary insights into modernisation change in Australia, including a useful summary of the salient features of modernisation, and an analysis of the major issues and concerns highlighted in the literature related to its outworking. The purpose of introducing findings from English and Skellern (2005) is to understand the differences between the PPP and network approaches to partnerships between the private and government sectors, thereby highlighting features of an alternative approach to co-operative engagement between public and private stakeholders that may mediate against the observed failure of NIE-based reforms (English and Skellern, 2005). The features of modernisation in Australia as outlined in *Paper 1* are summarised in section 3.2. The relevance of *Paper 1* findings to this thesis are presented in section 3.3. The alternative approach to

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<sup>9</sup> As indicated in Chapter 1, references to the five papers and material contained in them are distinguished by the use of the italic script. Italicised references to page numbers refer to the pages in the papers as published and not to pages in this thesis.

facilitating modernisation change is introduced in section 3.4. The chapter's findings are summarised in section 3.5.

### 3.2 Features of modernisation in the Australian public sector

The primary purpose of *Paper 1* is to provide the macro-level contextual background for the micro-level analysis of the development and use of PPPs to modernise services delivery that follows in Chapters 4 and 5. A secondary purpose of *Paper 1* is to highlight the motives, characteristics and critiques of modernisation in the Australian context, and their relationship to those outlined in Chapter 2.

Using a perspective derived from institutional theory (Di Maggio and Powell, 1983; Meyer and Rowan, 1997), *Paper 1* contends that the continuing momentum of public-sector modernisation change in Australia reflects ongoing processes of coercive and mimetic isomorphism. As explained in *Paper 1* (pp. 48-49):

Coercive isomorphism has manifested itself in electoral pressures for reduced taxes and greater individual freedom of choice of services, and in the pressure upon the public sector brought to bear by neo-liberal political ideology that has captured both sides of the Australian political debate. Mimetic isomorphism has manifested itself in the public sector's imitation and adoption of many private sector business structures, values, objectives, accountability systems, strategies, and performance indicators – in concept, language and action.

*Paper 1* introduces the logistical problems associated with public-sector research in Australia. These derive from a federal system of government, which gives rise to nine different governments (federal, six states and two territories). Each of these jurisdictions has its own legislative, judicial and public administration system, and its own auditor-general and audit legislation. Although there are significant commonalities between approaches taken in each jurisdiction (such as a common commitment to modernisation), researchers must take care to specify and describe the features of the context within which they conduct their research, as the outworking of modernisation differs between jurisdictions (English and Guthrie, 2001). The jurisdictional problem is relevant to this research as PPP development and implementation has not been uniform across Australia (English and Guthrie, 2003), and explains the focus on one site in this research. Because Victoria is Australia's

leading PPP proponent and has developed PPP policies that have influenced PPP implementation throughout Australia (English and Guthrie, 2003), PPP outworking in Victoria has been selected for investigation in this thesis.

*Table 2.1: Four Governance Models Implemented in Australia (Paper 1, p. 28)* identifies the primary features of four public-sector governance models that have influenced and shaped public-sector modernisation in Australia since the 1970s. *Table 2.1* indicates that the market model best explains Australia's current modernisation phase. *Table 2.2: Implementing the Market Model – Linking Organizational Characteristics with Objectives and Implementation Strategies (Paper 1, pp. 31-33)* outlines the organisational characteristics, objectives and implementation strategies of the market model. Relevant for this thesis are the influence of transactions cost economics [TCE] and public choice theory at the rhetorical level; risk management at the implementation level; and reducing the role of the state to promote cost-effective performance-driven service provision as primary objectives of modernisation.

Also, *Paper 1* explores implementation issues associated with the introduction of the market model in the Australian context. *Table 2.3: Implementing the Market Model in Australia: Issues and Concerns (Paper 1, p. 37)* identifies the key features of the market model, and potential problems relating to the private-sector derived accounting technologies devised to support its implementation. The purpose of *Table 2.3* is to identify and challenge some key assumptions explicitly or implicitly made about these technologies, and about their role in modernisation.

### 3.3 Characteristics of public-sector modernisation

*Paper 1* confirms findings in the international literature that modernisation in the Australian context (as in other OECD nations) has been driven by perceptions of the need to solve 'problems' such as fiscal crises, big government and inefficient service delivery. *Paper 1* also confirms that although the market model most closely characterises Australia's current approach to transforming the public sector, modernisation is an iterative process that reflects the struggle of governments to pursue their own reform agendas in response to changing political, social and economic circumstances. Perceived successes and failures of previous reforms also

shape future modernisation change. Research by Modell et al (2007) and Jacobs et al (2007) suggests that the differences between the four governance models identified in *Paper 1* may be more apparent than real because of the evolutionary nature of public-sector change, and the propensity in the public sector to value process and procedure, the hallmarks of the traditional procedural model. For instance, the work by Jacobs et al (2007) suggests that modernisation's commitment to radical transformation may be undermined in the longer term by the public sector's long-standing reliance on process and procedure to provide some assurance that outputs and outcomes (however specified) are delivered as envisaged in policy initiatives.

*Paper 1* also confirms the influence of new institutional economics [NIE] and private-sector derived accounting and management technologies on modernisation in Australia. For instance, the TCE framework has influenced the use of contracts to manage and control public service delivery and perceived agency problems. Public choice theory [PCT] provides the rationale for the introduction of artificial quasi markets to reduce costs, increase the competitiveness of service delivery and the focus on outputs and outcomes that supposedly eliminates the need to specify how suppliers should provide outputs, or the type of outputs to be provided. PCT has also contributed to the emphasis on cost as the basis on which to award contracts.

The emphasis on risk management, performance-based management and the concomitant adoption of accounting methodologies to measure and report on performance reflects the influence of professional accountants in shaping public-sector modernisation (Christensen et al, 2007). The introduction of accrual accounting has elevated the need to report assets and liabilities in public-sector financial statements, but has also introduced the recognition and disclosure issues familiar to corporate reporting. Finally, the commitment to reduce the role of the state and to make public services more responsive to customers' needs reflects the pervasive influence of the overall rationale of modernisation, which has been characterised by Savas (2000) as a desire to privatise the provision of public services.

*Paper 1* provides insights into potential implementation issues associated with key features of Australian modernisation that are relevant in the PPP context. The implementation issues identified in *Paper 1, Table 2.3* are VFM, risk management,

transparency and accountability, accounting and reporting, and performance specification and monitoring. For instance, *Paper 1* questions the concept, nature and use of VFM in public-sector decision-making, and distinguishes between the management of project risk and what constitutes a ‘successful’ transfer of risk to the private sector. *Paper 1* casts doubt on the ability of a slimmed down public sector to identify and manage complex risk effectively. *Paper 1* suggests that the modern Australian public sector has a poor record in identifying and transferring risk. Also, it questions whether risks, once identified, can be effectively transferred to the private sector, because some risks are incapable of being transferred, irrespective of contractual obligations.

In addition, *Paper 1* notes the paradox between the espoused use of contracts to increase transparency (VCA, 1993a; b) and governments’ growing reliance on commercial confidentiality to shield contractual details from disclosure (Barton, 2006; Watson, 2003; 2004). Modernisation has also resulted in a redefinition and reshaping of traditional accountability of governments to parliament to more narrowly focus on the administrative responsibility for performance (to the internal public-sector managerial hierarchy) by public officials (Pallot, 2003). As noted in the literature review in Chapter 2, the specification of performance has resulted in an emphasis on capturing the quantitative at the expense of the qualitative, with associated problems of rendering non-financial aspects of service provision largely invisible (Bowerman, 1998). Reflecting concerns in the international modernisation literature (see, for instance, Olson et al (1998) and Guthrie et al (2005)), *Paper 1* flags concerns about the will and ability of Australian governments to adequately monitor and manage performance, suggesting that performance monitoring may not be a high priority.

In summary, *Paper 1* concludes that the changes to the Australian public sector associated with modernisation are irreversible. *Paper 1* confirms the influence of NIE, private-sector derived implementation technologies, and political will on modernisation in Australia, affirming observations on the nature of modernisation change made by Lapsley (2001b; d). Furthermore, *Paper 1* indicates that public-sector transformation in Australia continues to evolve (sometimes in surprising ways, as suggested by the initiatives to help the unemployed find work), but that change has become essentially iterative and evolutionary (as opposed to a series of radical

transformations), confirming insights by Modell et al (2007) and Jacobs et al (2007). Building on the findings of Guthrie and Parker (1998), *Paper 1* demonstrates that accounting and management technologies have been integral to rationalising modernisation in Australia over a 20-year period, and to the nature of the transformation itself (Meyer, 1998). Longitudinal analysis of aspects of the effects and achievements of modernisation in a PPP setting is the subject of Chapters 4, 5 and 6.

### 3.4 An alternative approach: lessons from international experience

The objective of section 3.4 is to consider the features of an alternative approach to policy development and implementation that has evolved in continental Europe. The purpose of reflecting on the attributes of network governance is to understand how a softer, more context-sensitive approach (than NIE) to partnership may have the effect of limiting the incidence of implementation failure (Lapsley, 2001d) that has been observed as characterising modernisation reform in Anglophone countries (Guthrie et al, 2005; Olson et al, 1998).

Approaches to recent public-sector modernisation and change have been linked to the historical socio-political and economic cultures of different nation states (Pollitt and Bouckaert, 2000). Four governance models are identified in *Paper 1: Table 2.1* (p. 28). These are the traditional public-sector input-oriented model (identified as procedural governance), a transitional model (corporate governance), market governance, and the network governance model (the subject of this section). The period of modernisation change of interest to this thesis encompasses elements of the corporate, market and network governance models. As noted in *Paper 1* (p. 28) the presentation of *Table 2.1* suggests that these models have been adopted successively. This is an oversimplification. The dominant model of interest to this thesis is the market model, which continues to incorporate elements of the 'earlier' corporate governance model, and, more recently, of the network governance model.

The major differences between the modernisation model (which dominates change in the Australian public sector) and the network model are summarised in Table 3.1.

**Table 3.1: Comparison of Features of the Modernisation and Network Models Adapted from English and Skellern (2005, pp. 16-17)**

	Modernisation Model	Network Model
Origins	Administrative doctrine influenced by reworking of neo-classical economic theories, private-sector management practices & accounting technologies to ensure the efficient & effective production of public goods & services.	Governance model influenced by 'bottom-up approach'; intergovernmental relations literature; inter-organisational theory; & the interactive policy approach.
Political motivation	Increasing flexibility, quality & quantity of public resources at lowest cost.	Responding to unmet need in social policy areas.
Determination & implementation of policy	Development & implementation of policy viewed as rational outcome of separation of roles & design of contracts that reduce agency costs, information asymmetry & specify performance hurdles and monitoring requirements.	Development & implementation of policy viewed as games between actors, influenced by institutional context. Interdependence of public, private & semi-private actors, each with unique view of problems & solutions; outcomes result from negotiation, co-operation & other forms of network management.
Desired outcome	Transaction efficiency based on competition & price.	Optimal social outcome achieved through interaction between actors.
Emphasis of model	Separation of policymaking, purchasing & provision; central role for contracting in attempts to minimise waste & inefficiency; outcomes-focused performance-based management; use of private-sector accounting technologies; devolution of responsibility & decision making.	Institutional context in which complex interactions take place; assumes policy determination & implementation occur in complex & strategic interaction processes within networks of interdependent actors.
Locus of control	Despite emphasis on competition & contracts, involves strong top-down government control of policy making & implementation. Devolution of control at contract management level only.	Government policy establishes broad legislative and institutional context. Network partners free to develop policies & determine forms of implementation.
Role of contracts	Contracts used to manage incentives, through government specification of KPIs & output requirements in contracts. Legislation establishes broad framework within which contracting takes place.	Long term relationships based on trust, negotiation & collaboration; contracts used to specify agreements between actors negotiated co-operatively. Legislation establishes broad network framework.
General features	Universal prescription of private-sector management techniques, & introduction of market-based measures.	Focuses on mediating & co-ordinating inter-organisational policy making & implementation.
Service provision model	Fixed quantity & quality of service provision; determined by contracts; suited to mass production of standard products.	Services deployed according to unique characteristics and needs of clients; suited to individually-tailored negotiated solutions.

Table 3.1 demonstrates that the market and network models are premised on starkly different intellectual foundations and assumptions about the means to achieve public policy change. As noted previously, the market model is ideologically driven by NIE and certain prescribed private-sector derived implementation technologies that

privilege the financial aspects of services (possibly at the expense of non-financial aspects), resulting in its hard-edged features that give rise to a number of issues and concerns that are captured in *Paper 1 Table 2.3* (and have previously been raised in the Chapters 1 and 2, and earlier in this chapter).

In the context of this thesis, Table 3.1 emphasises the difference between the NIE and network approaches to the specification and management of modernisation change in a public-sector setting. In the modernisation model, government plays a key role in establishing the institutions, policies and implementation strategies, which, despite the rhetoric of responding to citizens' concerns, it drives in a command and control fashion (Pollitt and Bouckart, 2000). By contrast, from the network perspective, outcomes are negotiated by various stakeholders and consensus reached within a loose institutional and policy framework established by government. The NIE approach appears to provide governments with greater control and certainty, and to be easier to implement as it dispenses with the need to consult widely to promote a genuinely consensual solution. By contrast, the network process appears to be less amenable to central control, and to require time and skilled negotiators to facilitate workable (but not necessarily controllable) solutions. Trust and flexibility are emphasised in the network model, but are largely absent from the NIE-based approach. Thus, in the context of social policy that addresses complex interactions between the state and individual stakeholders (such as hospital patients or prisoners) it may be more appropriate (in some instances) to facilitate change from a network as opposed to NIE perspective (as suggested by the use of the network approach to helping the long-term unemployed find work, which was reported in *Paper 1*).

The network model was developed in continental Europe (as opposed to the Anglophone countries that have promoted and adopted the corporate and market models), and reflects European political traditions (such as a greater emphasis on consensus and mediation), which suggest a preference for long-term collaboration grounded in relationships of trust between the parties involved in providing and using public services.

At the theoretical level, the network model is premised on a belief (reflecting a political science perspective) that successful policy development and implementation

results from complex collaborative interaction processes that take place between a large number of networks of independent actors (Klijn and Koppenjan, 2000, p. 139). The network model recognises and facilitates the influence of a range of disparate stakeholders on public policy implementation strategies and outcomes (Bovaird and Löffler, 2004), emphasises the sharing of risks (and not its management through transfer or optimum allocation on the basis of contractual arrangements as does the market model), and is responsive to stakeholder perspectives. The role of government in a network society is to provide the systems-level conditions (through laws, regulations and policies) that facilitate the creation of trust, negotiated outcomes, and minimise project risk through the achievement of committed and concerted action (Klijn and Teisman, 2000).

By contrast, Anglophone implementation of modernisation has been characterised as a chain of low-trust principal-agent relationships mediated by contracts (Dunleavy and Hood, 1994). Network theorists eschew the TCE approach to contracting as a basis for partnership (Klijn and Teisman, 2000, p. 85). There is a stark difference at the rhetorical level between the market and network approaches to partnerships, as noted by English and Skellern (2005, p15):

One talks about the separation of purchaser and provider, the other about joint production. One talks about risk transfer and the contractual specification of costs and revenues, the other about 'sharing' risks, costs and revenues.

*Paper 1* suggests that corporate and market models may be inappropriate for the delivery of social policies because they fail to facilitate the development of long-term collaboration and trust between providers and recipients. Accordingly, there is some evidence in Australia and the UK (see, for instance, *Paper 1*; Chou et al, 2005; Kurunmaeki and Miller, 2006) that the alternative perspective characterised by the network model may have recently influenced elements of modernisation change in Anglophone countries (and represents another step along the iterative process of the evolution of modernisation. The question of interest to this thesis is whether the network approach has also influenced Australian governments' approach to PPP relationships.

### 3.5 Chapter summary

The purpose of this chapter was to address the first aim of this research, *to analyse the characteristics of modernisation in the Australian public services*. *Paper 1* addresses macro-level contextual issues and concerns about the implementation of modernisation in the Australian public sector.

In summary, *Paper 1* identifies the contextual complexities stemming from Australia's federal system of government that suggest the need for researchers to focus on investigating modernisation outworking in specific jurisdictions. Also, *Paper 1* establishes the theoretical rationales and associated private-sector derived accounting technologies that underpin modernisation implementation in the Australian public sector, and identifies four models of public-sector governance, two of which reflect the hard-edged approach to modernisation driven by proponents of NIE theories and the application of private-sector disciplines into the control and management of public-sector service provision. *Paper 1* outlines the features of the prevailing Australian approach to modernisation, and raises a number of issues and concerns relating to its implementation. Also, *Paper 1* introduces the network governance model, which is characterised by negotiation, co-operation, consensus and flexibility.

Modernisation, as implemented in Australia, resonates with the Anglophone hard-edged approach that has also been identified by Hood (1991; 1995), Humphrey et al (2005), Olson et al (1998) and Pollitt and Bouckaert (2000), as outlined in the previous chapter. However, analysis in this chapter of the theoretical underpinnings and practical outworking of the network governance model builds on *Paper 1* by providing additional insights into how elements of network theory could mitigate the negative effects of the Anglophone approach to modernisation which could undermine the effectiveness of long-term relationships grounded in hard-edged PPP contracting, a theme that is investigated in Chapters 4 and 5 of this thesis.

## CHAPTER 4

### Establishing Modernisation Objectives in the PPP Pre-Contracting Stage

#### 4.1 Introduction

The second aim of this research, *to analyse PPPs and their changing role as a modern procurement technology*, is addressed in Chapters 4 and 5. In Chapter 4 the analysis and discussion in *Papers 2 and 3* is supported and augmented by additional research findings. Chapter 4, which investigates PPP policies and the processes and procedures mandated to achieve policy objectives in the PPP pre-contracting stage, has two primary objectives.

The first objective of this chapter is to establish PPPs within their economic and institutional context. This objective is achieved in *Paper 3*, which presents a macro-level overview of PPP activity Australia-wide and distinguishes between two different PPP implementation periods. Thereafter, an analysis of evolving PPP policies in the period 1991-2007 summarises changing PPP objectives and identifies the accounting and management technologies mandated in the pre-contracting stage to achieve those objectives. Investigating PPP policies and their implementation in the pre-contracting stage is important because it establishes the policy context within which the achievement of agreed outcomes at individual PPP project level must be analysed.

The second objective of Chapter 4 is to investigate empirical evidence that illuminates PPP implementation in practice. In the absence of disclosure of pre-contracting processes and procedures, this objective is achieved through an examination of project objectives and risk allocations in two PPP hospital contracts (that are representative of four projects) and analysis of the failure of one early PPP hospital, the Latrobe Regional Hospital [Latrobe], which is the subject of *Paper 3*. Through focusing on pre-contracting appraisal technologies, the intention of Chapter 4 is to provide evidence and explanations of changing PPP objectives and implementation over time.

The development of skeletal theory began in Chapter 2. This chapter further develops skeletal theory, and also continues the middle range thinking process of progressing the research through the final two stages identified by Laughlin (1995; 2004). The

purpose of the skeletal theory is to guide and structure the way the organisational settings can be viewed (Laughlin, 2004, p. 267). The second stage involves applying the richness of the empirical detail to make the skeletal theory more meaningful. Reflexive interaction between theory and empirical data results in iterative discovery and interpretative processes that precede the separate third stage, the change dimension, which involves extending or reformulating prior theories (Laughlin, 2004, p. 268). Reflection on the goodness of fit of skeletal theory to empirical findings (the third stage) also begins in this chapter.

Chapter 4 is organised as follows. Section 4.2 reviews the PPP literature to clarify a number of themes and concerns that dominate critiques of the PPP pre-contracting stage. This section builds on the literature in *Papers 2* and *3*. The primary focus of the literature review in this chapter is to examine controversies relating to PPP objectives, and the pre-contracting accounting and management appraisal technologies designed to justify the PPP option and to manage the risks associated with PPP projects. Although there are some contextual differences between PPP implementation in the UK and in Australia, English and Guthrie (2003) confirm that the UK-based PPP literature is relevant to the Australian context. The literature review presented in section 4.2 identifies two appraisal technologies that are critical to the achievement of PPP objectives—risk management and VFM—and explores the nature of their relationship to the achievement of PPP objectives in practice.

Sections 4.3 and 4.4 summarise relevant *Paper 3* findings. Section 4.3 provides an overview of the incidence and characteristics of Australian PPPs. Section 4.4 introduces the characteristics of the PPP model of interest to this thesis, and establishes that PPP development and implementation in Victoria can be divided into two distinct periods: pre- and post-2000.

Sections 4.5 and 4.6 present findings that augment findings in *Papers 2* and *3*. Drawing on research undertaken for this thesis, section 4.5 presents an analysis of the Victorian government's approach to PPP use and implementation in the period 1991-2007. Section 4.6 reports empirical findings of an examination of approaches to risk management in two representative pre- and post-2000 hospital contracts. Section 4.7 reports findings contained in *Paper 3* in relation to pre-contracting occurrences that

contributed to the failure of the Latrobe hospital. Section 4.8 provides a reflective conclusion and chapter summary.

## 4.2 Literature review of PPP pre-contracting technologies

The themes and concerns that dominate the modernisation literature (as analysed in Chapters 2 and 3) are mirrored in the accounting-based PPP literature. The literature review in this chapter summarises and adds to the literature reviewed in *Papers 2* and *3*. Chapter 4 examines critiques of stated and unstated rationales for PPPs (i.e., their nature and purpose in the terminology used by Broadbent and Laughlin (1999)), and the relationship between PPP objectives, risk management and VFM in the pre-contracting stage. The literature relating to how PPP contracts manage and control performance and the partnership relationship in the execution stage is reviewed in Chapter 5.

### 4.2.1 PPP objectives

As noted in *Paper 2*, PPPs are time- and cost-specific agreements between the state and a private consortium for infrastructure-based service provision. The consortium undertakes responsibility for financing, designing and constructing (or refurbishing) a facility, and for providing a variety of infrastructure-based services. The consortium receives a revenue stream that is used to repay debt, fund operations and provide a return to investors (Pollock and Price, 2004). At the rhetorical level, many of the risks associated with financing and building the infrastructure and with service delivery are transferred to the consortium. The anticipated management of project risk and the efficiency gains resulting from reduced project costs derived from superior private-sector management practices and innovation (Lapsley, 2001a) are said to result in VFM savings. These VFM savings (which are crystallised over the duration of the project) are claimed to justify the use of private finance that is more costly than government borrowings. Accordingly, effective risk management (through risk allocation) and resulting VFM are ostensibly the primary motivations for these projects and, it is argued by their proponents, make these partnership arrangements viable for governments (Maguire and Malinovitch, 2004).

Investigations in the literature of the “nature and purpose” (Broadbent and Laughlin, 1999) of PPPs signal a questioning of PPPs’ real (as opposed to stated) objectives. The dual nature of PPPs (the procurement of an asset and the procurement of asset-based services) explains the debates about their stated (as opposed to unstated) objectives.

A UK House of Commons report (Allen, 2001, p. 10) explains the rationale for non-recognition of the asset and associated liability on the basis that the state has not acquired (and is not paying for) an asset, ostensibly because it has acquired, and is paying for, a stream of asset-based services:

Under the PFI [read PPPs] the public sector does not own an asset ... but pays the PFI contractor a stream of committed revenue payments for the use of the facilities over the contract period. Once the contract has expired, ownership of the asset either remains with the private sector contractor, or is returned to the public sector, depending on the terms of the original contract.

However, Broadbent and Laughlin (1999, p. 102) propose that the ownership of the asset (i.e., accounting for PPPs) is directly related to the degree of risk transfer to the consortium, and not to explanations of how the transaction is portrayed and rationalised. Broadbent and Laughlin’s (1999) interpretation appears to link PPP ‘success’ with an off-balance sheet accounting treatment, indicating that the management of financial risk (through maximising risk transfer to the private consortia) to avoid recognition of PPPs on government financial statements is the primary objective of (early) PPP arrangements<sup>10</sup>. Indeed, Broadbent and Laughlin (1999, p. 102) seem to reject the possibility that the achievement of whole-of-life VFM may be compatible with an on- balance sheet accounting treatment.

If the transaction is to appear ‘on balance sheet’ for the purchaser it raises ‘macro’ [economic] concerns. First, is the question of whether PFI is actually a financing arrangement for purchase of assets or a procurement of services? Secondly, and arguably more complex, is the possibility that PFI schemes which are ‘on balance sheet’ for the public sector may have national financial [debt] implications. There is a further and equally significant issue since the decision as to whether the transaction is on or off balance sheet for the public sector purchaser is the degree of risk transfer. If definable risks remain with

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<sup>10</sup> Broadbent and Laughlin (1999) confirm that the effects of macroeconomic pressures influenced the early development and implementation of the PFI. These pressures, which arose from high government expenditures etc, were also one of the original drivers of modernisation (and of PCT), as outlined in Chapter 2.

the purchaser then the view is that this is substantiation of ownership and the transaction needs to appear on the public sector balance sheet. If the risks are borne by the private sector supplier then the transaction will appear on the balance sheet of this 'operator'. Put crudely, how the PFI is accounted for is representative of the success or otherwise of this financing arrangement. If a PFI transaction has to feature on the balance sheet of the public sector then, ipso facto, 'micro' risk has not been transferred to the private sector and 'macro' benefits and arguments for PFI have arguably not been realised. This former element raises concerns about 'micro' 'value for money' issues...

When the accounting treatment does not reflect the substance of the transaction (English and Walker, 2004), and intentionally renders the transaction invisible in public financial statements (Hodges and Mellett, 1999), the real cost of PPPs and their impact on future spending remains hidden (Lapsley, 1999; NSWAG, 1994). It is generally agreed that the lack of an accounting disclosure of the asset and associated liabilities in government financial statements (Lambert and Lapsley, 2006) suggests that the management of financial risk is the primary objective of these arrangements (English and Guthrie, 2003; English and Walker, 2004). This view suggests that PPPs are a financially engineered package, the unstated purpose of which is to enable governments to acquire infrastructure through borrowings that are not officially recognised as national debt (Broadbent and Laughlin, 1999; English and Guthrie, 2003; NSWAG, 1994; Walker, 2002). In this interpretation of PPP objectives, the provision of services appears to be of secondary importance.

However, as early as 1995, the UK's Private Finance Panel (Private Finance Panel, 1995, para 3.1, p. 15) identified two fundamental requirements of PPP projects. First, PPP projects must result in demonstrable VFM for the public sector. Second, the private sector must genuinely assume risk. Furthermore, considerably complicating analysis, the Panel noted that these fundamental requirements are inextricably linked.

At the conceptual level, Grimsey and Lewis (2005, p. 363) contend that VFM is derived from three sources, which are established in the PPP contract. First, the resolution of agency problems which arise "due to the divergence between ownership and control of assets ... are easier to manage in the private sector through managerial incentives and market disciplines". Second, the transfer of risk (for example, of maintaining the infrastructure) to the consortium provides an incentive to maximise efficiency over project life. Third, resources are more efficiently allocated on the basis

of establishing property rights thorough contracts, where governments retain the risks associated with rights for which it is difficult to establish clear contractual specification, and transfer to the contractor those risks for which clear and unambiguous contractual and property rights can be formed (Officer, 2004). This analysis assigns a critical (NIE-based) role to contracts in establishing VFM in PPP arrangements, and explains their investigation in this thesis.

As indicated by the Private Finance Panel, mechanisms are required to demonstrate VFM. Two technologies dominate VFM achievement in the PPP pre-contracting stage. These are risk management and private-sector derived technologies such as the Capital Asset Pricing Model [CAPM] and the Public Sector Comparator [PSC]<sup>11</sup> used to calculate the cost of the public procurement option. In determining the cost of public procurement these technologies also facilitate the necessary demonstration of the dollar amount of VFM savings associated with the PPP option. A comparison of public and PPP costing estimates (enabling confirmation of VFM) is deemed to be both necessary and sufficient to rationalise the decision to choose the PPP procurement technology.

### Risk management

In the pre-contracting stage, standardised risk allocation tables documenting anticipated risks and their recommended allocation are typically provided in PPP policy documents. Risk allocation tables are designed to facilitate management of project risk through driving down costs by ensuring that the most appropriate party bears nominated risks (English and Guthrie, 2003; Froud and Shaoul, 2001). However, irrespective of agreed assumptions of risk, governments ultimately retain primary responsibility for the delivery of public services. This political risk can never be wholly offset through management of project risk (Edwards and Shaoul, 2003) or the application of principles derived from NIE (Barton, 2001). This suggests that private consortia may profit if the cost of political risk is not overtly factored into VFM calculations as governments are obliged to assume responsibility for the

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<sup>11</sup> Since 2001 the PSC has been the technology used in Australia for this purpose. The PSC is also used in the UK. Prior to the development of the PSC, the CAPM was used for the same purpose in Victoria after 1996.

delivery of core public services in the event of PPP failure (Barton, 2001; Edwards and Shaoul, 2003; Stanley and Hensher, 2004).

### The Public Sector Comparator

Grimsey and Lewis (2005, p. 3) define the PSC<sup>12</sup> as “the calculation of the benchmark cost of providing a specified service under traditional (public sector) procurement”. The PSC is developed iteratively in the pre-contracting stage and represents a composite project outcome derived from the original project brief. It incorporates accepted modifications (identified as a result of negotiations and discussions with interested bidders) prior to the determination of tender documents and the opening of the formal bidding process. It represents the net present cost [NPC] of the hypothetical public provision<sup>13</sup>. Importantly, the PSC is calculated solely on the basis of quantifiable financial costs and benefits (Grimsey and Lewis, 2005).

At the conceptual level, Heald (2003) endorses the technologies that underlie the concepts of risk allocation and VFM determination. Nevertheless, a number of concerns have been raised in the Anglophone literature concerning the conceptualisation of VFM. The overriding emphasis on quantifiable financial costs and benefits in PSC calculations and pre-contracting VFM assessments has been criticised because of the exclusion of non-financial qualitative factors (both positive and negative) in PSC modelling (Broadbent et al, 2004b; Froud and Shaoul, 2001; Shaoul, 2005a; b). Additionally, PSC calculations are seen as susceptible to changes in assumptions (such as discount rates) that potentially affect the VFM outcome (Grimsey and Lewis, 2005; Shaoul, 2005a; b). Also, Froud (2003) has questioned the assumption implicit in PSC modelling that VFM will remain stable and relevant throughout lengthy PPP terms, implying that even if VFM calculations are ‘correct’ at contracting, whole-of-life VFM (as conceived at contracting) may be unachievable over PPP life (Heald, 2003) due to the inability of contracts to fully anticipate (and

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<sup>12</sup> See Grimsey and Lewis (2005) for a description and analysis of the use of the PSC in Australia, and Broadbent et al (2004b) and Froud and Shaoul (2001) for a discussion of its use in the UK context.

<sup>13</sup> ‘Hypothetical’ because projects selected as PPPs are deemed, by definition, to exclude the possibility of conventional procurement, thereby eliminating the possibility of the public procurement option (English and Guthrie, 2003).

effectively minimise) the costs associated with the resolution of future uncertainty (Froud, 2003).

In addition, critiques at the level of practice suggest VFM calculations are “vulnerable to manipulation” and are “tarnished by the systematic suppression or foreclosure of options, allowing opponents of the actual decision to portray it as a fix” (Heald, 2003, p. 360). For Heald the fundamental question is whether PPPs evaporate, magnify or transfer the total amount of risk, which can only be determined empirically. There has been considerable debate about the theoretically sound interest rate at which to discount future cash flows (Grimsey and Lewis, 2005; Officer, 2004; Quiggin, 2004). The PSC has been criticised, most damningly by Jeremy Taylor, the Assistant Comptroller and Auditor-General responsible for the UK’s National Audit Office’s VFM audits of PPPs, who has (presumably) had access to the information identified by Heald (2003) as being necessary to evaluate PSC calculations. Jeremy Taylor has called the PSC “pseudo scientific mumbo jumbo” (as quoted in Broadbent et al, 2004b, p. 17). This comment echoes critiques of the claimed scientific rationality of many of the accounting and financial management technologies and their role in modernisation (Humphrey et al, 2005; Olson et al, 1998).

In summary, the PPP literature indicates there has been controversy about stated PPP objectives. Also, the role and specification of pre-contracting technologies such as risk management and the PSC have attracted debate, notably in the context of understanding how (if at all) they contribute to the achievement of VFM objectives in the execution stage, which is to be explored in Chapter 5. This chapter now reports on the empirical research undertaken for this thesis. Empirical findings are drawn from *Papers 2* and *3*, and from additional research undertaken during the course of writing up this dissertation.

### 4.3 Empirical findings: PPP activity in Australia

One objective of *Paper 2* is to provide an overview of the economic importance of PPPs to the Australian economy, and to highlight problems associated with PPP disclosure.

There is no consistently maintained and current PPP database in Australia (Hodge, 2005). A national inventory of PPP projects was maintained by the Australian Council for Infrastructure Development (AusCID)<sup>14</sup>. AusCID's most recent list of Australian PPP projects (AusCID, 2005) was compiled using data collected from "contacts with companies involved in the projects, annual reports and media releases from government and company websites" (AusCID, 2005, p. 5). The 2005 AusCID database was reviewed as outlined below.

A revised database that was prepared for the research reported in this thesis is summarised in *Table 1: Overview of the Financial Value, Category and Auditor-General Oversight of the PPP Activity in Australian Jurisdictions as at December 2006 (Paper 2, p. 257)*. *Table 1* provides a summary of the number and value of PPP projects undertaken by the various Australian jurisdictions. Also, *Table 1* indicates (in bold square brackets) the number and net present cost [NPC] of those projects that have been subject to performance audit within each category by jurisdiction. This table categorises PPPs into 11 project types and indicates that a total of 127 PPP projects had been entered into in Australia as at 31 December, 2006. Of these, only 16 have been subjected to performance audit by an Australian auditor-general as at mid 2007. The relative lack of attention PPPs have received from Australia's auditors-general is investigated more fully in Chapter 6.

The AusCID (2005) register contains 174<sup>15</sup> discrete projects for which contracts had been signed at 31 December 2005. The following steps were undertaken to update and correct the AusCID (2005) register. First, projects categorised by AusCID as privatisations, leases and additional capital expenditure (77 projects) were excluded because these projects fall outside a broad working definition of PPPs adopted by Australian governments and in this thesis. Second, the AusCID (2005) list was compared with the AusCID (2001) list and 17 projects that fell within the government's definition were added. AusCID (2005) provided no indication of

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<sup>14</sup> In 2006, the lobby group AusCID was amalgamated with Infrastructure Partners Australia [IPA], also a lobby group, and the membership of which includes government and private-sector representatives. The IPA website (<http://www.infrastructure.org.au/about/about.htm>) contains no publicly available list of any Australian PPPs as at 10 September 2007.

<sup>15</sup> The text in the AusCID (2005) report (at p. 5) states that the "database currently contains 164 projects". However, the register of projects contained in the report lists 174 projects so does not accord with this statement or the table provided on page 5.

reasons for the exclusion of these projects. However, one explanation appears to be that the 2005 database excludes some failed or discontinued PPP projects, including three in Victoria: the New Latrobe Hospital [Latrobe]; the Metropolitan Women's Correctional Centre [Deer Park]; and three Victorian metropolitan rail franchises. Failure also affected one PPP hospital in Queensland [Robina] and one in South Australia [Modbury]. The Port Macquarie Base Hospital in New South Wales [NSW] returned to government control as a result of a change of ownership of the operator. A second explanation for the exclusion of these projects could be the tightening of the definition of PPPs that occurred with the creation of PV in 2000 and the development of PPP-specific policies. Third, a search of government and company websites, annual reports, media releases, news articles and other publications was conducted, resulting in 13 additional PPP projects being added.

A number of additional problems were encountered in constructing *Paper 2, Table 1*. The major difficulty was the lack of consensus about the NPC (to government) of each of the projects. Costs identified in the AusCID (2005, p. 5) database are calculated from a contractor perspective, and exclude government contributions. Thus, the AusCID database *understates* the cost of PPP projects to the state because it omits financing and other PPP-specific direct and indirect costs<sup>16</sup>, including significant pre-contracting costs incurred by contracting agencies, and the social cost of other obligations undertaken by governments to get PPP projects up and running<sup>17</sup>. A search of the data sources noted above yielded some additional information about government costs for some, but not all, projects. Governments frequently provide no explicit information on financing costs, but do provide some information as to the overall cost of PPP projects. Whether these figures include estimates of indirect financial and non-financial costs is debateable. Where discrepancies could be identified, the AusCID figures were amended to provide a more appropriate cost for public accountability purposes.

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<sup>16</sup> For purposes of comparing the cost of PPP and 'in house' provision it is necessary to factor out costs that are applicable to both types of provision. Such costs include project management and monitoring costs.

<sup>17</sup> For instance, the NSW Joint Select Committee on the Cross City Tunnel (NSWJSCCCT, 2006a; b) commented that the non-financial costs incurred by the government included reduced flexibility to make future changes to the road network without exposure to financial liability (due to its contractual obligation to 'encourage' motorists to use the tunnel), community anger generated as a result of road closures and other 'traffic calming' measures.

The M5 East Motorway illustrates several of these problems. The AusCID (2005) database records the project cost as \$94 million, whilst the NSW Auditor-General indicates a cost of \$740 million (NSWAG, 1994, Vol. 2, p. 281). However, the NSW Roads and Traffic Authority [RTA] website states that the cost was \$794 million (RTA, 2007). In creating Table 1, \$794 million is identified as the cost, although the \$54 million discrepancy between the auditor-general's and the RTA's figures cannot be confirmed, but may reflect the cost of negotiated changes to the toll road subsequent to its commissioning.

Fitzgerald (2004) confirms that PPPs comprise about ten percent of Australia's annual investment in infrastructure. *Paper 2 Table 1* shows that Victoria is the dominant Australian jurisdiction in terms of the number of PPP projects and the total value of those projects. Of the 127 identified projects, 38.6 per cent (49 projects) are located in Victoria, followed by 23.6 percent (30 projects) in NSW. The Australian Capital Territory [ACT] is not engaged in any projects included in *Paper 2 Table 1*. In terms of the cost of PPP projects undertaken, Victoria again dominates with \$14,061 million of the total cost of PPP projects. The correctional and health categories are significant. Whilst correctional projects outnumber health projects Australia-wide by 13 to 12, the cost of the health projects greatly exceeds the cost of the correctional projects, with health projects accounting for 7.5 percent of the total cost of the 127 projects, and correctional projects accounting for 4.4 percent of the total cost. This statistic is possibly explained by the relative cost of building large modern hospitals compared to the cost of constructing modern correctional centres.

The decision to focus analysis on Victorian PPPs in this thesis is explained by the fact that Victoria is Australia's leading PPP proponent and PPP policy developer (as indicated in *Paper 2*). Additionally, in 2000 the Victorian government made a commitment to publicly disclose PPP contracts (English and Walker, 2004), making Victoria an attractive research site.<sup>18</sup> Also, the failure of three pre-2000 PPPs in Victoria, and extensive reviews of pre-2000 PPP prisons undertaken by a new government after its election in late 1999, has resulted in an unusual amount of

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<sup>18</sup> The Central Register of Major Government Projects (Victoria) website contains the contracts for major projects in Victoria (whether PPP or not) that have been signed since 1992. The Partnerships Victoria website contains the contracts for post-2000 PPPs.

publicly-available commentary and analysis in documentary form that is unavailable in other Australian jurisdictions.

In summary, *Paper 2* identifies a number of problems associated with the disclosure of PPP activity in Australia. There is a need for a timely, consistent and accurate Australia-wide PPP database. Given the problems associated with databases maintained by private-sector lobby groups and the demand for increased private investment in infrastructure identified above, it is recommended that a government body is responsible for the maintenance of a national PPP database that reports the NPC to taxpayers of all PPP projects.

#### 4.4 Empirical findings: overview of PPP development in Victoria: 1991-2007

As outlined in *Paper 2*, the establishment of Partnerships Victoria [PV] within the Victorian Department of Treasury and Finance in 2000 (VDTF, 2000) resulted in the development, for the first time in Australia, of a suite of detailed PPP-specific policies to guide and aid decision-making. The development of PPP policies by PV signalled the first attempt in Australia to rationalise and justify PPP decision-making on the basis of NIE, and acknowledged the influence of UK PPP policies on the Victorian approach<sup>19</sup>. Also, 2000 signalled the end of the use of various acronyms (such as BOO [build, own, operate] and BOOT [build, own, operate, transfer]) to identify PPPs, and the introduction of the generic term PPP(s).

Two primary PPP models are also identified in the Victorian policy documents (*Paper 2*). The models are distinguished by different payment scenarios based on the demand for services (PV, 2001c). The chief differences between the models are the source of the revenue stream, and the nature of government guarantees. The model of interest to this thesis is characterised by the provision of infrastructure that delivers core social services (such as clinical services in PPP hospitals and correctional services in PPP prisons), in which the state assumes demand risk and guarantees an agreed level of services and payments irrespective of actual levels of demand. Deductions occur if the

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<sup>19</sup> In the pre-2000 period generic infrastructure policies specified objectives and implementation technologies employed in all infrastructure projects (see Table 4.1 in this chapter).

consortium fails to meet specified performance standards. Typically, the service elements of these contracts are subject to recontracting at regular intervals, providing governments and consortia with the opportunity to finetune the service components to ensure they meet current market conditions in terms of VFM.

Importantly for this research, *Paper 2* highlights a fundamental change in this model over the investigated period. A feature of *pre-2000* PPPs is private-sector responsibility for delivering the full gamut of core clinical and correctional services in PPP hospitals and prisons, and of all non-core services (such as maintenance, security and car parking) required to run modern hospitals and prisons. However, *post-2000*, the role of consortia in Victorian PPP hospitals and prisons was restricted to the delivery of the non-core services required to facilitate the provision of core services by the government employees. Accordingly, this longitudinal study analyses the implementation of two distinct versions of the PPP model characterised by the state's assumption of demand risk, and the provision of public services at minimal (or no) direct cost to service recipients. The pre- and post-2000 distinction is used throughout the remainder of this thesis as an analytical tool to examine change in PPP use and implementation.

#### **4.5 Empirical findings: the government's approach to PPP use and implementation**

The PPP literature review in section 4.2 indicates that controversy surrounds PPP objectives and the technologies designed to achieve objectives in the pre-contracting stage. Broadbent and Laughlin (1999) suggest that if the management of financial risk is a primary objective then an off-balance sheet accounting treatment signals that the PPP project is 'successful'. Contrariwise, the Private Finance Panel (1995) suggests that the management of project risk is the primary PPP objective, and that project risk management is inextricably linked with the demonstrable achievement of VFM. These different interpretations of intentions (and outcomes) can only be determined empirically (Heald, 2003). *Paper 2* indicates that there was a change in 2000 in the Victorian government's thinking about PPPs.

This section has a number of aims. First, it analyses Victoria's policies from 1991 to determine stated PPP objectives. Second, it examines the changing role and nature of the pre-contracting appraisal technologies mandated in those policies. Third, this section elucidates on the *Paper 2*'s finding of significant change in PPP models and objectives.

Extant Victorian PPP policies (at the time of writing) are summarised in Table 4.1. Table 4.1 confirms differences between the pre- and post-2000 approaches to PPP development and use, and highlights significant change in PPP objectives and in the Victorian government's management and control of pre-contracting decision-making over time.

Section 4.5 introduces additional research and empirical findings that are not reported in the papers that comprise this thesis.

#### *4.5.1 Pre-2000 policies*

As indicated in Table 4.1 (below), the Victorian pre-2000 policies address the procurement of infrastructure in general, and are not PPP-specific. Confirming the thrust of Broadbent and Laughlin (1999), the 1991 policy (VDTF, 1991) is frank about the need to ensure borrowing remains off-balance sheet, indicating that the management of financial risk through the transfer of risk from the public sector to the private sector was the primary PPP objective. The 1994 and 1996 policies (VDTF, 1994; 1996) demonstrate a growing awareness of the role of private-sector derived technologies (such as the CAPM, which was formally introduced in 1994, and risk management techniques, which were first introduced in 1996) to achieve efficient, effective and accountable outcomes. Reflecting changes in the Australian Loan Council Borrowing Requirements (English and Guthrie, 2003) and the dramatic reduction of the indebtedness of the state (English and Guthrie, 2001) the 1996 policy signals that the management of financial risk may not drive projects executed after 1996. The 1996 policy suggests that the achievement of VFM had become acknowledged as the primary objective. These policies indicate a shift in the thinking of the government and its attempts to grapple with the concepts outlined by the Private Finance Panel (1995) above. The change in government thinking culminated

in the establishment of Partnerships Victoria in 2000 (VDTF, 2000) and the development of the PV policies summarised in Table 4.1.

**Table 4.1: PPP-Related Policies: Victoria 1991 – 2007**

(Adapted from Table 1 (English, 2005b))

<b>Policy Document &amp; Year</b>	<b>Underlying rationales of policy</b>	<b>Thrust of reforms</b>
Infrastructure Guidelines for Victoria: Public/Private Partnership (VDTF, 1991)	Strong financial need; overcoming fiscal restraints and Australian Loan Council restrictions: "The challenge of difficult economic times and national economic policies, which have reduced infrastructure spending to its lowest level since the end of World War II, mean that these vital investments cannot be met by Government alone."	Non-PPP specific policy. Acknowledges role for private sector in the delivery of infrastructure. Emphasis on packaging outsourcing arrangements to avoid 'on balance sheet' arrangements.
Infrastructure Investment Policy for Victoria (VDTF, 1994)	Increased private involvement to stimulate growth and efficiency: "The Victorian Government is committed to the pursuit of growth and efficiency. It believes that this will be facilitated if the private sector participates to a greater extent in the provision of infrastructure and related services."	Non-PPP specific policy. Delivery of core and non-core services based on savings to government of private service provision. Use of CAPM to determine NPV of costs of 'in house' option. Unique benchmark model to be calculated for each project. Evidence accounting treatment still paramount to government, despite thrust of policy documentation.
Investment Evaluation: Policy and Guidelines (VDTF, 1996)	Establishes policy for all government bodies when assessing infrastructure investment proposals over \$5 million whether wholly funded by government or funded in partnership with the private sector.	Non-PPP specific policy. Underlying principles: cost benefit and cost effectiveness analyses. Impact analysis employed for non-monetary and non-quantifiable impacts, distributional impacts and weighting the importance and magnitude of projects. Development of a total weighted score of financial and socio-economic impacts, combining financial and non-financial impacts NPV the preferred evaluation measure. Evaluation processes to ensure effective risk management through development of risk management

		plans, implementation management (including post-implementation review) and assignment of accountability for investment outcomes.
Partnerships Victoria (VDTF, 2000)	Seeks to harness benefits that may be gained by involving private parties in competitive bidding through achieving value for money in the public interest, and is more discriminating: “Choices between public and private provision of infrastructure and related ancillary services will be made on practical grounds. Such choices will be based on consideration of the needs of each project and will be assessed against a rigorous public interest test which will examine the potential impact on privacy, security, consumer rights, public access and equity.”	Notable reforms introduced in 2000 include: <ul style="list-style-type: none"> <li>• Option to restrict role of the private sector to the provision of infrastructure and related ancillary services – that is to the delivery of non-core services only.</li> <li>• Introduction of a formal Public Interest Test (PIT).</li> <li>• Introduction of the Public Sector Comparator (PSC).</li> <li>• Less emphasis on accounting treatment.</li> <li>• Willingness to proceed with ‘on balance sheet’ projects.</li> </ul>
Partnerships Victoria: Risk Allocation and Contractual Issues (PV, 2001a)	First of three documents to assist in implementing 2000 Partnerships Victoria [PV] policy framework. PV seeks to reap the financial and efficiency benefits of partnerships with the private sector, VFM criteria linked with public interest criteria to determine whether and how a PPP may be appropriate for a particular project.	Purpose to: <ul style="list-style-type: none"> <li>• Increase understanding of risk allocation.</li> <li>• Identify all major risks and indicate preferred government position on risk allocation.</li> <li>• Provide guidance (to government) as to how risks should be addressed to lower transaction costs.</li> </ul>
Partnerships Victoria: Public Sector Comparator: a Technical Note (PV, 2001b)	Second of three documents to assist in implementing Partnerships Victoria [PV] policy framework. The promotion of effective and sustainable competition is a cornerstone of PV and is an imperative of government policy. A competitive bidding process improves choice and helps deliver VFM.	Provides step-by-step guidance for construction of PSC. Establish the role of the PSC in PV project assessment processes. Acknowledges the PSC as a purely quantitative comparison that should be made in conjunction with assessment of qualitative factors.
Partnerships Victoria: Practitioners’ Guide (PV, 2001c)	Last of three documents to assist in implementing Partnerships Victoria [PV] policy framework. Establishes qualitative analyses required to justify PV delivery (via a PPP) and PSC’s role as a reference project – the most likely and efficient public-sector delivery option.	Identifies VFM drivers to look for in assessing the potential for a PV (PPP) project.

Partnerships Victoria: Non-Metropolitan Urban Water Authority Approval Process (PV, 2001d)	Establishes fast-track process to approve projects initiated by Non-Metropolitan Water Authorities pursuing water and wastewater projects under PV policy.	Streamlined approval process reduces PV pre-contracting stage to three distinctive phases: <ul style="list-style-type: none"> <li>• Investment decision – requires Treasurer’s approval above capex \$5 million; Minister forwards investment evaluation to Treasurer.</li> <li>• Project delivery solution – requires Treasurer’s approval.</li> <li>• PV stages – Treasurer approves stages against criteria of commercial principles and practices; Minister to endorse that service objectives addressed.</li> </ul>
Partnerships Victoria: Overview (PV, 2001e)	Reiterates government’s commitment to maximising level of infrastructure spending through responsible use of resources of both the public and private sectors. Choice between public and private provision made on basis of needs of each project and tested against a rigorous public interest test.	Summary of government’s PPP policy. Establishes rhetoric and rationale for PPP delivery in context that emphasises a level playing field between the sectors; full cost benefit analyses; transparent public tendering; accountability and disclosure framework. Emphasises role of PV policy and technical guidance material in assessment process.
Partnerships Victoria: Contract Management Policy (PV, 2003a)	Outlines components of the contract management framework and establishes accountabilities and responsibilities for contract management in PV projects.	Objective is to establish proactive, practical and constructive management of PV contracts to achieve project objectives incorporating balanced long-term VFM outcomes. Components include this policy statement, PV Contract Management Guide, a credentialed training program and the establishment of a forum for information sharing.
Partnerships Victoria: Contract Management Guide (PV, 2003b)	To help achieve project objectives incorporating balanced long-term VFM outcomes. To enable procurement team address and support principles of effective contract management. Supersedes the contract management material in PV (2001) Practitioners’ Guide.	Purpose to provide: <ul style="list-style-type: none"> <li>• Guidance for government management of PV contract through lifecycle of project.</li> <li>• Direction for procurement team.</li> </ul>

Partnerships Victoria: Use of Discount Rate in Partnerships Victoria Process: Technical Note (PV, 2003c)	VFM is a key element of PPP policy. PSC a key tool in determining VFM.	Provides additional guidance on construction and application of PSC. Further advice on defining the PSC and its role in the evaluation process. Detailed worked example of constructing a PSC for a hypothetical hospital project, building on example in the 2001 PSC Technical Note.
Partnerships Victoria: Public Sector Comparator: Supplementary Technical Note (PV, 2003d)	Provides additional guidance on preparing and using PSCs. To be read in conjunction with PV (2001b) Public Sector Comparator, and PV (2003) Use of Discount Rates in the Partnerships Victoria Process.	PSC located in PV process. Provides further advice on defining PSC and its role in the evaluation process. Incorporates practical advice learnt since PSC Technical Note released in 2001. Provides a worked example for constructing a PSC for a hypothetical hospital.
Partnerships Victoria: Standard Commercial Principles (PV, 2005a)	Outlines “current considered position” on risk allocations. Provides consistent and efficient risk allocation framework, that permits flexibility to allow for individual needs of each project Aims to standardise PV contracts. To be read in conjunction with PV (2001a) Risk Allocation and Contractual Principles.	Revises previous position on risk allocation. Objective is to ensure that pre-contracting agreements on risk allocation are captured in contracts. Details and explains implications of identified risks, indicates which party should bear them, and how they should be treated in PV contracts. Includes information on remedies open to government for non-performance.
Partnerships Victoria: Advisory Note Determining the General Inflation Rate for Use in Partnerships Victoria Projects (PV, 2005b)	Discusses appropriate source of general inflation forecasts to use in constructing the PSC.	Recommends that the PSC should generally be prepared on a nominal basis and before income tax. The forecast general inflation rates should be obtained from forecasts in state budget papers.
Partnerships Victoria: Managing Interest Rate	Advisory note on management of interest rate risk in the period between lodging bids and financial close. Aims to manage the cost of debt finance to	Recommends that interest rate risk between lodgement of bids and financial close remain with the government.

Risk (PV, 2005c)	<p>the state.</p> <p>Addresses effects of interest rate changes prior to financial close that could have a considerable impact on the payments by state.</p>	<p>Indicates that pre-financial close interest rate risk must be managed on a project-by-project basis.</p> <p>Provides for revisions to funding submissions in the event of changes in interest rate risk.</p> <p>Determines that risk related to foreign currency denominated borrowings remain with the bidder, unless government undertakes to bear foreign currency risk, when it should be fully hedged.</p>
Partnerships Victoria: Advisory Note Disclosure and management of conflict of interest for advisors (PV, 2005d)	<p>Provides a principles-based framework for practitioners, advisers, and government employees to identify, assess and manage conflict of interests in PV projects.</p> <p>Indicates what information should be disclosed to government by advisers to enable the government to identify, assess and manage conflicts.</p>	<p>Defines conflicts of interest.</p> <p>Identifies three categories of conflicts: actual, potential and perceived.</p> <p>Provides guiding disclosure principles.</p> <p>Outlines sanctions.</p> <p>Provides examples of disclosure events, and of exceptions to disclosure recommendations.</p> <p>Provides a conflict of interest test.</p> <p>Indicates how conflicts should be managed.</p> <p>Considers implementation of guidelines and governance issues.</p>
Partnerships Victoria: Advisory Note Interactive Tender Process (PV, 2005e)	<p>Complements previous PV guidance material.</p> <p>Designed to clarify and expand on the use of an interactive tender process.</p> <p>Aims to assist agencies and contractors to implement interactive tender processes.</p>	<p>The interactive tender process provides a confidential, active interface between the state and individual short-listed tenderers.</p> <p>Facilitates discussion of development of concepts and designs and receipt of feedback in the context of the state's output requirements prior to tender submission.</p> <p>Essential to reduce interface risk in social infrastructure projects; helps clarify state's requirements, reduces costs of misunderstandings, minimises need for re-bid processes based on design matters.</p> <p>Provides for a series of workshops (technical, service and commercial clarification) with individual tenderers.</p> <p>Provides examples of recent interactive tender process in action.</p> <p>Guides public officials in conduct</p>

		of interactive tender process.
Partnerships Victoria: Overview (PV, 2006)	Revised edition of PV (2001). Summarises PV objectives. Explains relationship between various PV policy documents.	Integrates PV lifecycle with Gateway Review Process*. Provides overview of PV objectives and implementation strategies. Reiterates and updates PV principles and links them to relevant PV policies.
Partnerships Victoria: Public Disclosure Policy (PV, 2007)	Provides for a Project Summary to accompany public disclosure of PV contracts. Objective to better inform the public about the nature and outcomes of PPPs in practice. Must be released within three months of financial close.	Contains two main sections: <ul style="list-style-type: none"> <li>• Summary of project features: rationale, tender process, VFM, risk management, comparison between PSC and winning bid, including details of estimated cost savings, disclosure of unquantifiable risks, public interest considerations, contract milestones.</li> <li>• Summary of commercial features: parties, key contractual relationships, risk allocation table, overview of contractual relationships, obligations of parties, government costs and payments, state contributions, performance measures and abatement, default and termination regime, state guarantees and rights at expiry, processes for government modifications of services/facility.</li> </ul>

\*The objective of the Gateway Review Process [GRP] is to review high and medium risk projects at key decision points. GRP involves independent, short, structured reviews at six critical stages of project lifecycle to identify issues that need to be addressed to ensure successful project delivery. The six critical lifecycle stages provide strategic assessments of: the business need, the business case, the procurement strategy, the tender decision, the readiness for service, and benefits evaluation (VDTF, 2007). Victorian Department of Treasury and Finance GRP documentation acknowledges that the GRP is based on material in the *Successful Delivery Toolkit Version 4.5*, produced by the UK Office of Government Commerce in 2004.

#### 4.5.2 Post-2000 policies

Subsequent to the establishment of PV in 2000 (VDTF, 2000), 16 PPP-specific policies have been developed. As indicated by Table 4.1 above, a feature of the post-2000 policies is the articulation of the government's PPP objectives, detailed

explanations of objectives, and instructions about how to ensure the achievement of objectives. The post-2000 policies can be categorised as follows.

Table 4.1 shows that five PV framework documents (VDTF, 2000; PV, 2001c; e; 2003a; 2006<sup>20</sup>) provide an overview of the government's PPP policies, its rationales, and of the role of technologies, including risk management, the PSC and contract management in achieving PPP objectives.

Seven documents provide extensive practical guidance as to how objectives are to be achieved. Risk identification and its management to achieve VFM is the subject of two policies (PV, 2001a; 2005a). Quantifying VFM and providing justifications for, and technical explanations of how to calculate and apply, the PSC technology are covered in four detailed technical policies (PV 2001b; 2003c; b; 2005b). PV (2005c) provides guidance on the management of interest rate risk in the period between the lodgement of bids and financial close. Capturing risk allocations and VFM in PPP contracts is the subject of PV (2001a), while PV (2003a) is concerned with minimising the unintended assumption of risk in the post-contracting stages of a PPP project.

Three policies are designed to streamline pre-contracting processes to reduce costs. Two policies (PV, 2005d; e) are designed to facilitate private-sector involvement in PPP projects. Another policy (PV, 2001d) establishes a fast-track approval process for non-metropolitan water projects.

The most recent policy (PV, 2007) is an attempt to appease public criticism of the lack of transparency surrounding Victorian PPP projects (VPAEC, 2006). PV (2007) provides for the disclosure of contract summaries and outlines what such summaries should contain.

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<sup>20</sup> PV (2006) summarises the subtle changes in approach since the development of the initial 2000 policy and outlines the government's current rationales and explanations of PPP policies.

### 4.5.3 Linking risk management with VFM

As indicated in Table 4.1, since 1991 risk management has subtly shifted from risk transfer (to enable the management of financial risk and an off-balance sheet accounting treatment (Maguire and Malinovitch, 2004; English and Walker, 2004)) to the management of project risk to achieve VFM. This transformation has been supported and accompanied increasingly by the development of highly sophisticated technologies to identify and quantify risk, particularly in the post-2000 period.

Reflecting the subtle shift from the use of PPPs to transfer risk to the use of PPPs to allocate risks, by 2001 the concept of risk management had been recast:

The principle governing risk transfer is that each risk should be allocated to whoever is best able to manage it at least cost, taking into account public interest considerations. This requires an optimal rather than maximum transfer of risk (PV, 2001b, p. 52).

The risk allocation guidance material (PV, 2001a) establishes the nexus between VFM and the management of risk:

The emphasis of Partnerships Victoria is on services received by government, not government procurement of infrastructure. Government pays for services provided by the private party, which are delivered through privately owned infrastructure as part of the service package. The philosophy of risk allocation underlying this emphasis on service purchase and delivery is that government frees itself from asset-based risk (including design, construction, operating and residual value risk), and becomes a service recipient... (p. 8)

Risk ... is at the core of project profitability (for the private party) and efficiency (in delivering public sector objectives). (p. 16)

The emphasis on the receipt of services as opposed to the procurement of the asset is reminiscent of the analysis and explanation of the nature and purpose of PPPs offered by the Private Finance Panel (1995), which was explicated in section 4.2 above.

By 2006, the government appears to have become more certain about the rhetoric surrounding sources of VFM and its role and meaning. According to the most recent PPP policy overview (PV, 2006, p. 8), VFM drivers are definable and measurable service outputs; whole-of life costing; integration of design, construction, operation and maintenance over the life of an asset in a single project package; opportunity for

innovation and transfer of risk to a private party; appropriate third-party use of facilities, either concurrently or out-of-hours (which reduce net cost to government); and market capability and appetite. It is interesting to note that the 2006 document (PV, 2006) includes risk management as only one of a number of sources of VFM.

In relation to the role and use of the PSC, the 2001–2003 technical guidance material (see Table 4.1) emphasises the linkage between VFM and the PSC (which is essentially a technical reworking of private-sector derived technologies to cost future projects):

The construction of a PSC is necessary in almost all Partnerships Victoria projects to test whether a private investment proposal offers value for money in comparison with the most efficient form of public procurement ... (PV, 2001b, p. 1)

A number of fundamental principles and objectives underpin government's approach to Partnerships Victoria, including ... encouraging the rigorous application of financial evaluation techniques, including a proper appreciation of the financial consequences of risk... (p. 3)

The PSC represents a hypothetical rather than actual dollar cost to government ... (p. 7)

It is government policy that a benchmark and formal evaluation process is to be used for all Partnership Victoria projects to assist in an assessment of whether bids in a Partnerships Victoria bidding offer better value for money than public procurement. (p. 12)

Reflecting on PPP policy development in the post-2000 period in Victoria English (2005b, p. 104) concludes:

There is less emphasis on accounting treatment and a stated increased willingness to proceed with on-balance sheet projects, reflecting the dramatic turnaround that had occurred in the state's on-balance sheet indebtedness ... The emphasis given to the Public Interest Test [see VDTF, 2000] indicates the growing sensitivity of citizens to PPP projects. The Public Interest Test assesses the impact of PPP projects in terms of their effectiveness in meeting government policy objectives and accountability standards; in ensuring that the rights of affected individuals and communities have been protected; in guaranteeing that disadvantaged groups have access to the infrastructure; that public access to the infrastructure is safeguarded; that consumer rights are protected; and that public health, safety and privacy are not impacted. The introduction of the PSC is a further step in the legitimisation of PPP on technical efficiency grounds.

... The ostensible purpose of [PPP policies] is to aid public servants and private parties in understanding the government's PPP policies and decision making criteria. Although most of the technical documents are produced in the period 2001-2003, they codified and rationalised previous practice, much of it derived from the UK (English and Guthrie, 2003). These complex financial technologies to define and allocate risk, calculate the PSC and quantify VFM have been increasingly used to legitimise the utilisation of PPP to deliver services that many citizens would rather were delivered by governments through borrowings. Their role has been to reassure the public that there are theoretically sound technical efficiency grounds for the implementation of PPP, and that the decision to enter into a PPP arrangement is based on mathematically sound financial modelling.

#### *4.5.4 Evaluation of PPP outcomes*

Analysis of the post-2000 policies above also confirms English and Guthrie's (2003) contention that PPP policies are largely concerned with managing and controlling PPP decision making in the pre-contracting stage. Appraisal of the achievement of objectives in the execution stage remains largely unaddressed in the PV policies. PV (2003b) guidelines require a formal review of PPP projects at the end of the first year of operations. However, in informal discussions, Department of Treasury and Finance officials were surprised to be reminded of this requirement, suggesting that, in the absence of treasury monitoring, such reviews have not taken place. Recent Gateway Review initiatives (see VDTF, 2007) represent an attempt to address this imbalance. The Gateway Review Process is a technology designed to systematically evaluate discrete stages in the implementation of projects, potentially providing the government with the ability to systematically evaluate the achievement of PPP objectives.

#### *4.5.5 Analysis of changing policy developments*

Maguire and Malinovitch (2004) suggest that there was realignment in government thinking in relation to PPP objectives and their implementation as early as 1993. They contend that the pre-1993 period was characterised by the objective to manage financial risk through maximising transfer of risk to private consortia. They argue that the period 1993-1999 was dominated by the belief that increased private-sector involvement (through PPPs) could deliver efficiency gains, as demonstrated in a high level of risk transfer, and private-sector responsibility for full-service provision. They

claim that the post-2000 policy phase is dominated by the objective of achieving VFM in the public interest through optimal risk transfer (Maguire and Malinovitch, 2004, p. 28).

Nevertheless, it is argued in this thesis, as contended in *Paper 2*, that PPP development and use in Victoria is more appropriately characterised by the pre- and post-2000 distinction. This distinction is important because it signals a significant change in PPP nomenclature, objectives, and approach to risk management. Also, it captures the significant change in the extent of private-sector responsibility for service delivery in the PPP model of interest to this research.

#### 4.6 Empirical findings: project objectives and risk management in pre- and post-2000 hospital contracts

Comment [le1]:

Comment [le2R1]:

The purpose of section 4.6 is to examine contractually-based empirical evidence relating to the nature of changing approaches to the management of risk in the pre- and post-2000 periods. Section 4.6 also introduces findings that are not reported in *Papers 2* or *3*. In the absence of disclosure of pre-contracting processes and procedures, contracts provide evidence of PPP objectives and the intended method of the achievement of these objectives. Consistent with the *Paper 3* analysis of the failure of a pre-2000 PPP hospital, the empirical examination of risk management strategies reported in this section also focuses on Victorian PPP hospital contracts. An examination of the pre-2000 Latrobe and Mildura Base Hospital [Mildura] contracts (accessed from the Central Register of Major Government Projects (Victoria) website on 8 August 2003) establishes that these two contracts are similar. Likewise, an examination of the post-2000 Casey Hospital [Casey] and Royal Women's Hospital [Royal Women's] contracts (accessed from the Partnerships Victoria website on 8 August 2003) establishes that these two contracts are similar. Accordingly, the La Trobe and Casey contracts were examined (as representative of the pre-2000 and post-2000 contracts respectively) to determine pre- and post-2000 objectives and approaches to risk management.

The pre-2000 Latrobe and Mildura PPPs include the design, financing, construction and maintenance of the public hospital, the delivery of core clinical services to public

patients (which are provided free of charge to public patients in public hospitals), and delivery of all associated services required to operate and maintain a large hospital and its grounds. In the case of each PPP, the consortium also received the right to build a private hospital on the government-owned land. The Latrobe contract provides for an initial term of 20 years (15 years in the Mildura contract). Both include an option to extend the term for an additional five years. Despite being built on crown land (English and Walker, 2004), there is no contractual requirement to transfer the two public hospitals back to the government at the end of the term. Latrobe and Mildura were not recognised in the relevant agency's financial statements on commissioning<sup>21</sup>. The Latrobe contract was signed in 1997, and the Mildura contract in 1999.

According to the pre-2000 La Trobe contract, the objective of arrangement was to provide for the operation and management of the hospital and the provision of services for public hospital patients to quality standards, where quality care was certified by the national accrediting body. In addition, clause 1 indicates that quality health care includes equitable access on the basis of clinical need regardless of financial or social circumstances; provision of effective linkages with other services providers for a smooth, integrated "seamless" transition between services for each episode of care; strategic targeting of services activity to maximise health outcomes in the context of demonstrated clinical needs of the region; attraction, retention and training of skilled and experienced professional service providers; integration of health promotion and education with the delivery of flexible services; and continued operation of the hospital within the requirements of relevant funding frameworks.

A contemporaneous document (VDJ, 1996) indicates that the only risks assumed by the state in the pre-2000 period were government-initiated variations relating to time and cost in the construction period and change in demand for services (which were guaranteed at a certain level). Clause 39 of the Latrobe contract confirms this approach. It states that the contractor accepted the entire responsibility for the costs and all risks of owning, operating and maintaining the hospitals, and for performing

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<sup>21</sup> The Victorian Auditor-General has indicated that as a result of the project to harmonise Australian with international accounting standards, all PPP accounting treatments have been reviewed and the relevant asset and associated financial obligations are now recognised in the balance sheet of relevant agencies (VAGO, 2006, p. 43).

any and all the obligations under the agreement. It is interesting to note that in addition to accepting the risks associated with the clinical management of the hospital, the contractor also accepted responsibility for changes in Commonwealth and state government health and funding policies, which have the potential (over long contracts in an environment of rapidly changing health care technology, clinical and patient care practices in the absence of recontracting provisions) to substantially increase daily per-patient costs (Broadbent et al, 2003a), apparently with no contractually-based mechanism (such as regular recontracting) to seek compensation.

The post-2000 Casey and the Royal Women's PPPs provide for the design, construction and financing of the hospital infrastructure by the private consortium for 25 years, with no provision for term renewal. However, the principal differences are that the delivery of core clinical services in these hospitals is provided by the state, and that operator-provided service delivery is regularly recontracted, with the intention to market test service delivery costs and standards to ensure that VFM for the state is achieved. The consortia's role in service delivery (and associated risk) is restricted to the provision of non-core support services such as security, car parking, a help desk, ground maintenance and training, thereby reducing project risks for both parties. Unlike the pre-2000 hospitals, the post-2000 hospitals are to be transferred back to the state for zero consideration at the end of their terms, and have been recognised in the relevant agency's financial statements since commissioning. The Casey and Royal Women's Hospital contracts were signed in 2004.

Part 1 of the post-2000 Casey contract articulates two objectives in clause 2. These relate to project objectives and project risk. Project objectives include the achievement of financial VFM in the procurement of the hospital facilities. Also, the contractor is required to provide a facility that assists the hospital operator (the relevant health authority) to deliver best practice patient care and efficiency outcomes (in use of facilities and in operating costs). As the consortium is not responsible for managing the hospital or providing clinical services, its role is to enable the public operator to achieve financial and non-financial VFM objectives over the life of the project as they pertain to providing quality health care. These VFM objectives are detailed as the provision of an operationally efficient facility capable of meeting service specifications (so that the operator is able to operate within its allocated

budget); and provision of a hospital with sufficient capacity to meet changing needs over time that is capable of adapting to future needs, new technologies and clinical practice changes. The risk management objectives provide for the contractor to accept all risks associated with the cost of constructing the hospital (including interest rate increases) and any future changes in hospital functions.

In summary, the pre-2000 policies conceal the scope of the modernisation objectives attached to the pre-2000 Latrobe project. Interestingly, the objectives of both pre-and post 2000 contracts are framed as aspiration qualitative outcomes. Differences between the range and scope of the objectives of the Latrobe and Casey contracts, and their different approaches to the management of project risk provide insights into the nature of change in the Victorian PPP context. The contracts confirm substantial changes to the PPP model over the examined period, and reflect the simplification of PPP objectives and the concomitant reduction of project risk in the post-2000 period. Also, differences in the language in the Latrobe and Casey contracts appear to indicate a softening in the government's post-2000 approach to managing and controlling the relationship through contracting. The ramifications of these changes will be examined in greater detail in the next chapter.

#### 4.7 Empirical findings: failure of the Latrobe Hospital

*Paper 3* analyses evidence related to the risk management in the Latrobe project and reasons for its failure. As noted in *Paper 3* (p. 294), the failure of Latrobe provides a case opportunity to compare *ex-ante* claims about anticipated VFM and the approach to risk management with *ex-post* outcomes. The evidence presented in *Paper 3*, which relies on several auditor-general reports that contained a running commentary on the Latrobe project<sup>22</sup> and also on a report written subsequent to the failure by a private-sector lobby group, Infrastructure Project Partners [IPP] (2003), augments the contractually-based evidence presented in section 4.6 above.

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<sup>22</sup> The Victorian auditor-general has not undertaken a performance audit of any PPP hospitals. As indicated in *Paper 3*, auditor-general commentary has been taken from various financial statement audit reports.

#### 4.7.1 Determining anticipated VFM

*Paper 3: Table 15.1 Latrobe Hospital provision of public health services: summary of bids and estimated NPV savings (8% per cent discount rate) (p. 296)* provides evidence that the government prepared a benchmark (using the CAPM technology as required in the 1994 policy) to calculate the cost of public provision of the project, and to quantify financial VFM and justify the choice of the successful bidder. *Paper 3 Table 15.1* indicates that the choice of contractor ('sponsor' in terms of *Paper 3*) appears to have been made solely on the basis of cost, suggesting that qualitative aspects of performance outlined in the contract were given insufficient attention in the Latrobe pre-contracting process, providing additional support for the contention that accounting treatment was the main driver of the pre-2000 hospital PPPs.

Initial auditor-general *ex-ante* analysis of risk management in the La Trobe contract (VAGO, 1997, para. 8.161-2) concluded that key risks associated with the development and operation of the new hospital had been substantially transferred to the private sector. It is interesting to note that, at the time, the auditor-general did not question the viability of the risk transfer arrangements or of the pre-contracting decision-making processes until after the failure of the arrangement.

However, an auditor-general report subsequent to the failure (VAGO, 2002, para. 3.23) suggests that the comparative analysis of the costs associated with public provision and the PPP option carried out by the Department was unsatisfactory. It does not make clear whether mandated government processes were in general unsatisfactory, or whether they had been applied unsatisfactorily in this instance:

[A]t the time these arrangements were established, comprehensive studies had not been undertaken by the Department relating to costs and efficiencies associated with the privatisation of public hospitals or the private provision of public hospital services.

Indeed, *ex post* the auditor-general (VAGO, 2002, para 3.22) suggested that the Department of Human Services had been unrealistic in its assumption that a private operator could extract the amount of savings nominated. In other words, the auditor-general suggested that government officials may have been naïve in their assessment

of the operator's capability of achieving the savings nominated, making acceptance of the bid risky for the government:

... AHCL's bid was based on the presumption that it could provide hospital services far more economically and efficiently than the public sector and on that basis it had tendered a contract price at a substantial discount (compared with the costs of internally providing the services). The fact that the tender process allowed for what proved to be an unsustainable bid price by AHCL to succeed is of concern.

In short, in this instance, the Victorian Auditor General drew contradictory *ex-ante* and *ex-post* conclusions of the appropriateness of the pre-contracting processes and decision making in relation to the La Trobe arrangement.

Additional research undertaken for this thesis suggests that the government's ideological commitment to NIE-based modernisation principles may have clouded its appreciation of the efficiencies achieved in the management of public hospitals as a result of the reforms it had instigated (Duckett et al, 1999). The Duckett et al (1999) discussion paper reviewed sector-wide hospital-based health care and confirmed that reforms had resulted in competition at sub-contractor level and that competition had driven significant technical efficiency gains in the public metropolitan healthcare sector after the introduction of the casemix-funding model in 1996. Accordingly, as noted by the auditor-general in the quotation above, the government had raised the bar in terms of the efficient delivery of hospital-based care and should have been sceptical about whether the apparent savings (see *Paper 3 Table 15.1*) could be delivered by the successful tender.

The IPP (2003) analysis of the failure indicates that unrealistic assumptions were not one-sided. As outlined in *Paper 3*, the IPP report reveals that the consortium did not understand the revenue implications of the casemix-funding model. The operator was committed to falling per-procedure funding on the basis that the model rewarded improvements of 1.5% with the same level of funding and penalised under achievement with a reduction in funding. Under the Victorian casemix model, funding only increases if hospitals significantly improve their performance in terms of the number and type of procedures they complete each year. Thus, the operator was committed to falling per-procedure funding in the context of having bid on the basis of outdated costs, and a funding model that also put significant pressure on public

hospital performance (VAGO, 1998), requiring public hospitals to receive significant on-going capital injections to keep operating (as confirmed in *Paper 3*).

#### ***4.7.2 Risk management, accounting treatment and project objectives***

Analysis of the pre-2000 Latrobe contract in section 4.6 above questions Maguire and Malinovitch's (2004) contention that by 1993 the state was more concerned with achieving efficiency gains than with managing financial risk. The blanket transfer of risk in the pre-2000 contracts is interpreted by Maguire and Malinovitch (2004) as the basis for efficiency gains.

However, a review of pre-2000 contracting in Victoria (Audit Review, 2000a, p. 47) indicates that financial obligations were either not reported, or only reported to "the limited extent identified by the Auditor-General" (i.e., disclosed as a contingent liability), and concluded that in many cases the disclosure was inadequate given the government's ultimate political obligation for service provision. The *Paper 3* analysis of the accounting treatment of Latrobe provides additional evidence in support of this conclusion, and confirms, contrary to the claims of Maguire and Malinovitch (2004), that an important objective of pre-2000 PPP projects was to avoid the recognition of associated debt in the government's financial statements.

In summary, analysis by the auditor-general subsequent to the failure of Latrobe (VAGO, 2002) indicates that the government held unreasonable expectations of the private sector's ability to produce cost efficiencies in health care delivery and that its pre-contracting decision-making processes and procedures were inadequate. Indeed, the government's (and the operator's) belief in the innate superiority of private-sector management and innovation appears to have been a contributing factor in the Latrobe failure. Also, the government had accepted an unsustainable bid price due to the emphasis at the time on maximising risk transfer and minimising cost so as to manage financial risk and achieve what turned out to be unrealistic savings. *Paper 3* indicates that the Latrobe consortium failed to comprehend the ramifications of the casemix funding model on contracted payments. *Paper 3* provides evidence that casemix funding has also undercut the ability of the public hospital system to provide quality health care consistently over time, for which the operators of the PPP hospitals (unlike

their public hospital counterparts) were not compensated. Arguably, the Latrobe case also illustrates that there may have been insufficient dialogue and trust creation between the state and the bidders in the pre-contracting stage, which resulted in the state remaining unaware that the bidder did not fully understand the mechanics and ramifications of casemix funding on its revenue stream, and the implication of this lack of understanding on the future of the project.

#### 4.8 Reflective conclusion and chapter summary

In conjunction with Chapter 5, this chapter addresses the second aim of this research, *to analyse PPPs and their changing role as a modern procurement technology*. Chapter 4 has continued the development of skeletal theory that began in Chapter 2. Chapter 4 has also begun the process of addressing the final two stages that comprise middle range thinking: the iterative reflexive process that allows the individual researcher to analyse and reflect on the meaning of the empirical data in the light of skeletal theory, and the refinement of skeletal theory in the light of conclusions drawn from the data.

Chapter 4 had a number of objectives. The first was to establish PPPs within their economic and institutional context. *Paper 2* presented evidence about the incidence and type of PPPs that indicated their economic importance in Australia. Also, *Paper 2* established the pre- and post-2000 distinction in the Victorian government's approach to PPP management and control. Analysis in this chapter provides insights into the differences in the pre- and post-2000 approach to PPPs and confirms that this distinction facilitates analysis of change over the investigated period. Chapter 4 focuses on decision making in the pre-contracting stage. The PPP pre-contracting stage is important because it establishes project objectives and understandings of 'success' in the execution stage.

The literature review in section 4.2 raised several themes and concerns relating to PPP objectives and the pre-contracting appraisal technologies designed to achieve those objectives. Section 4.2 indicated that the controversy surrounding PPP objectives reveals a possible discrepancy between stated and hidden objectives. Also, section 2.4 raised questions about the nature and purpose of risk management and the PSC in PPP

pre-contracting decision making. Although the lack of disclosure of pre-contracting decision-making processes and procedures hinders research into intended outcomes, it is contended in this thesis that PPP contracts provide a window through which intentions and approaches can be inferred. Accordingly, Chapter 4 investigated possible discrepancies between stated objectives and PPP practice through an examination of PPP policies over time and approaches to risk management in two representative pre- and post-2000 hospital contracts.

The empirical data presented in this chapter indicates that PPP objectives and the specification of risk management in the examined contracts has changed over the investigated period, and is reflective of changes observed in PPP policies in the pre- and post-2000 periods. It appears that blanket risk transfer and the lack of a requirement to transfer the hospital back to the public sector at the end of the term in the pre-2000 contracts has more to do with the management of financial risk (and the non-recognition of government debt) than with the espoused objective of managing project risk to achieve VFM, which appears to have become the dominant objective in the post-2000 period.

The analysis of the Latrobe case confirms that an absence of trust may have contributed to the failure of the project. Also, it demonstrates that, despite contractual agreements, governments cannot walk away from their responsibility to provide social services to the public in a modern democracy such as Australia. The Latrobe case supports *Paper 3*'s contention that the government had not taken into account the cost of political risk in its pre-contracting decision making. The evidence suggests that the government and the consortium had miscalculated the risks associated with the pre-2000 model and the project. The approach to risk management in the Casey contract, however, reveals an apparent softening of the government's approach that is more aligned to the thrust of its post-2000 policies; that is, with the management of project risk to achieve VFM. Heald (2003) raised the question of whether PPPs evaporate, magnify or transfer the total amount of risk associated with PPP projects. The investigations in this chapter confirm that PPPs can magnify risks due to the political risks associated with the provision of public services (Barton, 2001). The post-2000 changes to the PPP model had the unstated effect of reducing the political risks

associated with poor service quality and failure, and, accordingly, of potentially increasing opportunities to reap less ambitious VFM outcomes.

Section 4.5 revealed that paradoxically, as the PPP model under investigation in this research has become less complex and less risky for both the government and private consortia, pre-contracting accounting and management appraisal technologies have become increasingly complex and technical. The Chapter 4 examination of policy change suggests that the Victorian government began to subtly redefine the stated purpose of PPPs as the efficient procurement of services as early as 1996. This change in focus was accompanied by a shift to managing project risk to achieve VFM. In the post-2000 period the shift was underpinned by a consistently articulated raft of technically-based policy documents.

While the ostensible purpose of these policy documents is to aid the decision-making processes of public officials and potential bidders and to reduce bid costs, they can also be interpreted as an attempt to legitimate PPP arrangements and hence the use of private financing to fund the construction of infrastructure. It has been suggested in this chapter (and in English (2005b)) that this paradox may be explained by the government's need to provide an apparently technically-sound rationale and justification for its continuing use of PPPs in the face of growing public scepticism about their merit and worth, and its desire to manage and control decision-making by line agencies and to control the risk of failure<sup>23</sup>.

An alternative explanation of the apparent gulf between policy complexity and PPP model simplification is the use of technical developments to disguise unstated objectives such as a continued commitment to the privatisation of public services (Newberry and Pallot, 2005). Under this interpretation, previous implementation of a hard-edged NIE-based approach to modernisation in the PPP setting was replaced by a softer and apparently less-threatening approach that appears to be more responsive to public concern. However, the observed post-2000 changes in approach to risk

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<sup>23</sup> Subsequent to the election of a new government in late 1999 three ailing pre-2000 PPPs failed. In addition to Latrobe, the other failures were Deer Park Prison (to be investigated in Chapter 5) and the Metropolitan Tram and Train Franchises (see Stanley and Hensher (2004) for an analysis of the failure of that project).

management and the introduction of the Public Interest Test (VDTF, 2000; English and Guthrie, 2003) may be more appropriately explained as a pragmatic example of a change in government philosophy that questioned the efficacy of the hard-edged NIE-based implementation of modernisation, but not the NIE-based goals of modernisation *per se*.

The analysis of PPP policies in this chapter confirms that change in the modern public sector may be predominantly evolutionary as opposed to revolutionary. The findings in this chapter appear to resonate with the observations of Modell et al (2007) and Jacobs et al (2007) that, despite recent (post-2000) international trend towards increasing reliance on output- and citizen-centred performance management (that is also a feature of modernisation in Australia), processes and procedures still exercise an important influence on central government operations. Lapsley's (2001b) contention that the processes by which public organisations are reformed and become more modern is driven by reformers' beliefs in the benefits of modernisation also appears to explain the nature of change analysed in Chapter 4. Thus, although the post-2000 policies appear to represent a retreat from the hard-edged NIE approach to modernisation, Victoria's Department of Treasury and Finance (through PV) continues to dominate Victoria's use and development of PPPs, and its policies act to manage and control the pre-contracting appraisal of PPPs at agency level to achieve the government's broad economic, political and social objectives. It is contended in this chapter that these objectives have not changed substantially since the early 1990s. What has changed is the manner of their implementation. This thesis now turns to examine the achievement of project objectives in the execution stage.



## CHAPTER 5

### Using Contracts to Manage and Control the Achievement of Modernisation Objectives in the PPP Execution Stage

#### 5.1 Introduction

This chapter continues the investigation of the second aim of this research, *to analyse PPPs and their changing role as a modern procurement technology*. By way of establishing the macro-level context, Chapter 4 presented empirical data relating to the incidence and types of PPPs, and argued that PPP implementation in Victoria can be usefully classified into two periods: pre- and post-2000. Also, Chapter 4 established that PPP objectives (and their use as a procurement technology) have changed over time. Chapter 4 provided contractually-based evidence of the effect of policy change on PPP objectives and approaches to risk management and VFM achievement. The current chapter further continues the iterative process of reflective interaction between skeletal theory and the empirical data that began in Chapter 3.

The thesis is further progressed in Chapter 5 by examining the use of contracts to manage and control the achievement of modernisation objectives in the lengthy execution stage of PPP projects. Chapter 5 builds on the analysis in *Paper 4*. *Paper 4* outlines and discusses the contracting practices that have informed the governance of five Victorian PPP prisons commissioned between 1996 and 2007. One pre-2000 and one post-2000 PPP prison contract (representing five PPP projects) are examined in *Paper 4* to determine how, in the context of a dynamic environment, they facilitate the governance of PPP relationships and the achievement of long term policy objectives.

*Appendix A: Comparison of pre- and post-2000 Victorian Prison Contracts of Paper 4* analyses the representative contracts from the following perspectives: overview of objectives; approaches to risk allocation; service delivery standards; payment and incentive mechanisms; and management and control structures. *Section 5 of Paper 4* presents the discussion of these elements of the investigated pre- and post-2000 contracts. Due to a relative absence of publicly-disclosed information relating to the post-2000 contracts, the bulk of the discussion in *Paper 4* (and in this chapter) focuses on the pre-2000 prison contracts and their ability to manage and control service delivery and the PPP relationship.

*Paper 4 Appendix A* and *Section 5* confirm that the effects of the post-2000 decision to eliminate the role of the private sector in the provision of core service delivery in PPPs has radically altered project objectives and reduced project risk. Changes in the government's attitude towards contracting in the PPP setting, and a more pragmatic approach to allocating risk and dealing with the uncertainty arising in the execution stage, is evident in the examined post-2000 contract. For instance, the post-2000 policies (such as PV, 2001a) recognise the existence of 'difficult to allocate risks' which gives rise to embedding a material adverse effects regime (as advocated by transactions cost economics [TCE]) in the post-2000 contracts. By contrast, the pre-2000 contracts are characterised by the intention to maximise the transfer of risk to the operator, and are reflective of an unquestioning belief in the power of the practical application of NIE theories (particularly TCE) and private-sector accounting and management technologies to achieve desired modernisation outcomes.

In relation to service standards, *Section 5* of *Paper 4* indicates that the quantitative nature of the service delivery outcomes (SDOs) in the pre-2000 contracts (which are outlined in *Table 2: Service Delivery Outcomes (SDOs) for Deer Park, Fulham and Port Phillip Prisons* (at contract date)) inadequately specified performance standards anticipated by the government. Although *Section 5* provides evidence that the pre-2000 SDO regime was subject to regular recontracting, revisions to the SDOs in 2003 (see *Table 3: Comparison Port Phillip SDOs*) failed to counteract criticisms of SDO specification by the auditor-general (VAGO, 1999) and others (such as Kirby (2000)). The payment and incentive mechanisms (outlined in *Table 4: Payment Details of Five Victorian PPP Prison Contracts*) embedded in the pre-2000 contracts also failed to adequately penalise operators for poor performance. In relation to the management and control of the relationship, *Appendix A* and *Section 5* of *Paper 4* indicate that the representative contracts contain mechanisms to 'discipline' poor performance, including a default regime.

Chapter 5 contains a considerable amount of material that adds to the *Paper 4* analysis and conclusions. This additional material can be characterised along the following lines.

First, the *Paper 4* literature review (contained in *Section 2* of *Paper 4*) has been revised in section 5.2 of this chapter. These revisions challenge the power of TCE to explain contracting in long-term hybrid relationships. The addition of this material provides the basis of a richer understanding of PPP contracting than is presented in *Paper 4*.

Second, in writing this dissertation, *Paper 4*'s analysis of the objectives of the 1993 New Prisons Project [NPP], which is contained in *Section 3* of *Paper 4*, was revisited. As a result, it became apparent that NPP had dual objectives relating, first, to performance associated with the PPP prisons, and, second, to their role in driving modernisation reform across the whole of the Victorian correctional services sector. Analysis of the features and implications of NPP does not receive prominence in *Paper 4*. An appreciation of the objectives of NPP now contextualises the examination of the PPPs undertaken in this thesis. This approach resonates with the perspective taken by the auditor-general (VAGO, 1999) and others (Kirby, 2000; OCSC, 2000) who have investigated pre-2000 prison outcomes. This gap has been corrected in Chapter 5 with additional material about NPP in section 5.3.

Third, the systems-wide implications of NPP and the failure of the pre-2000 contracting regime to adequately capture the qualitative aspects of service delivery required by NPP prompted further examination of events after 2000. Kirby (2000) and others (VAGO, 1999) recommended significant systems-wide reforms to support the implementation of NPP objectives. Indeed, following the Kirby (2000) recommendations, significant cross-the-board reforms to the Victorian correctional services sector were implemented in 2001. The nature of the 2001 initiatives raises questions about the extent to which the rigid neo-liberal inspired pre-2000 contracting regime is capable of adapting to the modernisation of the management of the correctional services sector, prisons and prisoner management that these reforms required. The 2001 reforms were driven by a 'network governance' approach which emphasises consensus and cooperation in the individual case-management of prisoners. This is reminiscent of the reforms to reduce long-term unemployment highlighted in *Paper 1*, as discussed in Chapter 3 of this thesis. Table 3.1 in Chapter 3, which compares the network approach to the neo-liberal based approach to the modernisation of public services, indicates the two are diametrically different,

suggesting that the pre-2000 contracts may not have the capacity to support the introduction of negotiated, prisoner-based solutions.

Accordingly, Chapter 5 contains a great deal of additional material, much of which extends the analysis, findings and conclusions drawn in *Paper 4*. In writing Chapter 5 an attempt has been made to clearly identify material that is taken from *Paper 4* and from additional research that has been undertaken subsequent to its publication.

The organisation of Chapter 5 proceeds as follows. Section 5.2 extends the literature review presented in *Paper 4*. It introduces literature critical of the TCE-based contracting literature, providing the basis of alternative insights into empirical findings. Section 5.3 of Chapter 5 introduces NPP and analyses its objectives. Section 5.3 expands on material in *Section 3* of *Paper 4* and provides the frame within which the Chapter 5 evidence is presented and subsequent analysis is undertaken.

Section 5.4 presents empirical findings in relation to the examined PPP contracts. It examines performance specification, payment and incentive mechanisms and problems associated with the pre-2000 contractually-based default regime. Accordingly, section 5.4 expands on the analysis and discussion presented in *Section 5* of *Paper 4*.

Section 5.5 presents revised empirical findings and analysis relating to the achievement of NPP modernisation objectives over an eleven-year period. Section 5.6 presents the reflective conclusion and chapter summary.

## 5.2 Literature review: the use of contracting in a PPP setting

The following literature review extends the literature review findings presented in *Paper 4*. Additional material is drawn from empirical studies of long-term hybrid relationships in private and PPP settings that are critical of the power of TCE to explain contracting practices.

### 5.2.1 Insights from transactions cost economics

Chapter 2 and *Paper 1* indicated that TCE has influenced contracting practices associated with the drive to modernise public-sector procurement in Australia. TCE suggests that contracts can be used to manage and control agency problems associated with contracting out service delivery. As argued in *Paper 4*, from a TCE perspective, contracts are used to specify and manage performance and incentive mechanisms, and to control the resolution of uncertainty in order to reduce transactions costs in the execution stage.

In the PPP context, which is characterised by lengthy contracts that magnify the potentially negative effects of uncertainty on the achievement of VFM objectives, there is a need to actively manage risk (particularly as risk management is the basis of VFM achievement in the execution stage (PV, 2006)). In the Victorian PPP setting (as in the UK) the management of risk occurs through contract-based mechanisms, including regular market testing (recontracting) of the service elements of PPP contracts (Broadbent et al, 2003a). Recontracting provides a window for both parties to periodically reassess VFM/profitability, and to recalibrate agreements about the financial and non-financial parameters of service delivery.

TCE is founded on the premise that transactions for goods and services can be distinguished by their coordinating and control mechanisms, by varying abilities to adapt to unanticipated events, and the desire to minimise transactions costs and reduce overall project costs (Williamson, 1991; 2005). As indicated in *Paper 4, section 2*, transactions costs are related to the inability to control for bounded rationality, opportunistic behaviour and asset specificity. These variables can increase costs in the execution stage because of the need to resolve uncertainty, which cannot be perfectly anticipated or eliminated, resulting in incomplete contracting. TCE indicates that incomplete contracting forces parties to engage in ‘gap-filling’ in the execution stage. Williamson (1991) suggests that transactions costs in long-term hybrid contracts may be mediated by elastic contracting mechanisms which establish a framework (such as dispute resolution procedures) to cost-effectively promote gap-filling (i.e., by specifying how to resolve problems that arise from incomplete contracting, opportunism and asset specificity).

### 5.2.2 Critiques of TCE<sup>24</sup>

Recently, however, the TCE framework has been deemed inadequate to explain contracting in complex long-term hybrid relationships in private-sector settings. Tomkins (2001, p. 177) questions the agency role of contracts when he notes that “the major value of contracting may lie in it being a device to set down goals and methods to enable mutual planning, rather than being primarily an ex-post control device”. Mouritsen and Thrane (2006) and Dekker (2004) suggest that structural and functional approaches such as TCE are unable to explain the ways in which hybrid relations are constructed and governed. Cooper and Slagmulder (2004) contend that the emergence of hybrid forms makes relationships more complicated than contemplated by TCE. Also in a private-sector setting, Van der Meer-Kooistra and Vosselman (2000) have extended the TCE hybrid model to take into account embedded social factors, indicating that trust between the parties is necessary to guarantee continuity, and to retain the economic advantages to all parties of outsourcing in long-term hybrid relationships.

In a PPP setting, Broadbent et al (2003a; 2004a) have also challenged TCE’s ability to explain observed contracting outcomes. They argue that because it is a (theoretically-based) heuristic model and not empirically based, TCE is unable to adequately explain the management and control of PPPs, underscoring one of the major contributions of *Paper 4* and this chapter, which provide empirical evidence of PPP contracting practices. Broadbent et al (2004a) argue that if the PPP contracting regime is to successfully replace the essentially bureaucratic relationships that exist in the public sector, the development of goodwill trust and ‘relational contracting’ is necessary. They argue (2004b, p. 61) that the TCE bias towards economic analysis of contract law is misplaced in a public-sector setting because:

We need to ask the question as to whether PFI contracts have the capacity to become relational contracts. That is a contract that is geared towards defining the boundaries of the relationship that seeks to clarify a framework in which it can be seen how changes might be dealt with. It is based on notions of regulatory law ... and thus seeks to provide a framework in which social relations can develop autonomously rather than be pre-defined to bring about a particular end.

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<sup>24</sup> This section augments the analysis in *Paper 4*.

In the Broadbent et al (2003a; 2004b) analysis, the TCE concept of bounded rationality refers to something that has not been anticipated, whereas “presentation” (Broadbent et al, 2003a, p. 176) refers to the recognition in legal terms that contractors are aware of certain types of unanticipated events and provide a process in the contract for their *ex-post* resolution. This is based not on gap-filling and elastic contracting mechanisms written into the contract (as envisaged by TCE), but on reflexive social relations that are enabled and interrelate in complex ways. These social relations are facilitated by the contracting process, thereby stimulating the development of goodwill trust and relational contracting, which they characterise as “a consciously co-operative working relationship” (Broadbent et al, 2004a, pp. 59-61). Relational contracting is also in the long-term interests of private partners who are committed to a long-term capital investment (Spackman, 2002).

Froud (2003) has questioned the capacity of PPP contracts to become relational and effectively facilitate the management and control of future uncertainty. Broadbent et al (2003a), however, maintain that residual risk in a PPP setting is the result of the inability to eliminate or allocate uncertainty (the shared risks) through contracting, and that the development of goodwill trust is necessary for its resolution. It is interesting to note that relational contracting appears to share some of the features of network governance as identified in Table 3.1 (of Chapter 3). In both cases the role of institutional arrangements and contracts with government is to establish a framework within which the development of trust and negotiation are facilitated.

Busco et al (2006, p. 17) defines trust as “a mechanism that can reduce uncertainty in contexts of interaction and facilitate the functioning of organisational systems through the behaviour of social actors”. Dekker (2004, p. 46) concludes that although managing appropriation concerns resulting from opportunistic behaviour can be an important objective of control in hybrid contracting, “trust in a partner’s goodwill and capabilities may strongly influence the strength of association between the relationship’s control problems and the use of control mechanisms”.

Mouritsen and Thrane (2006) view trust as a problematising device that is closely aligned with interpreting and implementing various kinds of management accounting information. Busco et al (2006) and Dekker (2004) also suggest that management

accounting can play a significant role in the development of trust in new relationships (such as PPPs) that are forged on the premise of changing an existing culture. Similarly, Broadbent et al (2003a, p. 185) acknowledge the role of management accounting in the development of relational contracting through making visible the relationship between the parties, in demonstrating how control is operationalised, and in providing a means to measure the notion of VFM. Imperfect quantitative performance specification, monitoring and control mechanisms in PPP contracts, and the need to accommodate the effects of unanticipated events (uncertainty) inevitably impact the risk allocations agreed in the pre-contracting stage, resulting (in the execution stage) in negotiated (essentially qualitative) refinements to understandings of performance standards and payment streams, and what constitutes VFM (Broadbent et al, 2008).

However, in the PPP context, Broadbent et al (2003a, p. 184) suggest there may be a contradiction between the demands of achieving efficiency, and of the need to develop goodwill to manage a long-term relationship in an essentially bureaucratic (public-sector) system. Also, Broadbent et al (2003a) note that although risk assessment is central to pre-contracting project appraisal, they observed no explicit attempt (by the investigated NHS Trust) to seek to evaluate whether the required risk transfers had been achieved. Instead, the (management-accounting specified) contract-based performance monitoring procedures were used as a surrogate mechanism to manage risk.

In conclusion, recent literature has deemed TCE inadequate in the private-sector and PPP settings to explain contracting in complex hybrid relationships because of its failure to take into account the importance of social interactions in making these relationships work over the long term. Relational contracting requires the development of goodwill trust. Field-based research (see, for instance, Mouritsen and Thrane, 2006; Busco et al, 2006 and Van der Meer-Kooistra and Vosselman, 2000) suggests that goodwill trust is developed through the need to negotiate mutual understandings of the practical meaning and implementation of the accounting and management technologies embedded in contracts that manage and control performance specification.

In summary, this review of recent literature suggests that development of goodwill trust and of relational contracting are not based on gap-filling and elastic contracting mechanisms (as envisaged by TCE), but on reflexive social relations that lead contractual parties to a conscious willingness to negotiate and compromise. This outcome appears questionable given the hard-edged approach to risk transfer that is characteristic of the pre-2000 PPP contracts examined in this thesis.

### 5.3 Empirical findings: objectives of the five Victorian PPP prison contracts

This section expands on the analysis in *section 3 of Paper 4*, which outlines the institutional-level policy context that shaped the PPP prison projects. *Section 3 of Paper 4* alludes to the New Prisons Project [NPP] (on *page 15*), the objectives and outcomes of which are examined in greater detail in additional research undertaken for this thesis and reported in *section 5.3*. Accordingly, *section 5.3* adds to the analysis contained in *Paper 4* by further elucidating and reflecting on the ramifications of the modernisation objectives of the pre- and post-2000 PPP contracts.

#### 5.3.1 Objectives of pre-2000 contracts

*Paper 4 (section 3, p.15)* indicates that, prior to the execution of the three pre-2000 PPP prison contracts, significant changes occurred at the systems-level to facilitate their introduction and to clarify their objectives. However, *section 3 of Paper 4* fails to highlight sufficiently that the three pre-2000 PPPs (the Metropolitan Women's Correctional Centre [Deer Park], Port Phillip Prison [Port Phillip] and the Fulham Correctional Centre [Fulham]) had two broad objectives under the 1993 NPP.

First, the *financial VFM objective* is categorised as the achievement of cost savings in the delivery of prison infrastructure and custodial services in PPP prisons and, through the introduction of sector-wide competition between the publicly and privately managed prisons, throughout the correctional-services sector. In terms of financial VFM, NPP intended to drive competition in the management of correctional services by extending the PPP contracting framework, including the contractually-based management accounting control technologies (such as performance

specification, monitoring and payment for results) across the publicly managed prison system.

Second, the *non-financial VFM objective* was to transform (modernise) all aspects of correctional services management throughout the state's (privately- and publicly-managed) prison system. Its purpose was to improve the treatment and rehabilitation of prisoners (Kirby, 2000; VAGO, 1999; VDJ, 1996), and embraced across-the-board improvements in housing and educating prisoners. These non-financial VFM objectives were primarily established in the Performance Management System [PMS] which formed part of the Project Brief (VDJ, 1996) and are reproduced in Appendix A to the pre-2000 contracts and reflected in the objectives and body of the pre-2000 contracts (see *Appendix A: Comparison of pre- and post- 2000 Victorian Prison Contracts in Paper 4*).

NPP modernisation objectives are characterised as financial and non-financial for analytical purposes. It is recognised that this distinction does not adequately reflect the interdependence of these concepts, which are more complex than the analysis in this chapter suggests. The term 'non-financial VFM' has been adopted to draw attention to the fact that, contrary to assertions in the literature (see, for instance, Froud, 2003), PPPs can have significant non-financial objectives.

To support the implementation of these dual financial and non-financial modernisation objectives, the public choice theory [PCT] principle of function separation to replicate private-sector governance functions (Trebilcock, 1995) was implemented within the Department of Justice. The public prisons were managed by a new unit known as CORE<sup>25</sup>. An Office of Correctional Services Commissioner [OCSC] was established to monitor and report (to the Minister<sup>26</sup>) on service provision across the system, and to provide policy advice. Also, a Contracts Management Branch was established to manage the contractually-based relationship between the Department and the 13 public and private prison operators.

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<sup>25</sup> As far as can be ascertained, CORE is not an acronym, but was the name given to the division in the Victorian Department of Justice charged with managing the publicly-managed prisons.

<sup>26</sup> With the exception of OCSC (2000), OCSC reports are not publicly available in Victoria.

### 5.3.2 Objectives of post-2000 contracts

In keeping with the significant changes to Victorian PPP policies and objectives outlined in Chapter 4, the intention to reduce and more effectively manage and control project risk is reflected in two post-2000 contracts. The significantly less-ambitious objectives of the post-2000 prisons are outlined in the Recitals (objectives) to the contract in *Appendix A of Paper 4*. As indicated in *Paper 4 (page 17)*, the role of the operator is restricted to designing, constructing and financing the facility, and to providing accommodation, maintenance and security systems services. Essentially, the role of the PPP operator in these post-2000 arrangements is to construct the prison and to provide selected services (outside the perimeter of the publicly managed prison) which support and facilitate the delivery of correctional services by public service personnel.

## 5.4 Empirical findings: performance specification in pre- and post-2000 contracts

Performance specification in the two representative pre- and post-2000 contracts is analysed in *Section 5 and Appendix A of Paper 4*. *Section 5 of Paper 4* analyses the pre- and post-2000 contracts from the perspective of the key contractual elements designed to facilitate the achievement of stated objectives. However, as noted above, the role and achievement of the pre-2000 contracts in promoting the 1993 NPP objectives are less thoroughly examined in *Paper 4*. Sections 5.4 and 5.5 of this chapter respectively correct this imbalance. In relation to the pre-2000 contracts, section 5.4 provides empirical evidence on contractual specification of performance and on the problems associated with managing performance and implementing default mechanisms. Also, section 5.4 outlines contractual performance specification in the post-2000 contracts. The purpose of section 5.5 is to provide empirical evidence about the achievement of financial and non-financial VFM objectives of the pre-2000 contracts. The investigation of contract specification and achievement of financial and non-financial VFM objectives of the pre-2000 arrangements is undertaken over an eleven-year period (1996-2007). There is, unfortunately, insufficient publicly-available evidence to examine VFM achievement in the post-2000 contracts.

Analysis in sections 5.4 and 5.5 of this chapter is sourced from *Paper 4* augmented by material from the following four reports: VAGO (1999); Audit Review (2000b); Kirby (2000); and OCSC (2000). These reports are hereafter referred to in this chapter as VAGO, Audit Review, Kirby, and OCSC respectively. Additional material presented in section 5.5 relating to the achievement of the NPP's non-financial VFM objectives after 2000 is sourced from two auditor-general reports (VAGO, 2003; 2007a) and two Department-commissioned reports (Birgden and McLachlan, 2004; Graffam et al, 2005), which investigate the implementation of 2001 reforms designed to reduce the rate of prisoner re-offending.

The primary reason for relying on these eight reports is that they analyse the achievement of the objectives of the three pre-2000 Victorian PPPs within a policy context. This is important for a number of reasons. For instance, ignoring the objectives of NPP leads Andrew (2007, p. 4) to conclude that government policy "focused largely on cost-effectiveness rather than service quality". Andrew's (2007) review of eight PPP prisons in five Australian states also overlooks the subtle contextual differences (inevitable in the Australian federal system), which result from changing policies over time and place, and which give rise to different approaches and outcomes in different states. As a result, her analysis assumes that observed outcomes in one jurisdiction are applicable to all. As this thesis has demonstrated, changes in context over time, even within one jurisdiction, cannot be ignored in analyses of PPPs. For instance, in relation to Victoria, Andrew (2007) ignores information provided by VAGO and Kirby about the comparative performance of privately and publicly-managed prisons, thereby failing to place the evaluation of the performance of PPP prisons within its broader institutional context.

Features of the contractual arrangements of the three pre-2000 prisons (Deer Park, Port Phillip and Fulham), and the two post-2000 prisons (the Margoneet Correctional Centre [Ravenhall] and the Metropolitan Correctional Centre [Lara]) are outlined in *Paper 4, Table 1 Contractual Characteristics*. This table reveals details of the scope of the pre- and post-2000 contracts. *Paper 4, Table 4: Payment Details of Five Victorian PPP Prison Contracts* provides details of the contractually-based payment and incentives mechanisms. The original version of the pre-2000 service delivery outcomes [SDOs] are contained in *Paper 4, Table 2: Service Delivery Outcomes*

[SDOs] for Deer Park, Fulham and Port Phillip Prisons. Paper 4, Table 3: *Comparison of Port Phillip SDOs* provides a comparison of the original 1996 SDOs and 2003 SDOs (for one item, prison escapes) that resulted from the first round of recontracting of the pre-2000 arrangements. The analysis and discussion in subsections 5.4.1 and 5.4.2 builds on this material in Paper 4, and on the additional empirical findings presented below.

#### **5.4.1 Contractual specification of performance: pre-2000 contracts**

Section 5 of Paper 4 reveals that the original pre-2000 SDOs (as outlined in Table 2 of Paper 4) were quantitative, and that performance achievement determined the annual Performance Linked Fee [PLF] (the operator's return on equity). As indicated in Table 2 of Paper 4, the SDOs attempted to encapsulate both VFM and sector modernisation objectives. However, the pre-2000 SDOs have been criticised by VAGO and two government commissioned reports (Audit Review and Kirby) on a number of grounds. Notably, the SDOs fail to capture the qualitative elements of performance (devised to achieve non-financial VFM) that are outlined in the 1993 NPP, in the PMS (which was to be introduced across the correctional sector (VDJ, 1996)), the Operating Manual, and in Appendix A to the contracts (see, also, Appendix A, Paper 4). The primary purpose of the PMS was to operationalise the non-financial aspects of the NPP.

The capacity of consortia to integrate the prison management principles captured in the PMS into their bids was an evaluation criterion of the PPP project brief (VDJ, 1996, p. 13), suggesting that the contractors should have had an appreciation of the Department's understanding of required standards. The PMS, which was intended to drive the non-financial VFM objectives of the 1993 reforms, contains detailed quality specifications in relation to the key NPP objectives of containing and supervising prisoners in a safe, secure, humane and just manner; providing opportunities for rehabilitation to prepare prisoners for law-abiding and productive participation in the community on release; and facilitating reparation to the community through work performed in prison. Also, the contractors were expected to outline in detail how the achievement of these qualitative requirements was to be achieved in the Operating Manual. The Operating Manual was signed off by the Department, suggesting that the

two parties had reached a mutually negotiated understanding of the meaning of the PMS specifications and how they were to be achieved prior to commencement of the operating stage.<sup>27</sup>

Nevertheless, the VAGO, Audit Review and Kirby reports also confirm that these qualitative requirements, although subject to continuous prison-based monitoring by the OCSC, were not directly related to the contractually-based payment incentive scheme (i.e., the PLF). Accordingly, the quantitative pre-2000 SDOs inadequately reflect all key aspects of the prison operators' performance (VAGO, para. 7.36; Audit Review, p. 23). In addition, the mechanics of SDO linkage to the PLF meant that it was possible for a contractor performing poorly in a number of key areas to still receive the full amount (or a substantial proportion of) the annual PLF; and that the system potentially provided incentives for the under-reporting of incidents (Audit Review, p. 21). Also, VAGO (para. 7.72) noted that financial penalties had been minimal in terms of total contract value even though identified deficiencies remained unaddressed for long periods, and resulted in significant expense to the government in terms of OCSC monitoring.

*Paper 4, Table 3* reveals that the recontracting provisions in the pre-2000 contracts provided the Department with an opportunity to formally renegotiate the SDOs. However, *Table 3* also indicates that although some refinement to the SDOs was possible, the scope of change was limited. The renegotiated SDOs failed to include qualitative indicators and to recalibrate the link between the SDOs and the PLF (as recommended by the VAGO, Audit Review, and Kirby reports). Thus, the mismatch between stated modernisation objectives and the contractually-based payment and incentive scheme embedded in the pre-2000 contracts seems to remain largely immune to substantive change. The problems associated with performance measurement and monitoring also seem to have complicated the 2006 recontracting negotiations with one of the pre-2000 operators. These negotiations required a prolonged extension of the recontracting period to facilitate a mutually-acceptable outcome. Accordingly, it appears that the pre-2000 contracts constrain the facilitation of problem solving.

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<sup>27</sup> The Operating Manual was developed during the design and construction stage (i.e., prior to commissioning).

#### *5.4.2 Problems associated with managing operator performance and implementing default mechanisms: pre-2000 contracts*

Performance risk (which was identified by Kirby as the primary risk associated with the PPP prisons and is identified as sponsor risk in *Paper 3*) is further illustrated by additional problems encountered by the government in managing and controlling operator performance standards at Port Phillip and Deer Park.

Problems with accommodation services and correctional services at Port Phillip resulted in a Default Notice (VAGO, 2001), and in the Kirby inquiry (Kirby, p. 3). However, it was Deer Park that ultimately failed on 2 November 2000, after receiving three Default Notices that year relating to performance standards. The OCSC report into the Deer Park failure indicates that problems at the prison had begun to emerge in 1999, with an increase in the number of adverse incidents relating to security, prisoner management and safety. The report also provides ample evidence of OCSC difficulties in establishing the primary cause of identified problems, and in persuading the contractor (and the Contracts Management Branch) to fully comprehend and acknowledge the extent and implications of contractual obligations in relation to prison management. Furthermore, the OCSC report into Deer Park's compliance with its contractual obligations and the PMS also provides insights into the difficulties the OCSC encountered in managing and controlling operator performance.

The OCSC report catalogues the repeated efforts it made throughout 2000 to rectify poor performance at Deer Park. The Deer Park saga confirms that in the event of unsatisfactory performance, the government had difficulty in enforcing the contract due to a lack of clarity concerning the rights and obligations of parties, and in dispute resolution and default processes. It also supports Kirby and VAGO criticisms of structural weaknesses (particularly in relation to the establishment and funding of the OCSC) in the institutional framework established to implement NPP.

#### *5.4.3 Contractual specification in the post-2000 contracts*

Changes in the Victorian government's post-2000 PPP perspectives are reflected in the less ambitious objectives of the Lara and Ravenhall contracts (as outlined in *Appendix A* of *Paper 4*). Also, the contracts reflect the TCE-inspired post-2000

policies intended to facilitate dispute resolution and to foster the partnership relationship. For instance, *Paper 4* (pp. 21-22) highlights a more circumspect approach to risk management, the introduction of a contractually-based material adverse effects regime (including provisions for sharing risks and rewards arising from uncertainty) and pro-active efforts to promote the development of trust between the partners in the post-2000 contracts (as recommended by PV, 2003a; b; 2006).

*Section 5* of *Paper 4* also provides an interesting insight into the Victorian government's attempts to achieve financial VFM through controlling for uncertainty in post-2000 PPPs. For instance, *page 22* of *Paper 4* reveals the explicit role the financial model (prepared by the consortium as a key component of its bid) plays in managing and controlling the financial effects of negotiated changes to the contract to preserve anticipated financial VFM in the execution stage. The financial model provides details of operator-anticipated revenues and costs (and therefore of operator profitability) that the Department uses (in the five-year period preceding and during recontracting) to monitor costs to ensure that associated risks are not inadvertently transferred back to the state. Monthly monitoring by the Department of the effect of changes in costs on financial model specifications is diametrically opposed to Broadbent et al's (2003a) observation that the NHS Trust did not appear to overtly seek to evaluate whether required risk transfers had been achieved.

In addition, the post-2000 contracts provide for a targeted and pro-active project management regime that is intended to ensure the achievement of project objectives, facilitate early detection of problems, and to promote the development of trust (PV, 2003a). An edited version of a monthly Ravenhall facilities management report (Ravenhall FM Report, 2006) prepared by the operator<sup>28</sup> indicates that the performance monitoring system remains under continuous review. Agreed SDOs are monitored throughout annual cycles and are subject to yearly renegotiation. This approach appears to acknowledge the value of facilitating continuous finetuning of SDO specifications so that they more accurately reflect ongoing change in a dynamic environment. This dynamic environment is the result of changing influences on the public and private sector partners. The SDOs require finetuning so that they cater for the potentially conflicting objectives of the public-sector prison management team

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<sup>28</sup> Provided by the Department of Justice.

(whose objectives change as correctional services philosophy and policy change) and the private contractor, whose role it is to deliver essential support services profitably. It is tempting to conclude that this new flexibility reflects learning from problems associated with SDO specification in the pre-2000 contracts, and recognises the need to facilitate the development of goodwill as recommended (PV, 2003a).

### **5.5 Empirical findings: achievement of financial and non-financial VFM objectives: pre-2000 contracts**

Audit Review (p. 14) and the auditor-general (VAGO, para. 4.25) confirm that one of the main objectives of prison privatisation was to transfer design, construction, financing and operating risk to the private sector to achieve financial and non-financial VFM (as outlined in section 5.3 of this chapter). Despite the PPP contracts appearing to provide ample means of ensuring accountability to the Contracts Management Branch and to the OCSC through contractually-based monitoring arrangements to verify compliance with a range of requirements included in the contracts (VAGO, para. 7.61), poor contractual specification hindered the management and control of some critical performance outcomes, as outlined below.

#### ***5.5.1 Achievement of financial VFM***

From the perspective of the achievement of financial VFM, Audit Review (p. 18) confirms that the three pre-2000 PPP prisons were constructed for 20 percent less than the benchmark cost. Despite criticisms of the benchmark calculations, Audit Review (p. 18) concluded that the pre-2000 prisons had been good financial deals for the state. The Victorian auditor-general (VAGO, 1996, para. 8.88 – 8.106) indicated that projected operating savings over the lives of the three pre-2000 prisons were in the order of \$16m (Deer Park), \$157m (Fulham) and \$62m (Port Phillip). The 1999 performance audit into the implementation of NPP compared three similar publicly-operated prisons with the three PPP prisons (VAGO, para. 7.88). It indicates that average daily operating costs at the private facilities were significantly less than those in the comparable prisons run by CORE<sup>29</sup>. Audit Review confirms that daily costs

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<sup>29</sup> VAGO's assessment has not been collaborated by Audit Review (p. 49), which suggests the opposite. The difference in these conclusions appears to be related to the basis of comparison. VAGO

were trending down at the private prisons (possibly due to the effects of new building design changes (Spackman, 2002) or management and technological innovations (Maguire and Malinovitch, 2004)). Nevertheless, VAGO, Kirby and Audit Review agree that there were difficulties (due to, for example, prisoner mix, numbers, and facility design) in comparing costs of the publicly and privately managed prisons, and that such comparisons may not be reliable. Information about cost savings relating to the post-2000 PPPs is not publicly available.

### *5.5.2 Achievement of non-financial VFM*

In relation to the achievement of non-financial VFM (that is the modernisation of prison service delivery across the state to improve the treatment, housing, education and rehabilitation of prisoners), all three reports (VAGO, Kirby and Audit Review) indicate that although the private contractors encountered significant difficulties in performing to standards acceptable to the state, similar problems were also encountered in the state-run prisons.

The VAGO report examined the extent to which non-financial sector-wide modernisation objectives had been achieved. It found that a completely level playing field (between publicly and privately managed prisons) had not been created by 1999. The introduction of competition within the correctional services sector had been one of the primary objectives of NPP. However, VAGO noted differences in the contractual framework governing the public and private prisons, with the public prisons not being subject to the same degree of monitoring, or to reductions in payments through the lack of a performance linked fee. Nevertheless, Audit Review (p. 3) (confirming the assessment of the auditor-general in the VAGO report) noted that the presence of private operators had led to a form of “competition by comparison” which had helped to improve the management of prisons and the delivery of correctional services across the system, suggesting that some elements of the non-financial aspects of the NPP modernisation reforms had been achieved across the sector by 1999. Indeed, confirming the findings of Spackman (2002), the VAGO

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compared three ‘similar’ public prisons with the three PPP prisons. However, Audit Review compared the daily costs of all Victorian prisons with costs at the three PPP prisons. As Audit Review notes (p.19), the public cohort includes ‘open’ prisons which are generally less expensive to run (and would explain the relatively low daily costs of the public prisons) than the PPP prisons.

report acknowledged that the development of SDOs, the PMS and the benchmarking of PPP performance and costs against the costs of public provision in the pre-contracting stage had resulted in increased accountability of examined service public and private providers, and had the potential to further improve the quality of services across the system. The Audit Review and Kirby reports endorsed these findings and confirmed the difficulties facing the Department in implementing the NPP reforms across the system that had been identified in VAGO.

Although Kirby had significant concerns about the operations of Deer Park (which are elaborated on in OCSC and preceded its default), it nevertheless considered that a number of the programs and practices established at Fulham and Port Phillip deserved recognition. It acknowledged that Port Phillip is a particularly difficult prison to manage, given the profile of its prisoners<sup>30</sup>, and the substantial prisoner movements at that prison, commenting favourably on the introduction of quality program initiatives. It also is clear that Kirby regarded the management, programs and facilities at Fulham (an easier prison to manage than Port Phillip due to prisoner type and mix) as excellent.

Indeed, the Kirby review identified poor management (by the Department) of the corrections system at all levels, variable interpretations of case management, poor information management systems and the under-resourcing of the OCSC, as major problems in addition to those relating to inadequacies in the performance monitoring model, and in staff training and prisoner programs. Interestingly, for a review ostensibly into the management and operation of the three PPP prisons, the Kirby (p. 5) findings confirmed that some problems faced by the private operators were beyond their control:

When considering the performance of the State's prison system (both public and private prisons) it is important to recognise that the system's management is affected by a number of factors beyond the prisons' control. Changes to the law, law enforcement and sentencing policy, reflecting (as they may) changes in society and community expectations, have led to increasing prisoner numbers and rates of imprisonment. In turn, this has resulted in overcrowding in the State's prisons and a higher number of prisoner movements. Both these results give rise to significant additional difficulties for prison management.

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<sup>30</sup> Referred to as "the worst of the worst" by Departmental officials.

The Kirby report (Chapter 8) recognised that the systems-wide modernisation reform embodied in NPP was an ongoing process. Specifically, Kirby recommended the integration of the private and public prisons into one seamless system through changes to structural arrangements to ensure that the public prisons were subject to the same (or similar) management and control systems that applied to the privately managed prisons (as recommended by VAGO, Part 8). Furthermore, to support improved performance in all of the state's prisons, Kirby recommended the development of negotiated collaborative approaches (involving prisoners and custodial staff) to sharing information and designing and implementing programs for the security, safety and rehabilitation of prisoners.

The Kirby report recognised that additional modernisation reform was required to meet NPP objectives, and that such outcomes may depend on the adoption of a very different management model to that espoused by TCE and agency theory. These theories are premised on the assumption that increased competition and contractually-based service specification, incentive and reward and monitoring systems are capable of driving behavioural change. Kirby recommended a series of quality reviews to comprehensively evaluate the overall performance of each individual prison, including the quality of its management and the effectiveness of its correctional services in relation to individual prisoners and their rehabilitation.

Following the Kirby report, in 2001 the Department adopted the Corrections Long Term Management Strategy encompassing further reforms to the delivery of correctional services in Victoria (Graffam et al, 2005), which included attempts to reduce re-offending rates. Graffam et al (2005, pp. 40-41) provide an indication of the change in management culture that these reforms entailed:

The program model calls for a high degree of interaction among stakeholder groups. The model suggests collaboration between employment consultants and Corrections Victoria location personnel in relation to referrals, registrations, client progress, and outcomes. Clients are expected to maintain contact and communicate with both employment consultants and Corrections staff [including those at Fulham, which participated in the pilot program] ... Provider managers and employment consultants are expected to interact with relevant service providers in relation to advocacy and referrals to other needed services.

Subsequent performance audit reports into aspects of the 2001 reforms (VAGO, 2003; a) indicate that, as envisaged by Kirby (p. 107), reform to the prison system is an organic collaborative and negotiated process that continues to change as new needs are identified. Although these policies were implemented with extensive staff consultation and a strategic approach to managing the change process, the auditor-general's initial review of their implementation (VAGO, 2003) found (over a year into the reform process) that the Department had failed to manage the change process effectively, including a failure to implement the policies strategically. However, later Department-commissioned reports (Birgden and McLachlan, 2004 and Graffam et al, 2005) suggest that these reforms were beginning to achieve their desired outcomes.

Indeed, by 2007 the auditor-general reported (VAGO, 2007a) that considerable progress had been made. Offender management and monitoring practice in Victoria's prisons has improved, and progress is being made towards ensuring that all eligible prisoners receive a formal risk and needs assessment. Rehabilitation programs addressing offending behaviour have been fully developed and partially implemented<sup>31</sup>. Of particular interest to the concerns of this thesis, VAGO (2007a) noted that reforms have been implemented on a systems-wide basis. The VAGO (2007a) report confirms that the introduction of the reforms to reduce prisoner re-offending has been successful (with re-offending falling from 42.5 percent in 2001-2 to 36.5 percent in 2005-6 (VAGO, 2007a, p. 19)). It indicates that this success has been achieved through inclusive change management strategies that actively encourage prison management and custodial staff involvement in devising and implementing the 2001 reforms (VAGO, 2007a, p. 26), which Birgden and McLachlan (2004) confirm have been supported by additional funding.

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<sup>31</sup> VAGO (2007a) notes that although considerable progress had occurred in relation to the re-offending reforms has been made, there are still some outstanding implementation issues.

## 5.6 Reflective conclusion and chapter summary

In conjunction with Chapter 4, the purpose of Chapter 5 has been to investigate the second aim of this thesis: *to analyse PPPs and their changing role as a modern procurement technology*. By way of establishing the context, Chapter 4, which focussed on the pre-contracting stage, presented empirical evidence about the incidence, cost and type of Australian PPPs, and identified changes to the features of the pre- and post-2000 PPP model of interest to this thesis. Chapter 4 addressed the second aim of the thesis through an analysis of PPP policies over the period 1991-2007. This analysis was supported by an investigation of representative pre- and post-2000 hospital contracts. Also, a case study of the failure of the pre-2000 Latrobe PPP provided insights into the failure of pre-contracting processes and procedures to achieve project objectives.

Chapter 5 has investigated how PPP contracts have been used to manage and control the PPP relationship to achieve project objectives in the execution stage. Examination of two contracts (and other documentation) representative of five Victorian PPP prison projects has revealed that the pre-2000 prisons had significant financial and non-financial modernisation objectives. By 2000, the achievement of the 1993 NPP modernisation objectives was debatable. VAGO, Audit Review, Kirby and OCSC reveal that two of the pre-2000 PPP prisons had significant ongoing problems in prisoner management and in achieving performance levels stipulated in contracts, some of which may be ongoing. Arguably, however, the Department has changed its approach to implementing ongoing modernisation reform in the post-2000 period, resulting in the successful implementation of the 2001 reducing re-offending reforms (Birgden and McLachlan, 2004; Graffam et al, 2005; VAGO, 2007a).

### 5.6.1 Negotiating and managing change

In re-engaging with *Paper 4* in the course of completing of this thesis, section 5.2 of this chapter has highlighted concerns about aspects of the analysis of the contracting literature in *section 2* of *Paper 4* which affect aspects of the *Paper 4 section 6* analysis.

The nexus between the TCE concept of elastic contracting and relational contracting outlined in the *Paper 4* literature review (see, *Paper 4*, p. 38) has been reworked in section 5.2 of this chapter. Elastic contracting is a TCE concept that refers to *ex-post* control devices embedded in contracts to control costs associated with the resolution of uncertainty. TCE suggests that contractual parties engage in gap-filling in order to overcome the inevitable failure of contracts to perfectly specify all aspects of the relationship. Also, contractually-based mechanisms (such as material adverse effects and dispute and default regimes) facilitate the filling of contractual gaps.

Several studies (such as Dekker (2004), Tomkins (2001) and Van der Meer-Kooistra and Vosselman (2000), and (in a PPP context), Broadbent et al (2003a; 2004a) and Froud (2003)) have questioned the adequacy of TCE to explain long-term hybrid contracting. This literature questions the agency role of contracts, rejecting the disciplinary role ascribed to contractually-based mechanisms such as performance, payment and incentive regimes by TCE. Instead, the need to negotiate a mutually satisfactory interpretation of what these mechanisms mean, and how they are to be implemented in practice, is said to develop goodwill trust, although this outcome is not inevitable (Tomkins, 2001). Goodwill trust and relational contracting develop from relationships built on negotiation and collaboration. From this perspective the contract (and the negotiations preceding it) is merely the starting point from which parties will determine how the relationship is to be managed and controlled. Also, the choice of partner is crucial to the development of goodwill trust, the foundation of relational contracting (Broadbent et al, 2003a; 2004a; Dekker, 2004; Tomkins, 2001).

Evidence presented in this chapter and in *Paper 4* in relation to the ‘success’ of the pre- and post-2000 contracts to effectively promote the management of change required in the modernisation process is mixed. It is clear that the post-2000 contracts contain more formal mechanisms (such as the material adverse effects regime and flexibility to alter the SDO regime) than the pre-2000 contracts. However, a lack of publicly disclosed information makes it impossible to determine the success (or otherwise) of these mechanisms in fostering the management of change.

However, it is argued in *section 6* of *Paper 4* that there is evidence to suggest that the pre-2000 contracts have, to a limited extent, facilitated the successful management of

modernisation change. Although the first recontracting process in 2003 resulted in some changes to the SDOs outlined in *Table 3 of Paper 4*, the failure of the revised performance indicators to capture basic elements of the qualitative service standards relating to prisoner treatment, housing, education and rehabilitation established in the PMS suggests that contractual limitations constrained further reforms. In addition, the Department's willingness to extend the 2006 recontracting period by six months in order to secure a mutually-acceptable outcome at one of the prisons is further evidence of the difficulties it faces in negotiating and managing change within the parameters established in the contracts. It also indicates departmental reluctance to use the disciplinary mechanisms in the contract to 'solve' the problem by terminating the contract.

The failure of the Department to remedy the problems at Deer Park is the most glaring indication of the failure of the pre-2000 contracts to provide a workable framework within which disputes could be successfully resolved. It has been argued in *section 6 of Paper 4* that there are indications that the government overlooked early teething problems (at Deer Park and Port Phillip) in order to give contractors time to overcome difficulties without incurring penalties. It is argued in *section 6 of Paper 4* that such decisions indicate willingness to promote goodwill. However, the problems outlined in the OCSC report into the Deer Park failure are also a catalogue of the absence of goodwill trust. Arguably, the Department was also forced to recognise that some of the problems facing contractors were the result of events outside their control (such as changes in prisoner mix, numbers and profile), and that others had been caused the Department itself (for example, the decision to transfer all high-security prisoners to Port Phillip on commissioning with no allowance for prisoners to become gradually accustomed to the vastly different custodial style that Port Phillip represented). Kirby indicates that this decision had a number of unfortunate repercussions on prisoner behaviour, resulting in difficulties for custodial staff and management. Accordingly, it cannot be categorically stated that be the framing of the pre-2000 contracts and contractor recalcitrance were the sole contributors to ongoing difficulties in the first five years of at least two of the three PPP prisons. In relation to Deer Park, OCSC, Kirby and VAGO (2001) also suggest that poor contractor selection (Dekker, 2004) contributed to the irreparable breakdown in relationships and trust within the prison, and between the contractor and the government.

The strongest evidence that the pre-2000 contracts are capable of engendering the development of goodwill trust and of relational contracting is provided by the largely-successful implementation of the 2001 reforms aimed at reducing re-offending. VAGO (2007a) states that this success has been achieved through inclusive change management strategies that actively encourage prison management and custodial staff involvement in devising and implementing reform (VAGO, 2007a, p. 26). However, it would be a mistake to assume that the goodwill underpinning the successful implementation of the 2001 reforms has spread to all areas of interaction between the government and PPP contractors. Indeed, the problems associated with renegotiating recontracting arrangements in 2006 indicate that difficulties remain, at least in relation to one of the remaining two PPP prisons.

In summary, it appears that TCE theory has guided the Victorian government's approach to PPP contracting and explains contracting practices in the Victorian PPP setting. Nevertheless, it would appear from the analysis above that the 'alternative' contracting literature that rejects TCE-based explanations of long-term contracting in hybrid relationships has greater power to explain how the pre-2000 PPP contracts have been used to manage and control the PPP relationship and achieve modernisation objectives more recently. The evidence presented here, which covers an eleven-year period, suggests that despite the rigidity of their approach to risk transfer, the pre-2000 contracts have the capacity to foster goodwill and relational contracting in the special case of the implementation of the 2001 reducing re-offending reforms. In this case, the combative TCE-based arrangements were supplemented (financially and materially) by a more consensual approach that appears to have been successful in fostering change at all levels of the correctional services system. Evidence presented in this thesis (and by Broadbent et al, 2003a) challenges Froud's (2003) conceptually-based analysis that PPP contracting arrangements restrict the ability of governments to address uncertainties and respond to changes in a dynamic social, political, technological and/or economic context.

### 5.6.2 Achievement of financial and non-financial VFM objectives: pre-2000 contracts

The evidence presented in this chapter confirms that understandings of financial and non-financial VFM are not fixed, but that these are mutable concepts given meaning within a specific context and time in response to a dynamic changing context.

The literature implies that there has been little attempt by governments to evaluate whether required risk transfer (essential to achieve VFM) has eventuated in the execution stage (Edwards et al, 2004). For instance, Broadbent et al (2003a, p. 190), in their study of two NHS PFI projects, observed that the implicit monitoring of VFM occurs through the contractually-based performance monitoring mechanisms. In that particular UK case, post-project evaluation only extended to evaluation of build quality. However, there is evidence that financial VFM is monitored in Victoria. VAGO and Audit Review confirm PPP construction costs were lower than comparable public procurement costs, and that financial VFM is evaluated by comparing daily per-prisoner costs at comparative prisons (with all the difficulties that such a comparison entails). The financial VFM effects of changes to systems-level funding or to PPP-specific funding would appear to be captured (albeit crudely) in these statistics, providing that there is a reasonable basis for comparison.

It has been argued in *Paper 4* and in this chapter that, contrary to assertions in the literature (see, for, instance, Froud, 2003) the pre-2000 PPPs have far-reaching non-financial VFM objectives. The failure of Deer Park indicates, in that arrangement at least, that these objectives were not achieved, confirming that *ex-post* realisations of risk management and VFM may differ significantly from *ex-ante* intentions, which is highlighted in the case of PPP failure (Edwards and Shaoul, 2003; English and Walker, 2004). However, the early problems at Deer Park and Port Phillip were the catalyst for a number of reports (VAGO; Audit Review; Kirby; OCSC) into the operation of pre-2000 PPPs and the achievement of their changing non-financial VFM objectives, which were also extensively evaluated by the Department (Graffam et al, 2005; Birgden and McLachlan, 2004; VAGO, 2003; 2007a). Collectively, these reports indicate that a number of radical sector-wide modernisation objectives (including some that were not envisaged in 1993 when the NPP was initially devised) have been achieved, and that the pre-2000 PPPs have been integral to this

achievement despite the early teething problems reported in VAGO, Audit Review and Kirby. The empirical findings in *Paper 4* and this chapter are diametrically opposed to the view (proposed by Flinders (2005) in a conceptual analysis) that PPPs represent a 'Faustian' bargain in which short-term gains may be outweighed by longer-term problems.

Indeed, Broadbent et al (2008) note that determining whether PPP contracts are VFM (and cater effectively for unanticipated events) can only be proved empirically over the duration of the contract. The empirical evidence presented in this thesis appears to challenge conclusions in the literature that PPPs are not VFM (see, for instance, Andrew, 2007; Edwards et al, 2004; Pollock et al 2005; Pollock and Price, 2004; Shaoul, 2005a; b), and that the non-financial aspects of VFM (such as service quality) are of little interest to governments (Andrew, 2007).

As to questions of whether PPPs evaporate, magnify or transfer the total amount of risk (Heald, 2003), the empirical evidence presented in Chapter 5 and *Paper 4* suggests that although PPP contracts apparently establish an agreed approach to risk management, risk cannot be defined and measured as if it were static. Indeed, the evidence suggests that at different times and in different circumstances, elements of project risk may evaporate (as indicated in the implementation of the 2001 reforms), change (as suggested by the difficulties associated with the 2006 recontracting process), or be magnified (when performance is unsatisfactory and PPPs fail). This analysis also confirms that all risks associated with PPP projects can never be transferred to private contractors. Froud's (2003) question about whether VFM is achievable over the life of PPP projects can only be answered by empirical studies (Broadbent et al, 2003a; 2004b) because the unanticipated effects of change and uncertainty over PPP life on VFM is determined not only by contractual arrangements, but also by how the partners react to unexpected events, and whether or not sufficient goodwill trust has been developed to support relational contracting that facilitates finding solutions that are acceptable to all stakeholders.

As noted in Chapter 2, data sources are shaped by the political context in which they are produced, and by the cultural and ideological assumptions that lie behind them (Scott, 1990, p. 60). The reports examined in this chapter implicitly take as given the

government's decision to introduce privately managed prisons into Victoria's correctional services system. Accordingly, their starting point is not to critique policy or the NIE-based method of its implementation, but to examine outcomes within the context established by policy, and to provide recommendations for improvement within that context. As noted by Laughlin (1995; 2004) and Andrew (2007), choices regarding data sources and how data are analysed are subjective and determined by the ontology of the investigator.

One caveat: as noted by Andon (2007) and Lambert and Lapsley (2006), the PPP literature is characterised by the strongly-delineated research approach of authors which pervades their analysis of PPPs. Accordingly, whether the evidence presented here convinces (or fails to convince) readers may depend on the reader's perceptions of PPPs, and of the choice, reliability and interpretation of the data in the documents cited in *Paper 4* and in this chapter. The documents cited in *Paper 4* and in this chapter differ markedly, for instance, from the data choices made and the critical perspective adopted, for instance, by Andrew (2007), Shaoul (2005a) and Cooper and Taylor (2005).

The research into hybrid arrangements in the private-sector setting (see, for example, Busco et al, 2006; Cooper and Slagmulder, 2004; Dekker, 2004; Mouritsen and Thane, 2006; Tomkins, 2001; Van der Meer-Kooistra and Vosselman, 2000) draws on case-based field research to provide rich empirical data on the changing nature of the investigated relationships (which are considerably less complex than the relationships managed and controlled by the pre-2000 PPP contracts investigated in this thesis), and the role of contracts in their management. These studies, and the biases in the PPP literature, suggest that field research in the PPP setting could also enrich our understanding of these complex relationships and the use of contracts in practice to control and manage them over time and place. As empirically-based investigation of the PPP contracting practices has been largely neglected in the literature, this longitudinal study contributes significantly to our understanding of how risk and uncertainty have been managed and controlled in complex PPP arrangements that include the delivery of core correctional services in privately owned and operated prisons. This study also contributes to our understanding of how PPPs have been used to modernise the design and construction of prisons, prison management

practices, and the treatment of prisoners within the politically-sensitive correctional services sector.



## CHAPTER 6

### Modernisation and the Changing Characteristics of Auditor-General Oversight of PPPs

#### 6.1 Introduction

Addressing the third aim of this research, *to analyse the oversight of PPPs by Australian auditors-general*, is the purpose of *Paper 5* and Chapter 6. Auditors-general have unique independence from executive governments granted in legislation that enables them to determine the focus and scope of their investigations. Also, auditors-general have the unrestricted access to government documents and public officials necessary to undertake rigorous, substantive audit of PPPs (English, 2003; English and Guthrie, 2001; Heald, 2003). The primary purpose of Chapter 6 is to introduce and reflect on *Paper 5* findings, as no additional research has been undertaken to elucidate or augment *Paper 5* findings.

*Paper 5, Table 1: Overview of the Financial Value, Category and Auditor-General Oversight of PPP Activity in Australian Jurisdictions as at December 2005* highlights that only ten performance audits of 16 PPP projects (out of a total of 124 identified projects) have been undertaken by Australian auditors-general. Two of these relate to six Victorian PPPs<sup>32</sup>. Given the relative lack of scrutiny of this economically-significant and contentious procurement technology, the purpose of *Paper 5* is to investigate the characteristics of the oversight provided in all of the performance audits identified in *Paper 5 Table 1*, and to provide insights into the approach to the conduct of PPP performance audits as indicated in audit reports.

Chapter 6 is organised as follows. Section 6.2 summarises and adds to the literature review in *Paper 5*. Section 6.3 outlines the *Paper 5* research approach and method. Section 6.4 presents and reflects on *Paper 5* results. Section 6.5 concludes the chapter.

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<sup>32</sup> *Table 1* in *Paper 5* is virtually identical to *Table 1* in *Paper 2* (which was analysed in Chapter 4). The figures in *Table 1, Paper 5* differ slightly from those in *Table 1, Paper 2* due to timing differences.

## 6.2 Literature review: performance audit and PPP oversight by auditors-general

Performance audit is viewed as a technology developed to facilitate the transformation of the public sector by investigating and reporting on the effectiveness of the implementation of modernisation (Arnaboldi and Lapsley, 2008; Pollitt et al, 1999). Originally, performance audit focused on the need to provide assurance of the achievement of the administrative objectives of modernisation: the economy, efficiency, and effectiveness of the management of government programs (Guthrie and Parker, 1999; Hamburger, 1989). Despite agreement about its origins (English and Skaerbaek, 2007; Pollitt et al, 1999), the modernisation role of performance audit remains contested in the audit literature (Arnaboldi and Lapsley, 2008; Bowerman et al, 2000; Gendron et al, 2001; Power, 1999), and also in the PPP literature (Broadbent and Laughlin, 2003; Edwards and Shaoul, 2003; Edwards et al, 2004; Froud and Shaoul, 2001; Pollock and Price, 2004). More recently, English and Skaerbaek (2007, p. 239) have identified an interrelationship and a mutual co-dependency between modernisation and performance audit. Reflecting Meyer (1998), they view performance audit as a control mechanism, a framing device in shaping modernisation reform, and also as an integral component of the transformation of the public sector.

Just as modernisation was the rationale for performance audit and shaped its initial concerns and boundaries, performance audit has also been shaped by the changing demands of modernisation. Auditors-general have increasingly had to justify the performance of their own offices (English, 2003; Gendron et al, 2001), which has affected the relationship between auditors-general and the executive arm of government and the parliament on one hand, and between auditors-general and audited bodies on the other. Evidence that auditors-general have publicly championed significant modernisation reform is provided by Skaerbaek and Thorbjornsen (2007), who imply that the National Danish Audit Office may compromise its own reputation should the ambitious reforms (that it has largely driven) to the financial management system in the Danish Defence Force fail to achieve their objectives, or result in unacceptable (and unforeseen) consequences down the track. Irrespective of the eventual outcome, the independence of the National Danish Audit Office appears to have been compromised.

Also, Pallot (2003) has confirmed that performance audit has altered understandings of public accountability and the oversight role of state audit by raising the profile of the quality of program management. At the level of practice, auditing for effectiveness and ‘good management’ demands the investigation of outcomes (including those produced by private-sector contractors), and requires the use of independent evaluation criteria (Pollitt et al, 1999, p. 9). The controversy surrounding the audit of effectiveness and good management indicates that the meaning of these terms is context-dependent and mutable over time, and that conclusions about program implementation and achievements are contestable (Guthrie and Parker, 1999).

Adopting the Pollitt et al (1999) classification of performance audit into two types—systems-based and substantive—*Paper 5* characterises these classifications on the basis of the degree of independent investigation (as indicated in audit reports) that appears to have shaped the focus, scope, conduct and reporting of PPP audit. Pollitt et al (1999) suggest that a measure of the difference between these audit types is the choice of best practice framework against which observed practice is compared. Others (such as Guthrie and Parker, 1999; Hamburger, 1989) have suggested that the approach of individual auditors-general is correlated with systems-based and substantive auditing.

Systems-based audits essentially check adherence to procedures mandated by auditors-general themselves (Gendron et al, 2001) or procedures mandated by governments (such as PPP policies (Pollitt et al, 1999)). Such audits are premised on the assumption that government policy and associated processes and procedures represent good management practice and are, therefore, the appropriate criteria against which to audit performance.

An element of substantive audit does involve checking adherence to policy-mandated procedures and processes. However, substantive audits move beyond this narrow (and largely uncontroversial) framework to investigate the effectiveness of policy implementation against externally-derived criteria. Such a comparison can provide an indication of whether appropriate good management practices have been implemented, and program effectiveness (as determined by government policy) has

been achieved. The independent stance required for substantive auditing can result in performance audit appearing to cross the boundary between investigating the effectiveness of policy implementation and investigating the effectiveness of policies *per se* (Guthrie, 1989). This renders performance audit contentious and potentially costly for governments and for auditors-general (English, 2003) as such examinations are technically beyond their mandate (Pollitt et al, 1999).

The UK-based literature reveals a number of issues and concerns that relate to PPP performance audits undertaken by the UK's National Audit Office [NAO]<sup>33</sup> that appear to suggest that, for the most part, some scholars regard PPP audit as systems-based rather than substantive. For instance, researchers have called for in-depth investigation of the achievement of anticipated risk transfer and value for money [VFM], for example by an analysis of spending in the execution stage to determine whether it is in accordance with contractual agreements. This type of analysis is deemed critical to determining whether PPPs have achieved their objectives (Edwards et al, 2004; Pollock and Price, 2004). Also, Edwards et al (2004) have called for investigations into the decision to consider the PPP option in the light of the costs and benefits of the conventional outsourcing option. Broadbent et al (2004b) have suggested that NAO audits are too narrowly focused on the financial aspects of VFM at the expense of non-financial aspects. Shaoul (2005a) has criticised the failure to systematically compile evidence as to how a PPP is operating in practice. Pollock and Price (2004) indicate that there is a need to investigate the changes to risk transfer and risk premia. Broadbent and Laughlin (2003) confirm that some systems-wide NAO audits have played a role in legitimating the UK government's PPP policies and associated implementation technologies. The critical UK PPP literature and the Australian performance audit literature leave an impression (challenged by Pollitt et al (1999) in the UK context) that the bulk of performance auditing in the PPP context is not substantive, as it is characterised by investigating adherence to policies and mandated procedures and processes, or in elucidating how such processes should be implemented (Broadbent and Laughlin, 2003).

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<sup>33</sup> VFM Audit is the term used by the NAO to denote a performance audit (Sharma, 2007).

### 6.3 Research approach and method

It has been argued in Chapter 4 that PPP policies, and the procedures and processes mandated therein, provide the context in which the implementation of PPPs can be understood, analysed and audited (Broadbent et al, 2004b). *Paper 5 Table 2: Identification and Explanation of Procedures Outlined in PPP Steering Mechanisms* identifies and explains 11 key procedures mandated in the post-2000 Victorian PPP policies, further elucidating the analysis of PPP policies in Chapter 4. *Paper 5* contends that these 11 elements can be deemed to represent government-endorsed best practice performance audit criteria in an Australian PPP setting, and uses them to develop a framework to undertake a preliminary analysis of the focus, extent and characteristics of the ten audit reports. *Paper 5* indicates that the 11-element framework captures the focus of auditor-general investigations, even in audits undertaken in the pre-2000 period which predated the codification and extension of practice in the flurry of policy development in the post-2000 period. The findings of *Paper 5* indicate that there was broad auditor-general awareness and understanding of the key elements of PPP arrangements prior to their elucidation in the post-2000 policies; that Victorian post-2000 PPP polices are representative of Australia-wide approaches to PPP implementation; that there is broad consensus in approaches to performance audit practice in Australia; and that policies and mandated procedures and processes are used as best practice criteria in systems-based audits and in the systems-based elements of substantive audits.

Following Gendron et al (2001), the empirical data presented in *Paper 5* are derived from an examination of the identified PPP performance audit reports guided by the 11 key procedures identified in the framework explicated in *Table 2*, which are used to capture the extent and focus of the investigated audits. Three steps were undertaken in the empirical analysis of the data. First, the audit reports were read to determine which of the 11 elements are mentioned in each of the audit reports. Second, the reports were re-read to determine whether they are systems-based or substantive. Third, the primary impetus of the audit was ascertained in order to determine whether there were any correlations between substantive audit and auditor-general and controversy surrounding the audited project, a finding that is common in the early Australian performance audit literature (Hamburger, 1989). Results are reported in *Paper 5 Table 3: Performance Audits of Australian PPPs*. Following Peraekylae

(2005, p. 872) and Laughlin (1995; 2004), the audit reports were assumed to reflect the social practices of performance auditing, permitting interpretation of motives and events informed by insights from the literature.

#### 6.4 Empirical findings: performance audit of Australian PPPs

A number of findings can be drawn from the empirical evidence presented in *Paper 5*. Three primary findings are summarised below. These findings relate to: first, the extent and focus of Australian PPP performance audit; second, the classification of PPP audits as systems-based or substantive; and third, investigations of risk management and the achievement of VFM in the examined performance audits.

##### 6.4.1 The extent and focus of Australian PPP performance audits

Findings relating to the first issue are summarised in *Paper 5 Table 3: Performance Audits of PPPs* (pp. 324-325) which confirms that no Australian state audit office appears to audit PPPs on an ongoing strategic basis. Analysis and discussion of the examined performance audits in *Paper 5* uses a coding system introduced in *Table 3*. To maintain consistency in this dissertation, the *Paper 5* coding system ([PA1], [PA2]... [PA9], [PA10]) is not followed in Chapter 6 analysis and discussion of *Paper 5* findings. Where specific audit reports are referred to in the discussion that follows they will be referred to as in the *Audit report reference* row in *Table 3*. For example PA9 is the code for VAGO (1999), which has been extensively discussed in Chapter 5. In Chapter 6 discussion it will be referred to as VAGO (1999).

Turning back to *Table 3* in *Paper 5*, it is interesting to note that the most complex and controversial PPPs—the pre-2000 prisons and hospitals that include the direct provision of core public services to citizens by private operators (the three audits identified in *Table 3* as *Health* in WA and *Correctional* in Victoria)—have been relatively under-investigated by Australia's auditors-general. Toll roads have been the most investigated category of PPP, particularly in NSW, where six road projects have been investigated in five different reports. Most of the performance audits have been undertaken in NSW, followed by Victoria and Western Australia. Victoria and Western Australia are the only two jurisdictions whose auditors-general have

investigated outcomes in the execution stage of pre-2000 PPP prisons and hospitals respectively.

*Paper 5 Table 3* also reveals that risk allocation has received the most audit attention, followed by the public sector comparator [PSC] or other benchmark technology used to cost the public procurement option. As indicated in Chapter 4, and confirmed in the literature, these two pre-contracting appraisal technologies are at the heart of the determination and achievement of financial VFM, and provide the cost-based rationale to take the PPP option. Also, because of the unanticipated effects of uncertainty on financial and non-financial VFM achievement in the execution stage, substantive auditing of how effectively the state is able to manage and control performance outcomes through its contracting arrangements is also necessary. Accordingly, *Paper 5's* investigation of PPP performance audit is important to determining the extent to which auditors-general bring a critical independent approach to the evaluation of PPP outcomes.

Eight of the ten performance audits reported in *Table 3* focus on the pre-contracting stage, confirming that following mandated processes and procedures remains a central control element in the modern public sector because it is seen to provide some level of assurance that outputs and outcomes are delivered as intended (Jacobs et al, 2007; Modell et al, 2007). *Paper 5* results confirm that, for similar reasons, examining adherence to the dictates of policy is also a critical element of performance auditing. These findings are interesting because they suggest that, despite the change in focus from inputs to outputs and outcomes, and calls for devolved decision-making and responsibility (all of which are characteristics of modernisation reform) the modern public sector has nevertheless retained its essentially bureaucratic nature in which top-down central control remains dominant (as predicted by Jacobs et al (2007) and Modell et al (2007)).

Although it has been suggested that the duration of PPP arrangements explains the relative lack of performance auditing of the execution stage in the UK context (Broadbent et al, 2004a), it is clear from the performance audit of the implementation of the pre-2000 New Prisons Policy [NPP] reported in VAGO (1999) (which has been analysed in Chapter 5), that substantive auditing of the execution stage can occur

within two years of the commissioning of the asset and the commencement of operations. Also, *Paper 5* indicates that, contrary to some assertions (Edwards and Shaoul, 2003; Edwards et al, 2004; Pollock and Price, 2004), substantive auditing of the pre-contracting stage is also possible.

#### *6.4.2 Substantive v systems-based auditing and its linkage with auditors-general*

The second issue investigated in *Paper 5* is what audit reports reveal about the conduct of the audits. *Paper 5, Table 3* reveals that four of the ten performance audits have been categorised as substantive, and six as systems-based. The basis on which this categorisation was made is explained on p. 326 of *Paper 5*. Quotations from one systems-based and all substantive reports are provided in *Paper 5* to attest to the differences in approach between these classifications. Furthermore, the extensive analysis of VAGO (1999) in Chapter 5 provides further evidence of the qualities of substantive auditing, and substantiates the analysis of the differences between systems-based and substantive auditing that is presented in *Paper 5*. The analysis in Chapter 5 confirms that VAGO (1999) provides sufficient in-depth analysis and assessment (subsequently corroborated by Audit Review, 2000b and Kirby, 2000) to support the systems-based/substantive analysis that is presented in *Paper 5*.

Also, *Paper 5* analysis indicates that six out of ten PPP performance audits appear to have been conducted as a result of controversy surrounding the audit (with the primary impetus identified as public concern/parliament), and that four audits were undertaken on new initiatives. It is interesting to note that VAGO (2005) (which was identified as systems-based and analysed in the body of *Paper 5* and coded in *Table 3* as PA6] was actually conducted after the commencement of the execution stage, although the audit neglected to examine whether or not VFM had been achieved as anticipated. *Table 3* reveals that five audits were undertaken in the pre-2000 period; two audit reports are dated 2000 (which could be designated the cross-over period), and three audits were undertaken in the post-2000 period. As suggested in the literature, it would appear from the empirical evidence presented in *Paper 5* that the characteristics of a performance audit are most closely correlated to particular auditors-general (Guthrie and Parker, 1999; Hamburger, 1989). Three of the

substantive audits were undertaken by a NSW auditor-general, and one by a Victorian auditor-general. All substantive audits occurred during the pre-2000 period, and all are associated either with public concern, or a formal request that an audit be conducted from the parliament.

The audits identified in *Paper 5* as substantive provide an indication of why performance audit has been challenged by governments (English, 2003), and the demarcation between auditing policy and its implementation is contested. *Paper 5* confirms that auditors-general whose reports are classified as substantive are more likely to be seen to challenge this barrier, and also to investigate the audited program within a wider policy context. However, *Paper 5* also indicates that care needs to be taken in classifying audits as systems-based, as the apparently bland language in audit reports may be quite deliberate (as confirmed by Sharma, 2007) to promote co-operation with audited bodies, and the probability of acceptance of recommendations.

#### ***6.4.3 Risk management and the achievement of financial VFM***

The third issue investigated in *Paper 5* is the extent to which Australian auditors-general have investigated risk management and the achievement of VFM in audited PPP projects. *Paper 5* indicates that three audits have investigated pre-contracting procedures and processes and the achievement of anticipated risk transfer and financial VFM in the execution stage in two pre-2000 PPPs delivering core correctional and clinical services. (These are the three audits identified as *PA7*, *PA8* and *PA9* in *Table 3*.) A direction from the government (which was disputed by the auditor-general) in the substantive performance audit of the PPP prisons (VAGO, 1999) forced the omission of certain information in the audit report that related to the cost benchmarks established to assess bids submitted by prospective tenderers during the bidding and selection process for each of the private prisons, as well as the actual cost bid submitted by each successful tenderer; payments made to private operators for the periodic delivery of prison services; and amounts deducted to date from payments to operators for poor performance or non-achievement of outcomes specified in contractual conditions (VAGO, 1999, p. viii). However, VAGO 1999 confirms that average per-prisoner daily costs were lower in privately managed prisons than in publicly managed prisons.

In auditing the implementation of the 1993 NPP, VAGO (1999) confirms that the concept of VFM in the PPP context is far more complex (see also Chapter 5 and the substantive NSW audits into the pre-contracting stage of toll roads) than may have been assumed in the literature (see, for instance, the call for the UK's NAO to audit non-financial aspects of VFM by Broadbent et al, 2004a). The Victorian audit examined the rights and physical wellbeing of prisoners, the rights of prisoners, prisoner training programs (designed to promote their rehabilitation and successful reparation back into the community), and the quality of training and development programs for custodial staff (see chapter headings VAGO, 1999, p. 33). The list of bodies assisting the auditor-general (VAGO, 1999, p. 35) provides an indication of the level of scrutiny facing the managers of large modern prisons, whether they are publicly or privately managed.

### 6.5 Chapter summary

*Paper 5* indicates that insufficient and perhaps inappropriate oversight of PPPs is provided by Australia's auditors-general. The overall amount of performance audit has fallen in the post-2000 period. Although it has been argued in *Paper 5* that substantive audit of the pre-contracting and the execution stages is necessary, it seems that the primary audit focus has been on the pre-contracting stage, leaving the assessment of achievement of anticipated VFM in the execution stage largely unaddressed. However, this conclusion should be seen in the light of the evaluation of the pre-2000 prisons undertaken by the department and the government.

The classification of performance audits as substantive or systems-based in *Paper 5* has indicated that there is a correlation between auditor-general and the type of audit conducted, suggesting that the approach to auditing PPPs could change as new auditors-general are appointed. Also, *Paper 5* shows that all of the audits classified as substantive occurred in the pre-2000 period. Additional research is required to understand whether this phenomenon is solely related to particular auditors-general or if, more worryingly, there has been a more subtle change in the approach to performance audit by Australia's auditors-general in general. Sharma (2007) suggests that VFM auditors (read performance auditors) in England work closely with the Public Accounts Committee [PAC] to bring to the public's attention to weaknesses in

public administration that need to be addressed by the government. Sharma's (2007) paper suggests that the bland language in VFM reports is deliberate and allows the PAC more scope to more theatrically highlight problems and grill public officials. However, as it is uncertain whether Australian auditors-general and PACs work in the manner described by Sharma (2007). More research into state audit in Australia, its on-the-ground achievements, and the role of various PACs in monitoring PPP performance audits and implementation of audit recommendations, is required.

Clearly, perceptions that recent performance audit of Australian PPPs may be systems-based rather than substantive pose problems for the reputation of auditors-general, and raises questions about their supposed independence from executive government. Heald (2003) has argued that auditors-general are the only source of independent oversight of PPPs with unfettered access to government documents and officials, and with the right to determine how and when to conduct performance audits. In addition, audit reports are publicly available (unlike much of the evaluation undertaken by government departments). Accordingly, the nature and conduct of performance audit is critical to effective parliamentary oversight of executive governments and the effectiveness (or lack of effectiveness) of parliamentary scrutiny of the implementation of major government policies (including PPPs). The evidence presented in *Paper 5* suggests that Australian auditors-general have considerable work to do in relation to the oversight of PPPs. Indeed, the *concluding section* of *Paper 5* suggests that recently Parliamentary Accounts Committees have taken steps to fill the oversight role usually undertaken by auditors-general.

*Paper 5* (p. 332) raises the question of who provides independent assessment of PPPs in Australia. *Paper 5* notes that executive government (through their departments of treasury and finance) are the major PPP agenda setters and evaluators, implying that little independent internal examination of PPP outcomes is taking place. Chapter 4 confirmed that, aside from regular facilities management undertaken by departments that is overseen on an exceptions basis by the Department of Treasury and Finance, PPPs have remained largely unassessed at central government level where PPP policies are determined. The Gateway Review Process is designed to fill this gap. Nevertheless, findings presented in Chapter 5 suggest that the Victorian government has commissioned some *ad hoc* evaluation of PPP projects, and that the Department

of Human Services (at least) has undertaken significant ongoing evaluation of PPP outcomes through the work of the OCSC and also through reports commissioned to evaluate program implementation (such as the 2002 reducing re-offending reforms). Unfortunately, as noted in Chapter 4, these internal reports are either confidential, or difficult to access.

## CHAPTER 7

### Conclusion

#### 7.1 Introduction

This thesis has three aims, which were outlined in Chapter 1. The first aim was to analyse the characteristics of modernisation in the Australian context. The second aim was to analyse PPPs and their changing role as a modern procurement technology. The third aim was to analyse the oversight of PPPs by Australian auditors-general.

The purpose of this concluding chapter is to summarise the empirical findings arising from the investigation of the three aims of this research, to reflect on the source and nature of differences (if any) between the empirical evidence provided in this thesis and findings in the literature, and to indicate its contribution. Reflecting the iterative reflexive process of theory development in the light of empirical findings, the analysis in this chapter summarises and draws together the major implications of the discussion and conclusions in each chapter.

This concluding chapter is organised as follows. Section 7.2 reviews the research approach. Section 7.3 reviews the motivation of the research. Section 7.4 summarises and reflects on the principal findings in relation to the three research aims. Section 7.5 presents policy implications of the empirical findings. Section 7.6 considers the limitations of this research and outlines future research directions.

#### 7.2 Research approach

As explicated in Chapter 2, this documentary-based study has been undertaken using the middle range thinking research approach developed by Laughlin (1995; 2004). Middle range thinking is congruent with Peraekylae's (2005) approach to textual analysis. Scott's (1990) observation that documentary sources are inevitably shaped by their political context and the ideological and cultural assumptions that underlie them is relevant to the analysis in this thesis, and resonates with Laughlin's (1995; 2004) acknowledgement of the subjectivity of the middle range approach.

Five published papers comprised the core of this ‘by publication’ PhD. However, in addition, each chapter reviewed relevant literature to establish the skeletal theory that underpins the investigation of the three aims. According to Laughlin (1995; 2004), there are three stages to the middle range approach. The first process is the *a priori* theorising (to develop the skeletal theory), which contextualises the research and provides some guidance as to the empirical points of interest and how to interact with them. The second stage is the empirical stage, which involves gathering the evidence and also reflecting on and modifying (where appropriate) the insights from the skeletal theory in the light of the findings. The third stage of the middle range process is the separate change dimension. As noted in Chapter 2, the change dimension remains under-explicated by Laughlin (1995; 2004). Laughlin suggests that it may involve questioning previous understandings of prior theory, revisions of prior theories, and/or contributing to policy debates.

However, middle range theorists acknowledge that while generalisations about the empirical reality are possible, they are not guaranteed to exist as observed, interpreted and theorised. The subjectivity of the research approach has an additional outcome. It may not be possible for researchers to engage uncontroversially with any of the three stages, giving rise, for instance, to debates as to the nature of modernisation and its achievements in the literature.

In the context of this thesis, the subjectivity (Andon, 2007; Lambert and Lapsley, 2006) of PPP research (including in this thesis) is addressed in Chapter 5, which raises the notion of possible biases in relation to data selection and its analysis. In this thesis, the Victorian government’s decision to introduce PPPs within a particular policy context is taken as a given. Following Laughlin (1995; 2004), choices concerning data selection and the interpretation of data are determined by the ontology of the investigator. The inherent subjectivity of this research approach is acknowledged as a potential limitation of this thesis.

### 7.3 Motivation

In the light of scepticism about the use of PPPs and their outcomes, the overriding objective of this thesis was to analyse the use of PPPs as a modern procurement

technology. PPPs are a product of policies and processes devised to modernise public services (Broadbent and Guthrie, 2008). The modernisation of public services over the past three decades has affected not only how services are procured and delivered (such as through PPPs), but also how they are managed and controlled by governments. Modernisation has also reshaped the role and conduct of state audit (English and Skaerbaek, 2007; Pollitt et al, 1999; Power, 1999).

The modernisation, PPP and performance audit literatures have questioned the nature of these reforms, their impacts and their achievements. Overall, many of these studies have concluded that modernisation has delivered less than promised. Much of the Australian PPP literature is critical of PPPs, suggesting that they fail to deliver VFM (Quiggin, 2004; Stanley and Hensher, 2004); result in wealth transfer (Walker, 2003); constrain future planning and expenditure (Quiggin, 2004); and that governments have not been held sufficiently accountable for their economic and social repercussions (Andrew, 2007; Watson, 2003; 2004). These critiques mirror those in the UK literature (English and Guthrie, 2003). The motivation for this research is found in many studies that have called for longitudinal investigations into the effects of modernisation in different times and in different nations (see, for instance, Broadbent et al, 2004b; Humphrey et al, 2005; Lapsley and Pong, 2000; Lapsley, 2001c; d).

In recognition that the modernisation of public services must be researched within national and institutional settings (Broadbent and Guthrie, 2008; Laughlin, 1995; 2004), this thesis has located its investigation of PPPs within the context of the modernisation reforms that have been implemented throughout the Australian public sector. As noted by Broadbent and Guthrie (2008), there are many similarities between the implementation of modernisation throughout the OECD world. Also, as Australian PPPs are similar to the PFI in the UK (Broadbent and Laughlin, 2004) and in Europe (Bult-Spiering and Dewulf, 2006), the findings in this thesis may be relevant in other national contexts.

#### **7.4 Findings and contribution**

The purpose of this section is to summarise empirical findings and conclusions arising from the investigation of the three research aims. Each of the aims is addressed in

turn. As noted previously, the following discussion and analysis reflects on the source and nature of similarities and differences (if any) between the empirical findings in this thesis and in the literature, and indicates the contributions of the research. In this manner the iterative reflexive process of skeletal theory development and review that occurred in Chapters 3, 4, 5 and 6 is summarised and conclusions drawn.

#### *7.4.1 Setting the theoretical context: overview of the international modernisation literature*

The literature reviewed in Chapter 2 indicates that modernisation in OECD nations (although context-specific and changing over time) can be characterised by a number of common factors, including the application of classical economic theories to the public-sector setting, and the use of private-sector derived technologies to justify, rationalise and drive public-sector transformation. In this thesis, it has been confirmed that new institutional economics [NIE] (Trebilcock, 1995), which embraces agency theory [AT] (English, 2005b), public choice theory [PCT] (Barton, 2001; English, 2005b) and transactions cost economics [TCE] (Williamson 1981; 1991; 2005), has been identified as the primary theoretical driver of modernisation and the source of its rationalisation. The NIE goal of replicating private-sector disciplines in the public sector has resulted in the use of a number of technologies to implement modernisation reforms (Guthrie et al, 2005; Olson et al, 1998). It has also been argued in this thesis that modernisation has affected the nature and role of state audit, most notably through the development of performance audit, with its associated aim of providing assurance as to the achievement of results (Pollitt et al, 1999).

Chapter 2 reviewed critiques of modernisation, including its focus on quantitative attributes that are most easily captured by accounting and management technologies. The use of these technologies can result in the invisibility of qualitative considerations (Bowerman, 1998) that are pertinent to the objectives of the PPPs of interest to this thesis. Newberry and Pallot (2005) have highlighted the potential for differences between stated and unstated modernisation objectives that may be concealed in technical developments. Chapter 2 also reviews literature relating to the nature of modernisation change in the public sector that suggests that modernisation

transformation may be evolutionary. The Chapter 2 literature review provides a framework to guide the empirical analysis undertaken in the thesis.

Findings relating to the three aims are outlined below.

#### ***7.4.2 The first aim: to analyse the characteristics of modernisation in the Australian public sector***

Chapter 3 confirmed that modernisation in the Australian context, as in other OECD nations, has been framed by NIE theories, and its implementation and rationalisation dominated by private-sector derived accounting and management technologies. Chapter 3 identified a number of concerns relating to the practical implementation of modernisation in the Australian public sector. These concerns (which are also relevant to PPPs) relate to the concepts and implementation of VFM, risk management, performance specification and monitoring, accounting and reporting, and transparency and accountability.

Although hard-edged neo-liberalism (Dunleavy and Hood, 1994) is the predominant modernisation paradigm, Chapter 3 signalled that network theory has also influenced aspects of the modernisation of public services in Australia. Network theory is an alternative approach to public services delivery that emphasises negotiation, cooperation and consensus between stakeholders to arrive at mutually-acceptable solutions to social problems. Table 3.1 of Chapter 3 outlined the key features of these different approaches to service delivery.

#### ***7.4.3 The second aim: to analyse PPPs and their changing role as a modern procurement technology***

The second aim of this thesis was addressed in Chapters 4 and 5. In terms of empirical investigation, Chapter 4 focused on the PPP pre-contracting stage and Chapter 5 on the execution stage.

### Findings: Chapter 4

Chapter 4 had a number of purposes. In order to establish the context within which the second aim was investigated, Chapter 4 established the economic importance of PPPs to the Australian economy, providing data about their incidence and nature on a jurisdictional basis. It also examined the PPP policy setting in Victoria and outlined the features of the PPP model of interest to this thesis, which includes the delivery of core social services such as clinical services to public hospital patients and correctional services to prisoners.

PPP policies over the period 1991-2007 were analysed in Chapter 4. This thesis contends that the establishment in 2000 of Partnerships Victoria [PV] within the Victorian Department of Treasury and Finance marked a turning point in PPP use in that state. It resulted, for the first time, in the development of a coherent statement of PPP objectives and detailed instructions of how these objectives are to be achieved. These policies reversed the earlier approach of transferring to the private-sector responsibility for the delivery of core and supporting services in PPPs. By reintroducing the public management of core services delivery, the post-2000 policies reduced the overall level of project and political risk associated with PPPs, making it easier for the state to manage and control the achievement of more limited modernisation objectives. Also, these post-2000 policies strengthened the control of executive government (through the Department of Treasury and Finance) over PPP decision-making at agency level.

As noted in Chapter 4, the post-2000 PPP policies reveal a growing reliance, in the pre-contracting stage, on complex accounting and management technologies to guide, aid and rationalise PPP decision-making processes, and to manage project risk to achieve espoused VFM objectives. Chapter 4 confirmed the continuing role of NIE in framing the post-2000 Victorian approach to PPPs. It noted the clarification of objectives in the post-2000 policies. The achievement of VFM became the paramount rationale for PPPs as the need to control state debt receded. Also, despite their NIE foundations, the post-2000 policies reveal a more flexible and pragmatic approach to the management and control of uncertainty and the partnership relationship in the all stages of project development and implementation. These changes in perspective were

confirmed through an examination of project objectives and risk transfer arrangements in the pre- and post-2000 hospital contracts in Chapter 4.

Establishing the context in which PPPs are contracted and operate is important for several reasons. First, the research approach adopted in this thesis stresses the need to understand the institutional context in which the empirical investigation is situated (Broadbent and Guthrie, 2008; Lapsley, 2001d; Laughlin, 1995; 2004; Modell et al, 2007). Second, PPP policies and relevant legislation establish the government's stated objectives, rationales and implementation strategies, enabling investigation of stated (and unstated) objectives and their achievement (Newberry and Pallot, 2005). Third, as auditors-general conduct performance audits within the context of the program objectives established in government policies, cognisance of the policy framework also facilitates analysis of PPP audits (Pollitt et al, 1999).

Chapter 4 confirmed that a number of themes and concerns relating to the pre-contracting stage dominate the literature. Debates concern the nature and purpose of PPPs (Broadbent and Laughlin, 1999) and the role of pre-contracting accounting and management technologies in achieving objectives. The complex interdependency between PPP objectives, the management of project risk, the meaning of VFM, and the calculation of the PSC; and controversy relating to 'official' explanations of their role, were raised in Chapter 4. As pre-contracting decision-making technologies (such as the PSC) are not available to public scrutiny, the outworking of these variables was examined from three perspectives: 'official' public explanations contained in policy documents; evidence from representative pre- and post-2000 hospital contacts; and insights from the case of a failed pre-2000 PPP hospital.

Chapter 4 revealed some tension in the objectives of the pre-2000 PPPs relating to their dual purpose: infrastructure provision and infrastructure-based service delivery. Analysis of the three data sources revealed that controversy about the stated and hidden nature and purpose of PPPs is also a complicating factor in implementing the pre-2000 Victorian PPPs. Private-sector responsibility for all aspects of the financing, design, construction and operation of the pre-2000 hospitals, combined with the blanket transfer of risk and the off-balance sheet accounting treatment, indicate that the management of financial risk (to avoid the recognition of debt in the state's

balance sheet) was a primary objective of these early arrangements. However, the intention of shifting the risks associated with changes to health care policy (including funding) and in clinical practices to the private operators has the potential to create tension with the objective of achieving the delivery of quality health care services in a complex and changing environment over a long-term contract (in which the repercussions of unanticipated future events could require negotiated solutions). Indeed, the failure of the Latrobe hospital highlighted problems in pre-contracting decision making at agency and contractor level, the fallacy of blanket risk transfer, and the inability of the contracting regime to foster negotiated solutions. Irrespective of the contract (and the accounting treatment), the government had to accept the ultimate responsibility for the public's right of access to quality hospital services, and take over the ownership and management of Latrobe.

A second debate in the literature reviewed in Chapter 4 relates to what constitutes VFM as it is established in the pre-contracting stage. Echoing concerns in the modernisation literature reviewed in Chapters 2 and 3, the PPP literature reviewed in Chapter 4 suggests that the exclusive reliance on financial variables in the determination of the PSC (or equivalent benchmark technology), and a reliance on quantitative 'accounting logic' to specify and monitor performance in PPP contracts (Broadbent et al, 2008) privileges the articulation of financial (as opposed to non-financial) VFM modernisation objectives in PPP projects. Accordingly, by stressing the dominance of the PSC, quantitative VFM objectives and performance specifications, the literature implies that qualitative VFM outcomes are neither anticipated nor achievable in PPP arrangements. However, as noted above, the examination of the Latrobe case indicates that pre-2000 project objectives encompassed financial and non-financial outcomes. The examined post-2000 hospital contract also confirms that financial and non-financial VFM outcomes were anticipated, albeit in the context of more limited project objectives and a reduced role of the private operator.

#### *Findings: Chapter 5*

Investigation of the nature of VFM and its achievement in the execution stage were explored in more depth through an empirically-based analysis of two PPP prison contracts (representative of five PPP projects) in Chapter 5. In relation to the analysis

of the pre-2000 prison contracts and outcomes, the empirical examination included analytical reviews of correctional services policies and four pivotal (and some additional) reports published during the period 1999-2007. As is evident from the Chapter 5 analysis, there is significantly less documentary evidence relating to the post-2000 projects. Accordingly, the bulk of the evidence and analysis in Chapter 5 focused on the three pre-2000 prisons: Latrobe, Port Phillip and Fulham.

Confirming Chapter 4 findings, it was established in Chapter 5 that significant modernisation objectives were attached to the three pre-2000 prison PPPs. As shown in this thesis, the nature and purpose of the sector-wide modernisation reforms to correctional services in Victoria were established in amendments to the *Corrections Act 1986* and the 1993 NPP reforms that supported the introduction of NIE-based reforms across the correctional services system. These reforms, which were designed to deliver financial and non-financial VFM, attempted to create a contractually-based competitive market in correctional services delivery that was managed and controlled through contract-based performance specification and reward mechanisms. The approach to contracting was inspired by TCE. Also, the implementation of the NPP reforms was underpinned by the PCT-inspired separation of correctional services management, control and monitoring functions within the Department of Justice.

The financial VFM reforms related to the provision of cost-effective infrastructure and correctional services in the PPP prisons, and also across the system through the roll out (to the publicly-managed prisons) of the contractual framework governing the PPPs. The non-financial VFM reforms related to qualitatively improving the management, treatment, housing, education, and rehabilitation of prisoners. Expectations as to the nature of NPP and standards of treatment of prisoners were established in the Performance Management System [PMS], which was included in Project Brief, the contract, and the Operating Manual (prepared by the contractor).

Chapter 5 reveals that the SDOs were largely quantitative and failed to capture critical qualitative elements of the NPP objectives. In addition, it was shown that the contractually-based payment and incentive mechanism inadequately penalised poor performance, and that other mechanisms (such as continuous monitoring by the OCSC and the default mechanism in the contract) did not support the rectification of

problems. Evidence presented in Chapter 5 indicated that the recontracting provisions failed to facilitate the satisfactory resolution of friction. Indeed, the extension of the 2006 recontracting window to enable negotiations with one of the operators indicates that there remain ongoing difficulties with aspects of the pre-2000 arrangements. These observations confirm the tensions arising from inherently conflicting objectives and a contracting regime that attempts to impose solutions on the management and control of unanticipated future events.

In evaluating the achievement the PPP prisons to achieve their NPP objectives, it is necessary also to consider the achievement of modernisation objectives in the publicly-managed cohort of prisons, because NPP envisaged transforming the correctional services sector as a whole. Indeed, factors beyond the control of the prison operators (public and private) hindered the achievement of objectives (Kirby, 2000; VAGO, 1999). For instance, Chapter 5 revealed that (prior to 2000) prison management was complicated by exogenous factors (such as changes in prisoner numbers, mix and profile). Also, the impact of departmental decisions, and failings in the Department's management of the correctional services system negatively impacted the achievement of NPP objectives across the sector (Kirby, 2000; VAGO, 1999).

Despite these problems, Chapter 5 provided evidence that some aspects of the NPP objectives (both financial and non-financial) had been achieved by 2000 in PPP prisons and in the publicly-managed cohort (Audit Review, 2000b; Kirby, 2000; VAGO, 1999). For instance, savings had been achieved in the construction of the PPP prisons and average daily costs-per-prisoner reduced. It was also found that the presence of the PPP prisons had resulted in improvements in the management of prisoners and in accountability in the publicly- and privately-managed prisons.

In addition, this thesis established that reforms introduced in 2001 were intended to support the achievement of NPP objectives. These reforms transformed the Department's management of the correctional services sector (VAGO, 2003; 2007b) and aimed to reduce the rate of prisoner re-offending. Chapter 5 noted that these reforms had some measure of success by 2004 (Birgden and McLachlan, 2004 (whose findings are confirmed by Graffam et al (2005) and VAGO (2007a)). Accordingly, it

is possible to conclude that despite the conflicting objectives inherent in the pre-2000 arrangements and the inadequacies of the pre-2000 contracting regime, the pre-2000 contracts do not appear to have impeded the development of the goodwill trust necessary to support the successful roll-out of the 2001 reforms in the remaining two pre-2000 prisons (Port Phillip and Fulham).

It was noted in Chapter 5 that the 2001 reforms are grounded in a philosophy (and exhibit features) reminiscent of the network governance model. For instance, the reducing re-offending reforms require a high degree of collaborative interaction between stakeholder groups, including employment consultants, prison management, custodial staff and prisoners to achieve targeted outcomes at the macro (systems level) and, through negotiated management plans, for individual prisoners at the micro level.

The introduction of the re-offending reforms provides evidence of the successful achievement of the implementation of qualitatively-based outcomes in the PPP prisons, and across the system as envisaged by NPP. The introduction of the 2001 reforms support the conclusions in Chapter 4 that VFM (as quantified in the PSC or other benchmark calculation in the pre-contracting stage) is largely designed to control and rationalise the decision to take the PPP option. In the context of change over lengthy contracts and its omission of qualitative VFM objectives, the PSC's ability to provide a realistic indication of VFM over project life appears to be limited. Irrespective of the role of the PSC, the evidence presented in Chapter 5 confirms that the Department of Justice has put in place complex mechanisms to monitor PPP performance on a continuous basis. For instance, in addition to OCSC monitoring, the use of the financial model to actively monitor and control risk transfer back to the government in the execution stage in the post-2000 contracts challenges findings in the literature, which suggests that VFM achievement is not actively monitored in the PPP execution stage (see, for instance, Broadbent et al, 2003b).

The evidence presented in Chapter 5 seems to support the contention in the literature that successful partnership relationships in long-term hybrid relationships are based on goodwill trust (contrary to assertions by Froud (2003)). However, the evidence in Chapter 5 also suggests that goodwill trust itself is mutable, and does not necessarily support every aspect of the partnership relationship at any given time. For instance,

difficulties surrounding the recontracting process in 2006 occurred at the time that the 2001 reforms were being implemented successfully. This implies that, irrespective the presence of goodwill trust, managing change over the long-term in poorly specified TCE-based contracts remains difficult.

The problems associated with using privately managed prisons to foster modernisation change in a regime governed by NIE-based contracts raise questions about the assumptions underlying NIE and its application in some public sector settings (Lapsley, 2001c; d; Spackman, 2002). Classical economic theory questions whether ‘successful’ provision (in terms of cost, quality, public benefit and accountability) of social services (such as the management of prisons by private operators) is possible through unregulated competitive markets (Barton, 2002), which PCT and TCE attempt to replicate in a public-sector setting. Externalities make it difficult to establish a contracting regime that is capable of capturing the nuances of policy, public benefit, genuine and ongoing stakeholder participation, accountability, and of reacting to uncertainty required in the provision of social services in modern democracies, and helps to explain the problems experienced by the Victorian government in managing and controlling the project and political risks associated with the pre-2000 PPP prisons. As indicated in this thesis, network governance may provide an alternative approach in which the impact of externalities may be taken into account and neutralised. Also, critiques of the TCE literature introduced in Chapter 5 suggest that the purpose of contracting in long-term hybrid relationships should be to establish goals and methods to enable mutual planning, rather than to establish *ex-post* control mechanisms as envisaged by TCE (Tomkins, 2001). These findings suggest that Australian governments may need to re-evaluate their reliance on TCE-based contracting regimes to manage and support social policy change.

In summary, the case-based empirical evidence analysed in Chapters 4 and 5 of this thesis established that the management of financial risk and control of the disclosure of public debt appears to have been a primary consideration (as predicted in the literature (see Broadbent and Laughlin, 1999)) of the pre-2000 PPPs. Nevertheless, the pre-2000 prison projects were also intended to achieve significant financial and non-financial modernisation objectives, and to drive modernisation reform throughout the Victorian correctional services sector. Accordingly, the findings in this thesis

challenge assertions in the literature that anticipated VFM is largely based on cost savings achieved in the design and construction phase (Broadbent et al, 2004a). However, the findings also confirm that the Department of Justice has struggled over time to enforce and modify aspects of the quantitative and qualitative performance standards embedded in the pre-2000 contracts because of flaws in the specification of performance, payment and default mechanisms and problems associated with TCE-based contracting.

It is clear from the analysis in Chapters 4 and 5 that the nature of the observed change in the implementation of modernisation in the setting of Victorian PPPs is not straightforward. The work by Lapsley (2001d) and Modell et al (2007), as summarised in Chapter 2, suggests that, although central agencies (such as departments of treasury and finance) at the macro level may continue to embrace the theoretical and applied precepts of NIE, successful reform instigated by line agencies at the micro (organisational) level, while congruent with the broad objectives of NIE, may take different (and softer) approaches to managing change that are more responsive to context. This thesis has demonstrated that some aspects of successful reforms to the delivery of correctional services have been based on the seemingly contradictory principles and application of NIE and of network theory.

The observed flexibility at the micro level raises questions about the role of accounting and management technologies in the change process. Meyer (1998) has suggested that the public sector has been transformed, and that accounting and management technologies are an integral and dominating part of the rationalising and modernising transformation that has produced a new public sector. However, the work by Lapsley (2001d) and Modell et al (2007), and the findings in this thesis, raise questions about the appropriateness (at the micro level) of these technologies as change mechanisms in some circumstances, and also confirm that the modernisation process is still in a state of transition.

#### *7.4.4 The third aim: to analyse the changing characteristics of auditor-general oversight of PPPs.*

Chapter 6 contended that performance audit is a technology developed to provide assurance that modernisation reform has been implemented cost effectively. Despite agreement on its origins, the modernisation role of performance audit remains contested in the literature. English and Skaerbaek (2007) have identified an interrelationship and mutual co-dependency between modernisation and performance audit, which has given rise to suggestions that auditors-general are implicated in the introduction of modernisation reforms in the public sector (Gendron et al, 2001; Skaerbaek and Thorbjornsen, 2007), including PPPs (Broadbent and Laughlin, 2003).

At the level of practice, auditing for cost-effectiveness and the management of programs requires the use of independent criteria (Pollitt et al, 1999). The nature and use of independent performance audit criteria is contested (Guthrie and Parker, 1999). Pollitt et al (1999) suggest that substantive audit uses independently-derived best practice criteria to evaluate observed outcomes, while systems-based audit uses criteria developed by audited bodies or by auditors-general themselves (Gendron et al, 2001).

The empirical evidence presented in Chapter 6 relates to three issues: the extent and focus of PPP audit in Australia; audit classification as systems-based or as substantive; and investigations of the PPP attributes (risk management and VFM) that are most closely associated with the achievement of stated PPP objectives.

The analysis of PPP performance audit established the following. First, no Australian audit office appears to audit PPPs on an ongoing and strategic basis. Only 16 PPP projects (out of a total of 127 projects) have been audited in a total of ten performance audits. PPP auditing has been confined to three states: Victoria, NSW and WA. Most of the audits focus on the pre-contracting stage, although one substantive audit (of the implementation of the 1993 NPP modernisation reforms (VAGO, 1999), which is extensively reviewed in Chapter 5) indicates that, contrary to indications in the literature (Broadbent et al, 2004b), it is also possible to substantively audit the execution stage of PPPs within two or three years of their commissioning date. Again, challenging findings in the PPP literature (Edwards and Shaoul, 2003; Edwards et al,

2004; Pollock and Price, 2004), Chapter 6 reveals that it is possible to substantively audit the pre-contracting stage.

Second, Chapter 6 revealed that only four of the ten PPP performance audits (of the 16 projects) are classified as substantive. Also, Chapter 6 indicated that substantive audit is related to individual auditors-general, and also to public concern about the audited PPP. Substantive auditing appears to challenge the boundary between auditing policy and auditing the implementation of policy (English, 2003), whereas systems-based audit is more likely to act to legitimate the implementation of government policy (Broadbent and Laughlin, 2003).

Third, Chapter 6 indicated that risk management and the PSC (or equivalent benchmarks) are the most audited PPP technologies, confirming the focus in this thesis on these technologies and their role in implementing modernisation in a PPP setting. Furthermore, the Victorian audit of the implementation of modernisation in the context of correctional services provides some empirical flesh to the concept of VFM, indicating that VFM is more complex than may have been assumed in the previous literature (see, for instance, Broadbent et al, 2004b), and also confirming the analysis of VFM in this thesis in Chapters 4 and 5.

In the context of performance audit, this thesis has documented an apparent retreat from independent substantive audit in the post-2000 period. The Chapter 6 analysis resonates with Jacobs et al's (2007) findings that there has been a return to a reliance on process and procedure to provide assurance as to modernisation outcomes. Also, Chapter 6 raises the possibility that the documented change in PPP performance audits in the post-2000 period (from more auditing *per se* and more substantive auditing in the pre-2000 period to less auditing and all systems-based auditing post-2000) could reflect a widespread transformation in the approach to performance auditing by Australia's auditors-general.

Chapter 6 acknowledged that the evidence provided in this thesis requires longitudinal research in different contexts before such a conclusion can be drawn. Nevertheless, it could be tentatively inferred from the Chapter 6 findings that the recent reliance in performance auditing on adherence to best practice frameworks devised by audited

bodies (or recommended by auditors-general) could represent a return to an audit emphasis on process and procedure (Guthrie, 1989; Guthrie and Parker, 1999; Hamburger, 1989), confirming the findings of Jacobs et al (2007).

A significant contribution of this thesis is the wealth of the empirical data that supports its analyses and conclusions. Much of the PPP literature is based on normative argument and analysis of PPP technologies and their assumed effects in the absence of empirically-based evidence about aspects of PPP decision-making and outcomes (Heald, 2003). This thesis provides documentary-based evidence over 1991-2007 to support its findings. Longitudinal research provides opportunities to investigate and compare outcomes of particular reforms over the short- and long-terms, and is appropriate when investigating the implementation of complex modernisation reform in particular settings (Lapsley, 2001d).

This concluding chapter now turns to reflect on the policy implications arising from research findings, and limitations and opportunities for future research in section 7.6, the concluding section of this chapter.

## 7.5 Policy implications

A number of policy implications arise from the empirical findings in this thesis.

### *7.5.1 Achieving qualitative outcomes*

This thesis confirms findings in the literature that private-sector derived accounting and management technologies associated with NIE-based modernisation reforms privilege quantitative as opposed to qualitative performance specification (Bowerman, 1998; Broadbent et al, 2003a). This thesis has shown that the specification of qualitative performance outcomes associated with NPP were ineffectively specified in the original pre-2000 prison contracts, and that the Department appears to have had difficulty in rectifying this weakness. This finding supports similar conclusions in relation to performance specification in Australia's detention centres (ANAO, 2004; 2005), suggesting that Australian governments continue to struggle with how to

specify performance standards relating to the treatment of prisoners (for instance) that meet changing community expectations.

The field-based ‘alternative’ contracting literature reviewed in Chapter 5 suggests that long-term contracting requires the development of goodwill trust to support desired outcomes, and that the role of accounting and management technologies embedded in contracts is to facilitate negotiated understandings of their meaning and achievement. This thesis has provided evidence that a network approach may provide similar outcomes within a broader top-down NIE-based regime that establishes the broad parameters of political as opposed to project objectives. The 2001 reducing re-offending reforms appear to have been more successfully implemented than the non-financial VFM aspects of the NPP reforms that were initially incorporated into the pre-2000 prison contracts. The evidence cited in Chapter 5 seems to suggest that network governance may be more effective than a NIE-based contracting regime in achieving behavioural change. This is the case because the network model is premised on the notion of engaging stakeholders to reach consensual negotiated solutions supported by mechanisms to facilitate their achievement at the individual or community level. Accordingly, it would seem appropriate for Australian governments to investigate establishing frameworks to support a network governance approach where, for instance, desired change involves qualitatively improving standards relating to the treatment of vulnerable sectors of the community.

### *7.5.2 Closing the disclosure gap*

Independent researchers face significant problems in investigating PPPs in the Australian context. Governments’ propensity to rely on commercial-in-confidence as a reason to restrict access to information about PPP contracts, processes, procedures and outcomes (Watson, 2004) has even blocked parliamentary scrutiny of these arrangements in Victoria (VPAEC, 2006). In addition, as was illustrated in this thesis by the difficulties encountered in determining the number, type and cost of PPP projects in Australia (see Chapter 4), the diffusion of PPP disclosure (Watson, 2003) further hinders independent scrutiny.

English and Guthrie (2003) concluded that departments of treasury are the main PPP agenda-setters and evaluators. However, Kirby (2000) and Audit Review (2000a; b) support a contrary view that some evaluation of PPPs has taken place at central government level in Victoria. However, in contradiction to the English and Guthrie (2003) finding, this thesis has provided evidence that the Victorian Department of Justice has undertaken a number of measures (such as continuous OCSC monitoring and the commissioning of reports by external consultants) to evaluate various elements of the implementation of the modernisation reforms associated with PPPs<sup>34</sup>. Access to these documents is not straightforward, however. As noted earlier, the Victorian OCSC reports (with the exception of OCSC (2000)) are not publicly available<sup>35</sup>. Locating the evaluation reports cited in this thesis on the Department's website is also difficult because they are not cross-referenced according to topic, which makes finding them a rather hit and miss affair. In addition, it was found (see Chapter 5) that website maintenance processes have removed older (and possibly controversial) reports from public scrutiny.

Researchers into Victorian PPPs have access to PPP contracts and, more recently, to other PPP documentation (PV, 2007). However, the commitment to disclosure in Victoria may be more apparent than real (VPAEC, 2006). For instance, Dunckley (2007), reporting on the release of 1000 pages of documents detailing the PPP arrangements to build and operate the Melbourne Convention Centre, noted that the government claimed that the documents showed that the community was getting VFM. However, Dunckley (2007, p. 14) stated that:

[The government] blanked out every figure from the payment provisions section as well as removing other crucial numbers ... relating to interest, payment disputes and shares in savings or refinancing gains. It also deleted numbers detailing compensation and the triggers and penalties for service failures. [The] Major Projects Minister ... did reveal a \$93 million payment to the government by the successful consortium. ... [The Minister] said the money was paid to secure development rights for a new office and residential building, hotel, shops, cafes and a homemaker centre. ... Greens MP ... said the documents released yesterday did not provide any indication of the value to taxpayers of the PPP.

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<sup>34</sup> Additional research is required to determine whether other agencies are as committed as the Victorian Department of Justice in evaluating programs.

<sup>35</sup> This is in contrast to the situation in WA. The equivalent prison monitoring body in WA, the Office of The Inspector of Custodial Services, is statutorily independent from government, and reports directly (and in public) to the WA parliament (Robinson et al, 2007).

The continuing reluctance of governments to disclose information adds to suspicions that PPPs fail to deliver VFM (Quiggin, 2004; Stanley and Hensher, 2004), and that governments have not been held sufficiently accountable for their economic and social repercussions (Andrew, 2007; Watson, 2003; 2004). Interestingly, the matters raised by Dunckley (2007) have been the subject of a performance audit (VAGO, 2007b), which concluded that, on the whole, the Melbourne Convention Centre did provide VFM, and that the Department had managed the project appropriately.

However, this thesis challenges the notion that a lack of disclosure indicates a failure to achieve objectives *per se*. The paucity of publicly-available information and difficulties associated with locating it certainly impedes independent investigation of PPPs. Research efforts (and the accountability of governments) would be greatly enhanced if Australian governments provided more information about all aspects of PPPs, including information about projects and their costs to government; contracts (in addition to contract summaries); and internally commissioned evaluations. To facilitate independent evaluation of PPPs, excisions to PPP contracts and other publicly-disclosed material should be minimal. Also, information about PPPs from various government sources should be available in one place (Watson, 2003), for instance, in the case of Victoria, on the Partnerships Victoria website.

### *7.5.3 Harmonising the approach to PPP use and implementation*

This thesis has confirmed that PPP models change over time and are context-specific. This makes it difficult to establish generalised PPP policies and models that are capable of anticipating the requirements of future projects. Victoria is the only Australian jurisdiction to have invested considerable time and money in developing a comprehensive suite of PPP policies (albeit based on UK experiences). As noted above, in Victoria, all stages of PPP implementation are overseen and controlled by the Department of Treasury and Finance, which also retains ultimate control of PPP decision-making at agency level through its PV policies, and requirements that PPP projects receive Cabinet approval at three different stages during the pre-contracting stage (PV, 2006). The Victorian Department of Treasury and Finance also receives briefings from agencies on PPP projects in the execution stage.

In other jurisdictions there may be less central management and control of PPP decision-making than in Victoria. For instance, although the NSW government has adopted a number of the Victorian policies (as have other Australian states (English and Guthrie, 2003), Chapter 6 noted that recent parliamentary inquiries into the Sydney Cross City Tunnel (NSWPAC, 2006; NSW Joint Select Committee on the Cross City Tunnel, 2006a; b) stressed that the lack of a coherent PPP policy in NSW and undisciplined decision-making by the relevant agency resulted in less than optimal public interest outcomes.

The findings of the NSW inquiries suggest that Australian governments and auditors-general need to put considerable additional effort into overseeing the implementation of their (borrowed) PPP policies to guide, aid (and discipline) decision-making in line agencies if they intend to continue to use PPPs to deliver infrastructure-based services. Indeed, a harmonised national approach to PPP implementation could reduce costs and improve outcomes.

#### 7.6 Limitations and future research directions

Lapsley (2001d, p. 107) contends that the observed failure of modernisation reforms in the literature (see, for instance, Olson et al, 1998; Guthrie et al, 2005) could be related to the propensity of researchers to take a snapshot approach (Pettigrew, 1989) in investigating what is essentially an iterative and ongoing transformation process. Lapsley (2001d, p. 88) writes that longitudinal research overcomes:

...the distinct problem of examining the gap between strategic intent and operational implementation in this large, complex industry [the UK National Health Service]. In examining changes, Pettigrew advocates the longitudinal perspective as essential to understanding the processes of change and cautions against snapshots of reforms: 'episodic views of change not only treat innovations as if they had a clear beginning and a clear end but also, where they limit themselves to snapshot(s) ... fail to provide data on the mechanisms and processes through which changes are created (p. 26)'.

While one of the strengths of this thesis is its longitudinal perspective, it is also a potential limitation for the following reasons. First, this is a documentary-based study that does not include field-based interviews which could have provided richer

understandings of the use of PPPs as a procurement technology and also of changing auditor-general perspectives on the conduct of PPP performance audit. Second, the majority of the documents examined are either official government documents (such as the PPP policies and the 2000 OCSC report) or are government-commissioned reports (Audit Review 2000a; b; Graffam et al, 2005; Kirby, 2000; Birgden and McLachlan, 2004). As there has been relatively little substantive performance audit examination of PPP projects that investigate achievements in the execution stage in light of benefits anticipated in the pre-contracting stage, the work of Australian auditors-general is insufficient to enable a comprehensive evaluation of PPPs. The lack of field research means that the findings in this thesis have not been corroborated by parties actually involved in PPP practices. Third, this thesis has focused on one particular PPP category (PPP prisons and hospitals) in one site in Australia. Accordingly, the findings may not be representative of other PPP arrangements in Victoria, or elsewhere in Australia and other nations. Fourth, the pre-2000 PPP model appears to have been abandoned in Australia (except for a PPP prison commissioned in 2001 in WA (see Robinson et al, 2007)), perhaps rendering the bulk of the findings of historical relevance only because the pre-2000 model has been replaced by the post-2000 model, which has significantly reduced project risk for the government and contractors. Fifth, the findings in relation to the apparent increase in systems-based audit in the post-2000 period need to be investigated further.

In outlining the limitations of this research, this section has alluded to opportunities for future research. Clearly, there is a need for longitudinal field-based and documentary-based research to be conducted into Australian PPPs and their oversight by auditors-general. One of the contributions of this research is that it has provided for others an outline map of the PPP territory in Victoria. Victoria is Australia's leading proponent of PPPs and has developed the PPP policies that have been adopted in all other Australian jurisdictions with few substantive amendments (English and Guthrie, 2003). Accordingly, this study has done much to flesh out the institutional and policy context in which PPPs have been developed and implemented in this country. However, this thesis has also noted that jurisdictional differences require scholars to take care when examining jurisdictional-based initiatives as there may be unique features that affect objectives and outcomes. Nevertheless, others can build on the findings in this thesis.

Importantly, very little field research into PPPs has taken place internationally, and none has occurred in Australia. Field research provides opportunities for the collection of rich empirical data, which cannot be replicated in documentary-based studies (Laughlin, 1995; 2004). Field-based research is time consuming for researchers and subjects. More crucially, field-based research into PPP practices would require the consent and active participation of departments of treasury and finance, and of line agencies. Given the reluctance of governments to make contracts and other PPP related material publicly available, there may be considerable obstacles to undertaking field research into PPPs and their achievements. This is unfortunate. Field-based research could make a valuable contribution to governments' understanding of PPP implementation and strategies to improve outcomes.

## CHAPTER 8

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## CHAPTER 9

### Co-Author Attestations







## CHAPTER 10

## Thesis Publications

*Paper 1*

English, L., J. Guthrie and L. Parker (2005) Recent Public Sector Financial Management Change in Australia: Implementing the Market Model in Guthrie, J., C. Humphrey, L. R. Jones and O. Olson [eds] *International Financial Management Reform: Progress, Contradictions and Challenges, A Volume in Research in Public Management*, Jones, L. R. and N. C. Roberts [series editors] (Greenwich Connecticut, USA: Information Age Publishing), pp. 24-55

*Paper 2*

English, L. (2006) Public Private Partnerships in Australia: An Overview of their Nature, Purpose, Incidence and Oversight, *University of New South Wales Law Journal*, Vol. 29, No. 3, pp. 250-262.

*Paper 3*

English, L. (2005a) Using Public-Private Partnerships to Deliver Social Infrastructure: The Australian Experience, in Hodge, G. and C. Greve [eds] *The Challenge of Public-Private Partnerships Learning from International Experience* (Northampton MA, USA: Edward Elgar), pp. 290-304.

*Paper 4*

English, L. and J. Baxter (2007) *Using Contracts to Govern Hybrid Public-Private Partnership: A Case Study of Victorian PPP Prisons*, Fifth Asia Pacific Interdisciplinary Research in Accounting Conference, Auckland, New Zealand, 8-10 July. Available from:  
<http://www.mngt.waikato.ac.nz/ConferenceManager/report.asp?issue=5>

*Paper 5*

English, L. (2007) Performance Audit of Australian Public Private Partnerships: Legitimising Government Policies or Providing Independent Oversight, *Financial Accountability and Management Special Issue on Performance Auditing and the Modernisation of the Public Sector*, Vol. 23, No. 3, pp. 313-336.

















































































































































































































































































































