



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

FINANCE AND PUBLIC ADMINISTRATION REFERENCES  
COMMITTEE

**Reference: The government's information technology outsourcing initiative**

FRIDAY, 9 MARCH 2001

CANBERRA

BY AUTHORITY OF THE SENATE

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**SENATE**  
**FINANCE AND PUBLIC ADMINISTRATION REFERENCES COMMITTEE**  
**Friday, 9 March 2001**

**Members:** Senator George Campbell (*Chair*), Senator Watson (*Deputy Chair*), Senators Buckland, Lightfoot, Lundy and Ridgeway

**Participating members:** Senators Abetz, Allison, Brown, Calvert, Carr, Chapman, Conroy, Coonan, Crane, Eggleston, Faulkner, Ferguson, Ferris, Gibson, Harradine, Harris, Knowles, Mason, McGauran, Murphy, Murray, Payne, Stott Despoja, Tchen, Tierney and Watson

**Senators in attendance:** Senators Buckland, Campbell, Eggleston, Lightfoot and Lundy

**Terms of reference for the inquiry:**

For inquiry into and report on:

The Government's information technology (IT) outsourcing initiative in the light of recommendations made in the committee's report, *Contracting out of government services—First Report: Information technology*, tabled in November 1997, and the Auditor-General's report No. 9 of 2000-2001, and the means of ensuring that any future IT outsourcing is an efficient, effective and ethical use of Commonwealth resources, with particular reference to:

(a) the need for:

- (i) strategic oversight and evaluation across Commonwealth agencies,
- (ii) accountable management of IT contracts, including improved transparency and accountability of tender processes, and
- (iii) adequate safeguards for privacy protection and security;

(b) the potential impact on the capacity of agencies to conduct their business;

(c) savings expected and achieved from IT initiatives; and

(d) the means by which opportunities for the domestic IT industry, including in regional areas, can be maximised.

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**Committee met at 9.03 a.m.**

**CHAIR**—I call the meeting to order and declare open the third public hearing of the Finance and Public Administration References Committee inquiry into the government's information technology outsourcing initiative. I welcome my Senate colleagues and witnesses. Before we commence, I wish to advise for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to evidence provided. While the committee prefers to hear all evidence in public, if the committee accedes to such a request, the committee will take evidence in camera and record that evidence. Should the committee take evidence in this manner, I remind the committee and those present that it is within the powers of the committee at a later date to publish or present all or part of that evidence to the Senate. The Senate also has the power to order production and/or publication of such evidence. I now invite officers from the Department of Health and Aged Care to the table.

[9.04 a.m.]

**MAHAJAN, Mr Vipin Kumar, Director, Contract Management Unit, Department of Health and Aged Care**

**MORAN, Mr Peter, Assistant Secretary, Department of Health and Aged Care**

**CHAIR**—Do you wish to make an opening statement, Mr Moran?

**Mr Moran**—No, thank you.

**CHAIR**—Mr Moran, just as an opening question on this issue, what is your understanding of the current policy, given the Humphry report recommendations?

**Mr Moran**—As I understand it, the basic policy position of outsourcing of budget funded agencies' IT infrastructure remains on foot, with the significant proviso that the Office of Asset Sales and IT Outsourcing—I think in perhaps a couple of months—will no longer have that central coordination role. Indeed, in fact perhaps I should correct myself: I think they no longer have that central coordination role.

**CHAIR**—How do you see that differing from the whole of government approach that was in place prior to the Humphry review?

**Mr Moran**—I suspect I am being asked to comment—correct me if that is not the question—on a government decision which I assume is therefore part of government policy.

**CHAIR**—No, I am asking you really to comment on how you see the recommendations of the Humphry report and the government's response to those, what changes that has made to how you or your department view outsourcing and what that means in terms of your future approach to outsourcing of IT matters.

**Mr Moran**—I am sorry, I misunderstood the question. I did not realise it related specifically to Health. The majority of the Humphry review, apart from that fundamental issue of removing that responsibility from OASITO, addressed mostly issues of transition and implementation. The Department of Health and Aged Care had handed over and had moved through a large portion of its transition prior to the Humphry report. Indeed many of the findings of the Humphry report we had, I suppose, independently discovered. So in that sense it was of little direct relevance to us. In terms of the future, I guess I would have to say it is a little early to be making judgments about whether the department of health would continue, for instance, with the current provider, IBM GSA, or seek in some way to fundamentally vary the scope of the work which we put to the market and contracted last year.

**CHAIR**—Sorry, I missed that. You were saying that you have not made a decision whether you will continue with that?

**Mr Moran**—I am sorry, no. If that is the question, we have a services agreement with IBM GSA which is in place for another four years—over four years, actually. Certainly it would be our intention at this stage to proceed with that in terms of the contract that we have. But in

terms of any decision or variation on that in the future, I would say it is far too early to make a judgment on it.

**CHAIR**—Did you have any input into the composition of your cluster grouping?

**Mr Moran**—Not personally, but I understand that the secretary to the department had discussions with the then CEO of OASITO and his colleague the managing director of the Health Insurance Commission. They agreed that the health group would go out as a group of like agencies in terms of function rather than agencies with perhaps common or slightly common technology requirements.

**CHAIR**—So you were satisfied or your agency were satisfied with its inclusion in that group?

**Mr Moran**—Yes.

**CHAIR**—Were you satisfied that all your concerns and issues that were relevant to your particular agency were accommodated within the general parameters of that grouping?

**Mr Moran**—Yes, there was considerable discussion at the start of the process with OASITO about whether the three agencies would effectively sign a single contract with the eventually successful provider. But after some discussion and some legal advice, I gather, about the status of the Health Insurance Commission as a CAC Act agency, it was decided that each agency would have a separate contract, and that was mutually agreed between each of the parties.

**CHAIR**—To what extent was your agency involved in the negotiations and the details of the contract signed with your agency as opposed to those negotiations and the contract being developed by OASITO?

**Mr Moran**—I am not sure I understand the question. We had a very great deal to do with the preparation of the specification, the request for tender—in other words, the draft contract, in large extent. My own staff spent, I suppose it is fair to say, many months drafting that document. After we went to tender the department of health and indeed the Health Insurance Commission were very closely involved in the development then of the bids as they came forward and the parallel negotiations, I guess you would call them, to develop the final contract. We conducted a fairly extensive—and independent of OASITO, I might say—review of the contract towards the end, in the six weeks leading up to contract signature, and, to the extent that skill and ability can solve these things, we are comfortable that the services agreement we have with IBM GSA represents our needs and protects the Commonwealth's interests.

**CHAIR**—To what extent was your agency involved in determining the level of the efficiency gains that were determined that your agency would make as a result of the IT outsourcing?

**Mr Moran**—I am not entirely sure. I suspect not very much. I might have to correct that if I have misled you but I understood that, for the most part, it was a figure arrived at by the Department of Finance and Administration and applied to the forward estimates of the department, I think with the full year effect initially from the year 1999-2000. I will take it on

notice to correct that if in fact there was more involvement, but I seem to recall there was not a great involvement of the department.

**CHAIR**—To what extent was there agreement or acceptance by your agency that those efficiency gains were realisable in terms of your IT outsourcing?

**Mr Moran**—Again I think it was something of a question of ‘That is something of a done deal.’ The efficiency gains had been removed from the forward estimates, and I think it was then left to people like myself to do what we could to realise those.

**CHAIR**—How have they been realised within your agency?

**Mr Moran**—That is a very difficult question. It is now only nine months since we handed over to IBM GSA. I guess the best I could say is that we are optimistic that the combination of making visible what were previously invisible costs, hidden costs—the costs of outsourcing, the cost of consumption of IT—and introducing an internal charging mechanism in the department over the long term—and I do stress ‘long term’—will enable us to drive behaviour in such a way as to reduce consumption, but I cannot say any more than that. I have to say again that it is a little early to say.

**CHAIR**—Have you had any staff reductions in your agency, for example, over the past nine months?

**Mr Moran**—No. If anything, I understand the agency has grown slightly as a result of various pressures. I am sorry; if you are asking about the number of people who were made redundant as a result of the outsourcing, there were approximately 90-odd who were outsourced—they became redundant public servants—but in terms of the rest of the department there has been, I think, a slight increase.

**CHAIR**—So there has been a loss of 90 jobs within the department as a result of the outsourcing?

**Mr Moran**—It was approximately 90 public servants and perhaps another 20-odd contracted people.

**Senator LUNDY**—Can I follow up on that? I want to get clear in my head the implications for staff. How many positions overall does IBM GSA have within the health group?

**Mr Moran**—I cannot comment for HIC, the Health Insurance Commission. In a sense, it is largely irrelevant to us how many people IBM applies to delivering the services to us. I think I can give you advice from behind on the number of people they have in their program office, which is the office which manages it. But increasingly service delivery to health is being removed from what was the discrete health premises, and it is invisible and largely irrelevant to us as long as the services are delivered.

**Senator LUNDY**—If you could make that inquiry it would be useful. It is something we are particularly interested in, primarily because there have been claims made about the net increase



or growth of jobs in the IT area, be they in the private sector or transferred from the public sector, so I am interested in drawing those comparisons.

**Mr Moran**—I understand the question. I think I will be able to answer the second question about the contract offers shortly; in terms of more broadly, I will inquire of IBM and look at any material that we have. Certainly at the time of they bid and shortly after that, they did put a specific number of people to us as being necessary to deliver the services, but that number changed quite quickly after they started the transition process. I will try to find out if I can from them what the number is.

**Senator LUNDY**—I am looking for enough information to do a comparison with the number of people who were previously employed in-house. But I also know there was a lot of outsourcing done for different aspects of your technology prior to the health group contract being put in place and I have a few questions about the environment that you were managing prior to that. Can you give the committee an outline of the proportion of IT services, both infrastructure and services, that were being outsourced up to the transfer period?

**Mr Moran**—I will take on notice to correct myself if I am wrong, but I understood at the time I went into the job with the brief of outsourcing the IT infrastructure that nothing of any significance at all had been outsourced. There were contracts in place for network services and the provision of voice services with Optus, Telstra and people like that and we obviously had contracts in place for the provision of support to the hardware that we had. In a sense, it was almost insourcing—we were buying the service into the department. In the sense of any wholesale or even significant outsourcing along the lines of what we have just done, I do not recall that there was anything of significance, but I will undertake to confirm that.

**Senator LUNDY**—Perhaps I should use the words ‘contracting out’, because outsourcing seems to imply an all-encompassing approach. I am talking about the provision of the mainframe systems, for example. I am looking for a precis of whatever was sourced externally, and by that I mean desktop hardware as well. Could you give us a summary of the extent of that?

**Mr Moran**—As I understand the situation, the Department of Health and Aged Care, like most budget funded agencies, owned its hardware—it owned the mainframe, the desktop, the mid-range servers and the bits of wire that connected them all.

**Senator LUNDY**—So it purchased the hardware as required.

**Mr Moran**—And operated them with Health staff. I think that was almost universal throughout the Health infrastructure, but I will correct that if I have misled you.

**Senator LUNDY**—Okay. Thank you.

**Mr Moran**—I am sorry, there may be an addition to that. Mr Mahajan suggested that you might have been asking in terms of the staffing. Something like 85 to 90 per cent of the Health people who were outsourced in fact got employment with IBM or one of the significant subcontractors.

**Senator LUNDY**—Those figures would be good to build on the questions I was asking before. Can you describe the extent to which you used mainframe systems prior to outsourcing and what the process of transition has been for those systems with respect to the contract?

**Mr Moran**—The department of health had a relatively small Hitachi mainframe. It was located in the department's premises. It was about 300 MIPS. It was purchased, effectively, by IBM at the transfer of assets at the time of contract signature or handover. Sometime over the last few months, as part of IBM's bid to the department, our mainframe processing has been relocated from that machine—I have no idea what happened to the actual box; it has certainly been removed from the premises—and is being delivered to us from a partition on a machine in the Tuggeranong data centre where the Health Insurance Commission is. So in a sense we have been consolidated in that data centre in terms of our mainframe requirements.

**Senator LUNDY**—As part of the purchase of that mainframe system—and I do not know what sort of value can be attributed to it—do you have a notional value as part of the terms and conditions of the contract of that mainframe system?

**Mr Moran**—I need to correct something I said. Our mainframe processing is in fact on a separate box, not the same box, in the Tuggeranong data centre so it is physically and logically removed from the Health Insurance Commission processing.

**Senator LUNDY**—Right.

**Mr Moran**—We have a set of pricing schedules which specifies what we will pay for usage of mainframe services.

**Senator LUNDY**—That is under the current contract?

**Mr Moran**—That is with our current services agreement, yes.

**Senator LUNDY**—Can you provide the committee with the notional value of your former mainframe—the Hitachi 300 MIPS mainframe system—when it was purchased as part of the arrangements with IBM GSA? Do you have a figure that you can identify?

**Mr Moran**—I do not have a separate figure. As I recall it, the bids from the vendors, including IBM, involved a lump sum. We paid them some money for transition and they paid us some money for the purchase of hardware. It may be the case that the mainframe was separately identified. We will need to take on notice the actual value that was agreed for the selling of the mainframe to IBM.

**Senator LUNDY**—If you could also take on notice finding any disaggregation that can be done of that whole figure and providing us with the whole figure for the transfer of the assets as well, that would be useful.

**CHAIR**—Mr Moran, when you provide those figures can you also provide the current asset value of the mainframe at the time of the transfer and what the expected life left in the mainframe was?

**Mr Moran**—Yes, I can undertake to do that. It may be the case that the Commonwealth would prefer that that material not be widely known. It was very much an issue of negotiation between ourselves and IBM. I think they would have some merit on their side if they were to suggest that that figure were slightly sensitive to them in terms of the deal they did with us, but we can certainly get the numbers.

**Senator LUNDY**—If you can take the question on notice. The committee is capable of determining whether it should hold material in confidence, but it is your responsibility to provide us with that material and present a case as to why in fact it should be held in confidence by the committee.

**Mr Moran**—Sure.

**Senator LUNDY**—I am not sure whether I am using the right words here, but you mentioned that the value of those assets in the transfer under the terms of the contract somehow offset the transition costs. Can you elaborate on that, or am I just interpreting you further than I should?

**Mr Moran**—It is nearly always the case in my experience of something involving the transfer of assets, staff, buying a business and selling a business that, during the process of negotiation, trade-offs along the way develop. I guess it is not revealing any particular secrets to suggest that some of the tenders included offering us nothing—a notional \$1—for the assets against a very small transition fee that we would pay for the X period of transition. In some cases it might be the other way around. It is the difference between what you have to pay for your transition and what they pay you for your assets that is important. So in a sense you are right.

In terms of the money we paid them over the last 12 months for the transition fee in the grand scheme of things, it would be offset in part by the money they paid us for the assets. It is not the case that there is a direct one-to-one correlation. During the negotiations with at least two vendors the amount they were offering for our assets moved enormously but so did the transition fee on the other side. As I said, it is like trading in a car: you end up with the best deal you can get. The balance is the money that is there.

**Senator LUNDY**—Who handled those discussions? It sounds like obviously there was some, as you have described it, flexibility in the negotiation process. Was that something that Health had control of?

**Mr Moran**—To the extent that I know about, yes. As I suggested earlier to the chair, the department took a very active role. As I think I mentioned at Senate estimates a while ago, we did regard this as a very important thing and put a lot of resources into it, and we continue to do so. But I think it is fair to say that in each of the evaluation areas—financial, technical and corporate—we took a very vigorous and up-front role both with OASITO and obviously with each of the vendors. So we conducted a very high proportion—certainly the majority—of the negotiations face-to-face. There was no question of us, if that is what you are suggesting, being victims of something.

**Senator LUNDY**—I would not suggest that at all, but I was curious as to who managed that negotiation process, particularly if it directly involves the value of Health's assets.

**Mr Moran**—That is in the sense that the policy framework had OASITO managing the entire transaction, but I do not think it is the case that Health at any point was not comfortable with the negotiations in which it took part.

**Senator LUNDY**—Just going on from that, I have a few more questions about that mainframe system. I need your help here: can you describe to me the outputs of that system? Does it house a database? What is its primary purpose in terms of the operation of the health department?

**Mr Moran**—You are going to stretch my technical ability, but essentially it holds a large amount of information on the health sector. I risk misleading you if I say any more than that. It holds a lot of records and information.

**Senator LUNDY**—Do you know if it holds records of individual Australians?

**Mr Moran**—I was also going to say that it processes a large number of payments in the aged care system to nursing homes and so on.

**Senator LUNDY**—Could you provide me with a summary of—I do not even know the words to describe it—the actual services performed or the uses of that computing database?

**Mr Moran**—That should not be a difficult thing to do. I am just not able to describe it in any detail beyond that it holds a lot of information and pays out a lot of money to places.

**Senator LUNDY**—You have described it as a business critical system.

**Mr Moran**—Yes.

**Senator LUNDY**—What safeguards did Health put in place to protect that business critical system, given that it had not only physically moved from your premises to be co-located with the Health Insurance Commission in Tuggeranong but also come under what I would term the immediate control of staff of Health—that is, someone under your direction was managing that system?

**Mr Moran**—I guess there are a number of things I could say about that. Firstly, we have a very precise set of contractual obligations with IBM GSA in terms of the things that they will do. If you have not already seen the services agreement, I could point you to schedule 1 of that agreement, the statement of work, which describes over many pages what IBM is required to do. Schedule 3 to the services agreement describes the sanctions in a financial sense that the department will apply to IBM GSA should they not fulfil those obligations. So I guess that is the contractual framework.

In a technical sense we did not hand over to IBM until 9 June. One of the reasons why we took on both sides—it was an agreed lengthy transition to IBM—was that we wanted to be satisfied that all of our requirements, and they were not just IT systems but the range of business systems associated with the transaction, were robust, and that IBM understood that they were fully documented and that there were mechanisms in place to deal with problems. That is the case: we did not hand over until that was in place.

Thirdly, I have retained in the department a small technical team who are ex-Health people who have a role in working with IBM, in terms of advice and on some occasions monitoring of their service delivery, not in a sense of doing their work for them; it is an advisory role given their long familiarity with the systems. For instance, the relocation of the mainframe from Woden to Tuggeranong was, in a sense, a joint project in that my technical people had a considerable amount to say about it to help IBM.

The fourth angle is that the people—if not exclusively, certainly largely—who are operating the systems mainframe included, on behalf of IBM, nearly all—a very high proportion of them—ex-Health people. That is a long answer, but I would have to say there are no guarantees. But to the extent that commonsense, logic and reasonableness can drive a good outcome, that is what we hope safeguards us.

**Senator LUNDY**—Thank you. Just going back to your third point, you say you retained a technical team. Are they staff of Health?

**Mr Moran**—They are retained by Health. They are ex-public servants who have come back to the department as contractors through various contracting houses around Canberra.

**Senator LUNDY**—So they worked in Health previously?

**Mr Moran**—Yes, all of them.

**Senator LUNDY**—And then took a package through this whole arrangement?

**Mr Moran**—I think four of them were public servants and took packages. Two of them are in fact already contractors and have stayed on. I have simply extended their contracts.

**Senator LUNDY**—So you contract them on a six-monthly or 12-monthly basis. Are they full time?

**Mr Moran**—Largely; I do not think any of them are employed elsewhere; the ex-public servants in particular are not necessarily working the sorts of hours they worked before, given that they are now paid hourly or daily rates. In a sense I have sole use of them but they are not working the sorts of hours that they used to.

**Senator LUNDY**—Could you provide details of their terms and conditions of contract and also their terms of engagement under the contract?

**Mr Moran**—I could take that on notice. I am not entirely sure what my obligations are to them in terms of their privacy, but I will certainly undertake that.

**Senator LUNDY**—Again, you can express those views to the committee.

**Mr Moran**—I understand that.

**Senator LUNDY**—I can say what I said before but I think you understand the situation.

**Mr Moran**—I do understand that. I am expressing ignorance at this point about what my obligations to them might be.

**Senator LUNDY**—That would still not override your obligations to the parliament.

**Mr Moran**—I understand that.

**Senator LUNDY**—I would like to go on to another area that relates to the industry development aspects of the health group contract. Can you tell me what involvement you had, if any, in negotiating or participating in discussions about the supplementary industry development requirements of IBM GSA as part of the health group?

**Mr Moran**—I had none.

**Senator LUNDY**—That says it in a nutshell. Are you aware of the industry development requirements that are associated with the health group now?

**Mr Moran**—Broadly speaking; I think we see the manifestation of that, in part anyway, on the floor in that ASI and Hallis are significant subcontractors to IBM. More broadly, it is only in the very general sense of having read through the schedule—I think it is schedule 10—and having decided that it is unlikely to have any impact on my responsibilities for delivering service.

**Senator LUNDY**—Are you aware of any impact or effect that those industry development requirements had on any of the costings, estimations or negotiations of the health contract?

**Mr Moran**—I know nothing of what the details might be. I assume that at the end of the day the people handling the industry development side of the negotiations sought the best deal for the Commonwealth. To the extent that I am able to judge, that is what we are seeing now.

**CHAIR**—Who handled those negotiations, Mr Moran? Do you remember?

**Mr Moran**—It was OASITO and the department of industry, communications and technology—I am sorry; I have forgotten the name of the department—assisted by a firm of consultants and perhaps one or two advisers.

**CHAIR**—Is there a written contract in terms of the industry development outcomes?

**Mr Moran**—Yes. IBM GSA has obligations to the Commonwealth which I think—and I stand to be corrected—are captured in schedule 10 to the services agreement.

**CHAIR**—The industry development provisions are actually written in the service agreement.

**Mr Moran**—Yes.

**Senator LUNDY**—I have a couple more questions and then I will hand over to Senator Buckland. In the Humphry review, there was a brief section with regard to industry

development which spoke of future directions. The Humphry report alludes to the fact that it might be appropriate for departments and agencies to take a greater role in determining the industry development outcomes associated with their contract. Do you have a view on that? Have you had time to assess what potential that has in the management of the contract?

**Mr Moran**—I will answer the last question first: I do not think that it has any impact. With regard to your first question, we recognised very early in the process that it might be the case that the vendors would bid, as part of their industry development, on significant health, rather than technology, things. We were in part alerted to that by the vendors themselves, who—all three of them—made much of their involvement in the health sector in other countries. We then pressed hard for an officer of portfolio strategies division to be consulted on any health, opposed to technology, industry offering. I understand that he was consulted on some occasions. It was also the case—although this is still a slight difference between OASITO and us—that the secretary of the department took part in the options committee consideration of the final bids, which obviously included the bringing in of the industry development things. In that sense, I would agree with the finding of Mr Humphry.

**Senator LUNDY**—Did you have or do you still have any partnerships for development or fixed term arrangements programs operating in association with any of your IT or existing contracts?

**Mr Moran**—I am sorry, I missed the last part of a question.

**Senator LUNDY**—Do you have any partnerships for development or fixed term arrangement with IT vendors?

**Mr Moran**—We have separate arrangements with Telstra at the moment for the provision of voice services and we obviously have a range of software licenses. We retain the licence, which IBM manages on our behalf. I cannot detail all of them off the top my head.

**Senator LUNDY**—Can you take on notice if those partnerships for development or fixed term arrangements are industry development style initiatives.

**Mr Moran**—I am sorry. I misunderstood the question.

**Senator LUNDY**—I thought you did.

**Mr Moran**—We have none of those.

**Senator LUNDY**—Were any of them operating before the health group contract came into place?

**Mr Moran**—Not that I am aware.

**Senator BUCKLAND**—You were placed in a cluster grouping, as I understand it. Can you remind me who that cluster consists of.

**Mr Moran**—It was the then Department of Health and Family Services—now the Department of Health and Aged Care—the Health Insurance Commission and Medibank private.

**Senator BUCKLAND**—What input did your department have into arriving at that collection of departments as a cluster?

**Mr Moran**—It happened before my time, Senator, but I understand—and I will take on notice to correct the record if I am not right—that it was the subject of some discussion between the secretary of the department, the Managing Director of the Health Insurance Commission, the Managing Director, I assume, of Medibank and the then CEO of OASITO. They decided that that ought to be the sensible grouping of agencies. I am not aware of the detail of any negotiation but certainly that was the outcome and I understand it was arrived at without a large amount of angst.

**Senator BUCKLAND**—You were not there at the time, so some of these questions may need to be taken on notice. Do you know whether the minister, or a minister or ministers, had any direct input into arriving at the cluster groupings?

**Mr Moran**—I do not know for certain, but I would be surprised if the Minister for Health and Aged Care was not asked to agree with it. But I need to take on notice whether that was formally done.

**Senator BUCKLAND**—Again you may have to take this on notice. Do you know how far down through the department hierarchy it filtered for input into who should be clustered together?

**Mr Moran**—I will certainly have to take that on notice.

**Senator BUCKLAND**—Yes. Would you undertake to give us an answer to that?

**Mr Moran**—Certainly.

**Senator BUCKLAND**—Who exactly are the parties to the contracts?

**Mr Moran**—From the Department of Health and Aged Care, it is us as a single agency and IBM Australia and IBM GSA as joint contractors. I understand that is the same in respect of each of the Health Insurance Commission and Medibank Private.

**Senator BUCKLAND**—The department is far-flung; it is in each state and in outlying locations. Who assessed the needs of the department for outsourcing? Was it done in-house or was there a consultancy brought in?

**Mr Moran**—It was done in-house. The project was managed by me. I have a range of assistants, both public servants and contractors, some of whom worked and continue to work in the department and others were brought in for short periods to do specific tasks associated with



developing the request for tender and managing the contract negotiations towards the service agreement which we eventually signed.

**Senator BUCKLAND**—Could you describe the contractors in outsourcing—

**Mr Moran**—Perhaps I should describe them as consultants.

**Senator BUCKLAND**—Can you describe the type of consultants they were? Were they consulting firms or individual people.?

**Mr Moran**—I think we used a couple of consulting firms. I recall we used a firm called Acumen Alliance to do a lot of the number crunching and financial analysis. We used a firm called PSI to do some work on risk assessments. We used PricewaterhouseCoopers to do an overall business risk assessment. We also used individual consultants who contracted to the department through their own firms or through small companies.

**Senator BUCKLAND**—I might be going over old ground here, and forgive me for that, but I am a pretty recent addition to the scenery here. On the costing, is there a breakdown of costing insofar as how much it cost for the department itself, that is, your own personnel, and how much it cost for these contractors or consultants?

**Mr Moran**—I can get an aggregated figure for you in a second, but the actual cost in the sense that I was able to measure it of what it cost to manage the project from its start includes my Public Service staff as well as contractors. I have not got it disaggregated by public servant and non-public servant.

**Senator BUCKLAND**—Would it be difficult to obtain that information?

**Mr Moran**—It would be complicated if you wanted it precisely. I could undertake to do it if you bear with a margin for error where clerical records are not available or we have not quite got the dates right—

**Senator BUCKLAND**—To be honest, if you are paying a consultant to come in, surely you know how much you are paying them.

**Mr Moran**—I am sorry, I misstated that. I can certainly provide it. To answer your question, it would be complex to give you the detail but, if that is what you require, yes, we can do that. As best I can discern from this, the number is \$4.1 million. That is the combination of staff and contractors to move to the point of outsourcing.

**Senator BUCKLAND**—In selecting the winning outsource company to do the work for you, what parameters did you have? How was it managed? Was it a matter of cheapest wins? How did you select these people to manage the system for you?

**Mr Moran**—We operated within the framework provided to us by OASITO, which made it very clear that a major objective of outsourcing—and therefore of the successful tenderer—would be, I think the term was, ‘significant cost savings’. That, combined with an assessment of, I recall the term, ‘service and risk’—that is, no vendors would go past the point of being assessed for cost savings if they did not satisfy the criterion for being able to deliver the services

for cost savings if they did not satisfy the criterion for being able to deliver the services at an acceptable risk. That was the parameter in that sense. There was also a requirement that they comply with the range of contractual terms of conditions—corporate, legal requirements.

**Senator BUCKLAND**—When the decision was made to outsource, it must have been known very early in the piece that cost savings was going to be a major objective—and there is no criticism of that; the world is heading that way. Was there any consideration given at all at your level or above to looking at an in-house option—that is, to see if using your own expertise, the people who were actually on the ground at the time, could contribute to a cost saving exercise for the department?

**Mr Moran**—It was one of the first questions we asked as we moved into this outsourcing arena. The answer from our OASITO was, ‘No, that was an option that the government had considered and had formally rejected.’

**Senator BUCKLAND**—So it was not a matter of you being able to make a submission and say, ‘Look, hang on a minute, we aren’t complete fools. We could put an option up that could compete against an outsource company’?

**Mr Moran**—By that stage, that decision had been taken. I understand that various agencies at the time that the initiative was first mooted raised the issue of in-house bids but, certainly, by the time we were initiating the project, the decision had been taken that there would be no in-house bids.

**Senator BUCKLAND**—At some point in time I trust that you advised all your staff from your level down, including the janitor, that you were going to outsource your systems. What process was used to announce it to the work force that this was going to happen?

**Mr Moran**—It was a progressive process. At the time that the government made its decision that all budget funded agencies would outsource their IT infrastructure—unless, as I understand it from memory, there was a compelling business case not to—it was generally understood by people in budget funded agencies delivering IT infrastructure services that they would, at some point, be outsourced. The department of health moved quite quickly. Again, that is before my time, but looking at the files and talking to the people involved, it moved quite quickly to make a number of decisions about that basic government decision, including offering at that point the ability for people to move away from being outsourced.

There was always the option for public servants to transfer or to move to other parts of the department. It also made a fundamental decision that it would adopt what is referred to as the ‘clean break approach’, which involved retention, colloquially referred to as ‘golden handcuffs’ and a redundancy package at the end of it. It was about the time that I arrived in mid-June that we made a conscious decision that we would work with the group being outsourced—at that stage it was 120-odd—rather than go somewhere else and do it to them. Indeed, much of the work associated with the outsourcing project, particularly a lot of the very specific evaluation, was done by people who were referred to as in scope.

So it was a progressive series of announcements from the point of the government decision to the human resources framework which would manage their lives and careers for the next two

and a bit years. We retained an organisation called DBM Australia—human resource consultants—who provided us with a range of advice on how to handle sensitively the sorts of changes that people were going through. As I say, we involved them actively. My project office was on the same floor and worked with the same people who were being outsourced, and we kept them up to date, in many cases on a daily basis.

**Senator BUCKLAND**—Was a special team set up to handle any queries from the staff?

**Mr Moran**—There was a specific team set up within my branch. We referred to it as the ‘change management team’. It was a small group of people who had spent a long time in the department of health, who were known personally to the people being outsourced and who had some expertise in those areas as well as the HR area of the department as a whole, and the firm that I referred to which offered more specific and professional advice.

**Senator BUCKLAND**—The cost-cutting was a significant factor in the department’s consideration to outsource—as I said earlier, I can understand that;. was there any consideration of the customer satisfaction that may be delivered by an outsourcing arrangement?

**Mr Moran**—Yes. As an early part of the project planning, we went to some length, in conjunction with the information technology services branch, which was the one being outsourced, to measure to the extent that it was possible the service levels across the range of services which were going to be outsourced that were then being delivered to the department of health by its in-house provider. We determined at that point that that was the bare minimum that we would aim for in terms of signing a services agreement with a private deliverer. That, if you like, was the mechanics of it. We then went to considerable lengths to caucus with each of the business areas across the department to have them describe in specific terms their business needs as they related to their IT needs, and those needs were documented in an extensive schedule to the RFT on which, I suppose in a sense during the evaluation, we tested the vendors’ ability to understand our IT needs in respect of our business requirements. So the answer is a very long ‘yes’.

**Senator BUCKLAND**—Sometimes a long ‘yes’ is better than just a ‘yes’ without background. One thing that worries me all the time about outsourcing—and I have been through a lot of outsourcing arrangements in a former life—is the level of protection for the client, that is, the people whom you service through the department, because, as I understand, the outsourced company will be managing a computer system that, in the main, will be collecting data and all those sorts of things on people. What degree of protection of the clients’ private information is built into that? What is in the contract to protect the names and information of anyone who is using the service from being passed on?

**Mr Moran**—I would start my answer to that question by saying that we have extensive requirements of IBM GSA in the services agreement to protect what is referred to as ‘health data’, which is a generic term for all of the information residing on all of the systems. We require IBM to act as though it were bound by the Privacy Act—in other words, it is obliged to perform and conduct itself in all of those ways. If there were any material breach of that privacy, from memory, that would be a predetermined cause for termination of the contract, should we wish to exercise that. So there are some very heavy sanctions on IBM GSA to protect information.

We also have a range of practical measures in place, as I alluded earlier to Senator Lundy in terms of the procedures manual, and before we handed it over we required them to design, describe and document all of their processes for data security, data management and the protection of privacy. We have an IT agency security adviser in my branch with staff whose job it is, among other things, to audit IBM GSA's obligations under the contract and to ensure that each of its many procedures are being followed. As I said, there are some fairly significant sanctions should they not be.

**Senator BUCKLAND**—Okay. I think I can probably conclude on this: those sanctions and parameters that are there to protect information are all in legal terms, no doubt?

**Mr Moran**—Yes.

**Senator BUCKLAND**—Did the department have the choice of selecting its own legal advice on that or did government solicitors just say, 'Here you go; make sure this is complied with.'?

**Mr Moran**—Most of the relevant parts of the services agreement which relate to privacy and confidentiality are contained in the general terms and conditions to the contract, although there are, obviously, requirements in the technical descriptions of IBM's obligations. A firm called Blake Dawson Waldron were retained by the Commonwealth through OASITO to provide that advice. In terms of privacy and confidentiality, I also relied on the advice of the in-house legal practice in the department of health and, towards the end of the contract negotiations, at the point where issues around privacy were being debated with the then preferred tenderer, AGS supplied us with a senior solicitor to help refine and protect our requirements.

**Senator BUCKLAND**—It may be a frivolous question, but I always think it is a pretty interesting one, and I will finish on this. I always finish on the second or third last question. If a survey of your department was done today—and let us not go too far down the senior levels, and I want you to be very honest with this—as to whether we should retain the system we have now or go to outsourcing, what do you think the outcome would be?

**Mr Moran**—Right now, I suspect they would rather have it the way it was before.

**Senator BUCKLAND**—I think that answers the question.

**Mr Moran**—In fairness, one month ago they would have been agnostic because, to be honest, IBM has provided a pretty good level of technical service. There have been a few problems in the last month and I do not know what they might say in a month from now.

**Senator BUCKLAND**—Thank you very much.

**CHAIR**—What provisions are in the contract with respect to the development of any software and the control of intellectual property?

**Mr Moran**—That is a very good question and I am afraid I will have to take advice and I may have to take it on notice. Certainly, in the general sense, I can say that the Commonwealth's intellectual property requirements are very heavily regulated and we retain all of the rights that we would otherwise have. It is not likely to be the case that much software is

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going to be developed under an infrastructure outsourcing, although it is possible that some may be. As I recall, the department certainly has untrammelled access to any material which it might need to either operate or provide to any new supplier. But that does not sound like a particularly satisfactory answer. Perhaps I ought to take it on notice.

**CHAIR**—No, it is not. I think that you had better take it on notice, because I have concerns. In particular, if the development of new operating systems arises out of the contract with IBM GSA, who, ultimately, owns the intellectual property?

**Mr Moran**—I might be able to get a very simple answer to that. If it is specific to us, we own it. If it were something that we ask IBM GSA to do for us, it would become a regular commercial negotiation about who might own it. To be fair, I might provide you with those portions of the contract that deal with intellectual property.

**CHAIR**—I would appreciate that. In terms of your experience so far, has outsourcing been a cost-effective exercise for your agency?

**Mr Moran**—A cost-effective exercise?

**CHAIR**—Yes.

**Mr Moran**—As I said earlier, given that we have a five-year contract in place, and given that in any outsourcing of something this major there is a hump at the start in terms of outlay, if you were to look at the balance sheet right at this moment I think you would probably say it was still in the red. But, as I indicated earlier, if we are able to maintain the pressure, if you like, on consumption behaviour through a mechanism of making visible invisible costs in the charge-back regime, the internal charging regime, we remain optimistic that we can drive consumption and therefore costs down.

**CHAIR**—But you underline the word ‘if’.

**Mr Moran**—Yes, absolutely. I can give no guarantee about that.

**CHAIR**—I have just one general question. In terms of the management of the contract and the contract negotiations, can you briefly explain the extent to which OASITO was involved in that process, the extent to which Shaw Pittman provided advice in respect of that process, and whether or not it is your view, or your agency’s view, that you would have been competent to manage the outsourcing process yourselves irrespective of the assistance from OASITO?

**Mr Moran**—Forgive me if I stray off the point with all of those questions. As I said earlier, the department of health had a major involvement in the negotiation of the request for tender and considerable responsibility, and almost autonomy, in terms of conducting negotiations with initially three and then ultimately one vendor. Shaw Pittman brought to the initiative, as I understand it, something of a methodology but certainly a contract framework which they have used and I believe continue to use in other places, which is the very detailed terms and conditions and extensive schedules. They brought with them a negotiation framework in broad and also brought with them—although it might have been modified internally in Australia—the cost modelling that was underpinning the financial negotiations. It is the case that, as far as I

recall, certainly at the time that there were still three vendors in the equation, no negotiation took place without either an OASITO person or persons and one or two people from Shaw Pittman present, and I think it is fair to say that one or two of the Shaw Pittman people brought considerable experience to the negotiating table. After we went to the preferred vendor there was a flurry for a moment, before we brought it back in line, of one-on-one negotiations between the department and health, but it was quickly brought back into line that this was still a tender that was live rather than a done deal. Does that answer the question?

**CHAIR**—In part it does. We are pressed for time. The other question I am asking, though, is whether or not you would have been competent to manage the process yourselves of outsourcing in the department without the assistance of OASITO or Shaw Pittman.

**Mr Moran**—It is a fairly difficult question. I would like to think, and I think with some confidence, that the team that I had and continue to have could have outsourced the Department of Health and Aged Care's IT. Whether or not it would ever have got to the point of doing so because of reluctance more broadly, in the technical and professional sense I think we could have done that. It is probably fair to say that some of the negotiating leverage which we were able to apply—more particularly I think that OASITO was able to apply during particularly the parallel negotiations—arguably would not have been available to the department of health had we been doing it on our own.

**Senator LUNDY**—I have a couple of questions, and I am conscious of the time so please take them on notice if they require a bit of delving. First of all, on the issue of cost savings, in the Auditor-General's report at page 130 there is a table which identifies for each of the groups investigated in this audit report estimated savings in cash outlays under the agreements. The next column is 'Agency cash budget reductions' and the final column is 'Difference'. Could you please provide the figures—obviously not the full health cluster—specifically for health? I actually think I know what these are but I am interested in health's analysis of those figures.

Can you tell me what proportion of the estimated savings in cash outlays has been identified, either by OASITO or you, as being attributed to an increase in the taxation liabilities of your outsourcing vendor, whether in GST, company tax or payroll tax? We know the department of finance has identified those as a proportion of the savings. Finally, on those savings, can you give me some detail as to whether or not the redundancy payments as part of your clean break process were part of your transition costs and how and where they factored into your costing analysis of the whole process?

**Mr Moran**—That is a fairly large—

**Senator LUNDY**—I know there is a handful there. Maybe you can tackle the last one and I am happy for the answers to the other questions to come in later.

**Mr Moran**—The figure I gave you earlier—from memory, \$4.1 million—did not include the redundancy payments to the public servants who became redundant. That was strictly the cost of running my own operation and managing the outsourcing process. I can probably give you the figure for redundancies—I have it here somewhere. It was \$5.9 million we paid out in redundancies to public servants who became redundant as a result of this initiative.

**Senator LUNDY**—That was not factored into the agency costing analysis?

**Mr Moran**—Yes.

**Senator LUNDY**—Okay. If you could show me how, that would be great. I have a question that relates to the section of the audit office report on data security and it follows on from Senator Buckland's question. In 1997, DSD, Attorney-General's and then OGIT released an IT infrastructure security framework for outsourcing. The audit office report identifies problems with at least two of the clusters in the implementation and adherence to the recommendations or guidance contained in that report. Can you provide the committee with a full description of Health's treatment of that DSD framework and the timing and how it related to the preparation of your request for tender and, indeed, the transition and implementation?

**Mr Moran**—Yes.

**Senator LUNDY**—Again following on from Senator Buckland's questions, can you also cover the implementation of the privacy requirements, and specifically reference the problems identified in the audit office report about the contractual privacy arrangements?

**Mr Moran**—I can give you a short answer to the question on the DSD requirements. It is relevant to what I said earlier, that IBM GSA is obliged to provide a range of security plans and reports, and the request for tender was developed in line with what DSD regarded as appropriate. To the best of my knowledge, and certainly in terms of our response to the ANAO report, we were satisfied that both the request for tender and our procedures satisfied the DSD requirement. That would be my initial response, but I have undertaken to come back to you in more detail on that.

**Senator LUNDY**—If the system has a problem—for example, if there is a breach of privacy—who is ultimately liable for that: you or IBM GSA?

**Mr Moran**—If IBM is responsible for it, then they are. I have significant ability to sanction them.

**Senator LUNDY**—Sure, but if there is a damages claim from a citizen, is that IBM's problem or your problem?

**Mr Moran**—That, I think, is the subject of some legislation or draft legislation about extending the Privacy Act. The best I can say at the moment is that the last piece of legal advice I saw on it is that it would likely become a football.

**Senator LUNDY**—Yes, that is my very specific concern. This was raised back in 1995-96 in an Ombudsman's report and, in fact, prompted the first Senate inquiry into contracting out. I would like a very specific answer—if you need to get legal advice on it, do so—on that precise question of liabilities.

**Mr Moran**—It is a question and an answer I guess for every agency which has done this—

**Senator LUNDY**—Absolutely.

**Mr Moran**—and its heart goes to the policy of outsourcing. I will undertake to give you the best answer that I am able to, but it is not something that one agency I think can be definitive about.

**Senator BUCKLAND**—I think Senator Lundy asked for legal advice, not the best you can.

**Mr Moran**—I understand that. It certainly was not going to be my opinion.

**Senator LUNDY**—Thank you for that. It is a crucial point.

**CHAIR**—Thank you, Mr Moran and Mr Mahajan.



[10.11 a.m.]

**JAY, Ms Dianne, General Manager, Corporate Services, Medibank Private**

**McNEIL, Mr Peter, Chief Information Officer, Medibank Private**

**CHAIR**—I welcome witnesses from Medibank Private. Would you like to make an opening statement?

**Ms Jay**—At the outset I would like to clarify Medibank Private's involvement in the OASITO process. Medibank Private participated as an observer. As a government business enterprise we were not required to be part of the OASITO outsourcing process. However, we chose to be involved as a participating observer and in the process to transfer the provision of mainframe and mid-range IT services from the Health Insurance Commission to finalise our separation from the HIC and to establish a relationship with a third party provider of services.

**CHAIR**—Who is the third party provider of services?

**Ms Jay**—IBM GSA.

**Senator BUCKLAND**—I note that Medibank Private was really invited and did not really have to join this cluster. What was the contributing factor that tipped you over the edge and made you say, 'That is the way we're going'?

**Ms Jay**—As you are probably aware, Senator, we were once part of the Health Insurance Commission. As part of the separation process, we put in place an agreement with the Health Insurance Commission—the technical services agreement—for the provision of IT services as part of the transition post-corporatisation of Medibank Private. Those services were to be provided for a definitive period. It was a contractual relationship between the Health Insurance Commission and Medibank Private. We had anticipated establishing a relationship with an outsourced provider of service to Medibank Private prior to the expiration of that technical services agreement. The OASITO process gave us an opportunity to do that and to do it in concert with the Health Insurance Commission, because we ended up with parallel events—we were looking to establish a new relationship with a service provider and were also looking to conclude the last elements of our separation from the HIC and the HIC had to outsource in the same time frame. Does that make sense?

**Senator BUCKLAND**—It does to some extent, and I am sure that when I read the *Hansard* it will make more sense—and I am not being rude to you at all. I did follow what you were saying. Outsourcing has been around for a long time—this is not looking at just the public sector; I am including the private sector as well, of course—and some projects have been monumental disasters. Please make your answer as concise as you can, because the question is not. What was it that really made you decide to go down the track of outsourcing—that one contributing factor? Was it that you woke up one morning and you said, 'Hey! We'll go this way.' Was it government pressure? Did the minister or senior advisers put pressure on you? What did it?

**Ms Jay**—It was a clear commercial decision for Medibank Private that we were not in the business of IT services. It was not core to our operations, and we were looking for someone with expertise in the provision of those services to provide those services to our company.

**Senator BUCKLAND**—Before this great invention of information technology and collecting data on computers, it was all done on carbon paper and pencils by people sitting at desks. Are you trying to say that in those days we had people who could push pens but we did not have people we could transfer to operate this new technology? Is that what you are trying to tell us?

**Ms Jay**—No, not at all. There are costs and issues associated with providing those services in-house, and we took a strategic decision that, for Medibank Private, we did not want to be in the business of running those services for ourselves. We were very clear in that.

**Senator BUCKLAND**—I said this once before to another committee: I know where I am going, it is just that the bus I caught might not be going the most direct route, so I want you to bear with me on this. When the decision was made to outsource, did you set up your current model and then set up a parallel model, the outsourced model, and did you try to number-crunch those down to see which was the best option? Or did you just decide, ‘We’re going to go that way; come what may, this one is going to be the winner’?

**Ms Jay**—We looked at it from a business point of view to come to a rational conclusion about what was in the best interests of Medibank Private. We were, as I said, running two processes in parallel and looking at how we wanted to run the business post separation, conscious of the fact that the HIC was required to be involved in the OASITO process. We were looking to establish our own baseline costings for the provision of IT services at the same time that HIC was looking to do that. So, certainly, we looked at the baseline costings of the provision of IT services and we then looked at what was available in the marketplace, using our participation in the OASITO process to do that. We drew the conclusion—which we had already intuitively drawn—that we were better off looking to outsource the provision of IT services for Medibank Private.

**Senator BUCKLAND**—This question you may have to take on notice: what will the cost of setting up your outsourced program be, and how does that compare with the in-house model that was used?

**Ms Jay**—In order to be precise in the response, I would like to take that on notice, Senator.

**Senator BUCKLAND**—It would be very interesting to find that out. How is Medibank Private going to effectively provide market surveillance and analyse the support information that is coming in?

**Ms Jay**—In effect, we were already outsourced before we went into this process. The HIC was providing services to Medibank Private. Post separation, we established a team within our IT services area which was responsible for managing the day-to-day relationship with the Health Insurance Commission as a supplier of service. What we did in the process of shifting our supply arrangement from Health Insurance Commission to IBM GSA was to establish account management processes within the organisation, which exist today, to manage that

relationship with IBM GSA, to be very clear about the costs of those services and to manage all dimensions of the contract with the outsourced company.

**Senator BUCKLAND**—In evaluating what you had and what had to be outsourced, did you use any consultants or contractors? I think you heard the line of questioning this morning.

**Ms Jay**—Yes, we had a team of internal people—as did the department, I believe, and the Health Insurance Commission—made up of staff from our IT services division. We also brought in some additional contract people to assist us in that process. We had a contract project manager working with us and we also used external legal advisers—we engaged Minter Ellison to work with us on the legal dimensions of the process.

**CHAIR**—Just to go back a step, did you say in a previous answer that you were previously outsourced anyway and that the service provider was the Health Insurance Commission?

**Ms Jay**—That is right.

**CHAIR**—So you say that the shift to IBM was really a technical shift?

**Ms Jay**—The relationship between the Health Insurance Commission and Medibank Private for the services of IT provision was determined through a technical services agreement, which was one of the formal agreements put in place as part of the corporatisation of Medibank Private in its separation from the HIC. So the short answer is: yes, we had a contractual arrangement with the Health Insurance Commission for the provision of service and we were looking for a transition from that arrangement to IBM GSA.

**CHAIR**—Can you tell us what the difference is in terms of the previous service agreement you had with the Health Insurance Commission and the service agreement you now have with IBM GSA?

**Ms Jay**—That is very difficult to encapsulate in a few words. Perhaps I could take that question on notice.

**CHAIR**—I am not trying to pin you down on the detail; I am actually trying to understand what the overall conceptual difference is.

**Ms Jay**—I think it is fair to say that when we established the contract with IBM GSA it was perhaps a little more rigorous in the area of service provision than the agreement with the Health Insurance Commission post-separation. One of the things I think we learned in the process of separating was that we needed to be very specific about the service levels we required.

**CHAIR**—What about the cost side?

**Ms Jay**—Certainly there was a cost side to the agreement with the Health Insurance Commission under the TSA, so the HIC were recovering costs from Medibank Private for the provision of those services.

**CHAIR**—Is the cost of the service with IBM dearer or less than it was with the Health Insurance Commission?

**Ms Jay**—The component of Medibank Private's IT services that were outsourced to IBM GSA from HIC was quite similar. I cannot be more specific than that in terms of cost.

**CHAIR**—Why can't you be more specific than that?

**Ms Jay**—Because I do not have the numbers in my head.

**CHAIR**—Can you take that on notice?

**Ms Jay**—I can certainly take that on notice.

**Senator BUCKLAND**—You mentioned that you had Minter Ellison as legal advisers, but what about consultants to look at the services you provide as Medibank Private? Were any consultants used to analyse or evaluate those operations that were to be outsourced?

**Ms Jay**—I am not sure that I understand the question.

**Senator BUCKLAND**—You have a department that is going to be outsourced and someone has to make a decision, 'This is what is going to be outsourced; these are the components that are to be outsourced.' Who analysed that and who valued that?

**Ms Jay**—We had an internal team that looked at our needs prior to the transition from HIC to IBM GSA. We made a decision at Medibank Private that, in terms of the scope of outsourcing, we would go with an outsourcing of mainframe and mid-range services. That was the core element we were looking to outsource through this process.

**Senator BUCKLAND**—I think that has answered the question. You did not bring an external body in?

**Ms Jay**—No.

**Senator BUCKLAND**—Great.

**CHAIR**—Were they essentially the same services that you were outsourcing from the Health Insurance Commission?

**Ms Jay**—That is right.

**Senator BUCKLAND**—Answering an earlier question, you made mention of the IT Services Division within Medibank Private. What was wrong with them continuing the operations rather than outsourcing—or do I have that wrong?

**Ms Jay**—We did not own the sorts of assets that we are talking about at the time in any case. Those assets were owned by the Health Insurance Commission and we already purchased services from them.

**Senator BUCKLAND**—Would the cost of purchasing additional equipment or services have outweighed the cost of outsourcing?

**Ms Jay**—We made a decision that we were not in the business of providing IT services to ourselves or to anybody else and that it was cost beneficial. In a management sense, it was strategically more important for us to be focused internally on other things.

**Senator BUCKLAND**—Was the protection of privacy a significant issue weighed up in the minds of Medibank Private?

**Ms Jay**—Certainly, given the business that Medibank Private is in. We are very interested in protecting the privacy interests of our membership. Despite the fact that Medibank Private is not required to comply with the Privacy Act, we have always had policies consistent with the privacy principles. Also, privacy issues are specifically covered in the contract and we were very concerned to ensure that they were appropriate.

**Senator BUCKLAND**—This is something that would have been looked at very thoroughly, I imagine, by Minter Ellison.

**Ms Jay**—Yes, absolutely. We spent a considerable amount of time looking at the privacy dimensions of the contract.

**Senator BUCKLAND**—If there is a breach of confidentiality, what provisions are in place to remedy that?

**Ms Jay**—We believe the contract clearly articulates the responsibilities on both sides. In the event of some challenge to how an individual's privacy is being protected, it would be clear from the contractual arrangements where the liability might sit. Of course, we would have to take the advice of lawyers.

**Senator LUNDY**—Can you tell us where the liability sits at the moment?

**Ms Jay**—I can take that on notice. We can certainly provide you with advice as to exactly how those responsibilities sit in contractual terms.

**Senator BUCKLAND**—I would certainly like to see that because I think it is something that we are all going to face with the constituency. Privacy is a fairly big thing. I am covered by Medibank Private and I certainly do not want everyone knowing my business more than they do.

**Ms Jay**—From a commercial point of view, we appreciate that that is part of the value that you expect to derive from being a member.

**Senator BUCKLAND**—But it is a big issue that needs to be clearly addressed and we would appreciate the information.

**Senator LUNDY**—I would like to move to a couple of questions that perhaps follow from the liabilities question. I asked a question of the other witnesses about the implementation of the IT Infrastructure Security Framework for Outsourcing which was released in 1997. Did you adhere to those guidelines prior to outsourcing?

**Ms Jay**—In terms of the precise nature of the security arrangements that we had in place, I would like to take that on notice. I do not believe that I can answer that off the top of my head.

**Senator LUNDY**—Sure. It may be that it relates to your technical services agreement, so take that into account as well. Regarding the question of costings, in previous committees we heard that the government estimated the overall savings for the health group as in the vicinity of some \$54 million. Can you tell me what proportion of that amount was specifically identified as being Medibank's contribution to their savings outcomes?

**Ms Jay**—I will have to take that on notice.

**Senator LUNDY**—Can you also take on notice—if you cannot tell me now—what proportion of that figure can be attributed directly to an increase in tax revenue from corporate taxes that the government, through the department of finance, would derive. Obviously, that would lead to a net figure of savings that you are theoretically going to achieve.

**Ms Jay**—I am happy to take that on notice.

**Senator LUNDY**—Thank you. Can you tell me what the extent of your budget deductions have been previously, and perhaps continuing into the out years, that were attributed to IT outsourcing?

**Ms Jay**—Is this in our internal budget?

**Senator LUNDY**—Yes.

**Ms Jay**—I would like to be specific and be sure that I am being accurate in the response, so, if I may, Senator, I would also like to take that on notice.

**Senator LUNDY**—Okay. Have you had budget deductions?

**Ms Jay**—As a consequence of the decision?

**Senator LUNDY**—Yes.

**Ms Jay**—Certainly our estimates indicated that there would be a benefit as a consequence of the outsourcing process. Those estimates were based on the full life of the contract and we are only a short way into the life of that contract.

**Senator LUNDY**—Do you have those estimates contained in—for our purposes—portfolio budget statements? If you have got that information handy, it would be very useful because I have some questions about that.

**Ms Jay**—Just to be sure that we are not talking at cross-purposes, Senator, there is no Commonwealth budget funding whatsoever for Medibank Private. We are dependent solely on member contributions for our operations; there is no budget dependency at all.

**Senator LUNDY**—That does clarify it. I was not sure if there was an allocation that could be identified.

**Ms Jay**—No, absolutely not.

**Senator LUNDY**—That certainly changes the context of the questions I asked previously. Those assessments may well not have been determined externally but within Medibank itself, so they still apply. Having previously outsourced—through a technical services agreement—your IT to the Health Insurance Commission, for the committee’s benefit can you describe the nature of that technology? Does it constitute a mainframe system, databases, mid-range systems, et cetera?

**Ms Jay**—Peter, you might like to answer that.

**Mr McNeil**—Yes, it does. It is a mainframe environment and mid-range systems.

**Senator LUNDY**—How many MIPS in the mainframe environment?

**Mr McNeil**—Currently, it is in the order of 240 MIPS. I have not got the actual numbers at the time of outsourcing. Medibank has undergone substantial growth, with Lifetime Health Cover, et cetera, and we have had a substantial increase in our MIPS.

**Senator LUNDY**—Can you give us a brief description of the sort of data that is retained on the mainframe.

**Mr McNeil**—The mainframe is the primary source of all of our processing. It has all of our membership, claims and contributions data and is the source of all our member servicing.

**Senator LUNDY**—Business critical systems.

**Mr McNeil**—Absolutely.

**Senator LUNDY**—Do you consider the operation of that mainframe core business?

**Ms Jay**—No.

**Senator LUNDY**—Why not?

**Ms Jay**—The operation of the mainframe is not core business. The core business is the provision of private health insurance services to our membership and that is only one means by which we do that.

**Senator LUNDY**—I am very interested in this issue of what is considered core business. If there was a problem with that mainframe and a disruption to service, would that affect your core business?

**Ms Jay**—With any decision that a business takes there are potential risks. One of those risks for us is that there might be some sort of disaster which might impact on the provision of those services. Clearly, one of the things that we have looked to do through the contractual arrangements is to ensure that we have disaster recovery arrangements with the vendor, the provider of services. That applies across all of our business in terms of ensuring that we have business continuity plans in place that ensure that if there is a problem we have contingency plans to be able to deal with it.

**Senator LUNDY**—In terms of the mid-range systems that you have in place, can you describe their contribution to your business?

**Mr McNeil**—The primary mid-range system is housing our financials, basically our accounting systems, and operating those.

**Senator LUNDY**—I am trying to get an idea of proportions of your systems. Mid-range is, what, two per cent, 10 per cent of your systems?

**Mr McNeil**—It would constitute two to five per cent, maximum.

**Senator LUNDY**—Right. So the mainframe is the main game, so to speak.

**Mr McNeil**—Absolutely.

**Senator LUNDY**—Just going back to the mainframe systems, I presume that through your service level agreements you define the things you just spoke of, Ms Jay, about service levels that are expected and contractual obligations. Can you tell me if there is any difference in the service level outcomes that you have specified in this current contract from those specified in the technical services agreement? It is actually a very big question, and I am happy for you to take some of it on notice. But can you give me a general indication of whether there is an enhancement, a decrease, or it depends on the actual service?

**Ms Jay**—I think it is fair to say that they are defined differently. The service level specifications in the current contract with IBM GSA are much clearer so that on both sides of the contractual arrangement there is a much better awareness of the expectation and a clear articulation of the consequences if service provisions are not met.

**Senator LUNDY**—Have you had cause to apply a service credit—or, as I prefer to call them, a financial penalty—to IBM GSA for failure to achieve the service level agreements?



**Ms Jay**—Yes, we have, but in the overall scheme of things, in terms of the value of the contract, extremely minor.

**Senator LUNDY**—To what value have you applied service credit?

**Ms Jay**—We might need to take the one on notice. Of course, there are commercial issues are which are highly sensitive—

**Senator LUNDY**—None that any other agency has found prevents them from providing this committee, or indeed a legislation committee, with the figure.

**Ms Jay**—We will take that on notice.

**Senator LUNDY**—Could you also provide us with details as to the nature of the breach for which they were applied and the time, and any prevailing circumstances around the breach. That would be helpful.

This goes back to the savings figure I requested earlier: what proportion of the estimated savings do financial penalties actually constitute? I find that a useful calculation.

**Ms Jay**—Very small.

**Senator LUNDY**—We will see. Thanks for that. I have a few further questions. Can you clarify whether applications development is part of this contract you have with IBM GSA and the health group?

**Ms Jay**—No.

**Senator LUNDY**—What are your applications development arrangements within Medibank?

**Mr McNeil**—Currently our applications development has been outsourced to DMR Consulting.

**Senator LUNDY**—How long has that arrangement been in place?

**Mr McNeil**—Since the end of August last year.

**Ms Jay**—Just to clarify, that was not part of the outsourcing which we determined we would undertake whilst we were a participating observer in the OASITO process.

**Senator LUNDY**—I presumed as much. I just wanted to clarify my understanding. I am trying to recollect whether applications development was part of the health group's discussions overall, but other members of the health group—again I am working from memory—opted to outsource their applications development as well in some way, shape or form.

**Ms Jay**—You will have to ask the other agencies specifically about what they have done, but I do not believe it was part of the process for the health cluster.

**Senator LUNDY**—We can follow that through. In terms of your decision to outsource your applications development to DMR, can you tell me what was the arrangement prior to the decision, whether you in fact outsourced it partially or wholly prior to that contract?

**Mr McNeil**—Prior to that they were conducted in-house.

**Senator LUNDY**—Can you describe the staffing issues, arrangements, transfers, if you like, that were involved in the process of having applications development moved from in-house to an outsourcing arrangement?

**Mr McNeil**—We had a mixture of Medibank staff and contractors supporting the development and maintenance of our internal applications.

**Senator LUNDY**—Can you take on notice to provide the detail of the numbers of those people, how many were on contract and how many in-house, comparable figures to the personnel that DMR now engage and how many of your in-house or contracted staff now work for DMR? And anything else you can think of. I am just trying to think of the specifics, but we will leave it at that for now. I am trying to get a picture of the staff implications of that particular portion of outsourcing, even though it was not associated with the group.

**Ms Jay**—I am happy to take that on notice. I need to emphasise that the employees of Medibank Private are not employees under the Public Service Act and that decisions we have taken there are on the basis of the normal employment arrangements for Medibank Private.

**Senator LUNDY**—Okay. If you could make those points in your response I think that would deal with that.

**Ms Jay**—Yes.

**Senator LUNDY**—With regard to applications development and intellectual property issues, I am interested, given your status as an incorporated body, in how you have chosen to manage intellectual property and licensing of pre-existing software or applications specifically in that relationship with DMR. I do not know if you are in a position to give a brief description now on the degree to which you have retained that intellectual property. I am particularly interested in what your contractual obligations are to share subsequently developed modifications or applications under your contract with DMR.

**Ms Jay**—I can make the general comment that intellectual property is an asset and that, from a commercial point of view, it is another area of key importance to us to ensure that we protect the assets of Medibank Private for its membership. We certainly look to do that in our contractual arrangements with both IBM GSA and DMR. If you do want details on the specific contractual relationship we will have to take that on notice.

**Senator LUNDY**—Thank you. What are the implications or issues that have been arising between DMR and IBM GSA, given the proportion of your IT requirements managed by IBM GSA on the mainframe and DMR?

**Ms Jay**—We do have arrangements in place which ensure that there is a smooth relationship between IBM GSA, DMR and us. I alluded earlier to account management and relationship officers within Medibank Private who have responsibility for managing those relationships day-to-day. If there are issues that arise, the contractors certainly know who to contact internally. We think we have pretty good operating relationships in place.

**Senator LUNDY**—Can you tell me whether IBM GSA house your data within the Health Insurance Commission systems or separately, as we have heard from the department of health?

**Ms Jay**—Logically separated, but the hardware is housed at the Tuggeranong data centre.

**Senator LUNDY**—Is it a separate box or a virtual separation?

**Mr McNeil**—It is a virtual separation; it is logically separated.

**Senator LUNDY**—So when you say ‘logically’ it is actually in the same computer—

**Mr McNeil**—It is in the same data centre.

**Senator LUNDY**—Does that mean computer?

**Mr McNeil**—Yes.

**Senator LUNDY**—But ‘logically separated’ means that is the actual software and application systems that are separated.

**Mr McNeil**—And the data is housed separately so there is no crossover.

**Senator LUNDY**—Was that the case under the technical services agreement as well?

**Mr McNeil**—Yes.

**Senator LUNDY**—So that has not changed?

**Mr McNeil**—No.

**CHAIR**—To what extent are there provisions in your contract with IBM GSA to ensure that data held by them is secure not only in terms of external sources but in terms of the transfer of information within IBM GSA, given that IBM GSA is a provider for a number of other government agencies and also is an international provider-operator? In other words, what are the contract provisions in terms of the Chinese walls?

**Ms Jay**—Obviously, that was an important issue for us. There are elements of the contract that deal with those issues. Schedule 20 provides for a deed of undertaking in relation to personal and confidential information and schedule 23 deals with nondisclosure undertakings. There are nondisclosure undertakings signed by every member of IBM staff who might have access to Medibank Private information.

**CHAIR**—Can we be provided with copies of those undertakings? I am not out to find the individuals, just the contents of the undertakings given.

**Ms Jay**—Certainly there is a pro-forma undertaking. Yes, we can provide you with a copy of that.

**Senator LUNDY**—What quality assurance controls do you have in place for effectively policing the adherence to those undertakings?

**Ms Jay**—The contract is quite clear in terms of what is required on both sides. Part of the process of managing the relationship and the responsibilities of people within Medibank Private who are doing that is to ensure compliance with all elements of the contract.

**Senator LUNDY**—That does not answer my question in the sense that I am actually after the processes and procedures. You are alluding to the fact that you have a team within Medibank Private whose job is compliance. Can you give me some more detail?

**Ms Jay**—I need to take that on notice. There certainly are security procedures in place within Medibank Private to protect our data. It would be more useful I think to document those for you than to provide you with a sketch outline in a few words.

**Senator LUNDY**—I am particularly interested in the degree of access those compliance officers, for want of a better description, have to IBM GSA systems. What depth of analysis are they able to access and what specific legal rights do they have under the contract to pursue their investigations?

**Ms Jay**—I understand.

**Senator LUNDY**—I do not know whether we have managed to ask this in the midst of all of these questions, but can you tell me within Medibank Private how many staff you have engaged in the process of holistically managing this outsourcing contract, whether it is compliance, relationships and so forth? I am interested in the overall number of staff, their roles and costs of contract management of this and indeed associated contracts like the one you have with DMR.

**Ms Jay**—Six are directly involved in the relationship management activity and two in security.

**Senator LUNDY**—And how many of those are on staff and how many of those are on contract?

**Ms Jay**—These are employees of Medibank Private.

**Senator LUNDY**—Do you have any additional consultants or contractors engaged in that process as well or participating in some way in that compliance process?

**Ms Jay**—One.

**Senator LUNDY**—Who is that? Where are they from?

**Ms Jay**—Do you want me to name that employee of that subcontractor?

**Senator LUNDY**—No. If they are an individual expert, then the name of the consultant.

**Ms Jay**—Individual expert, yes, not associated with the particular company as such.

**Senator LUNDY**—It might be a legal firm—

**Ms Jay**—No.

**Senator LUNDY**—or a specific IT consultant.

**Ms Jay**—No, with a high level of expertise in this area of contract management and outsourcing.

**Senator LUNDY**—If you could provide the name, if it is appropriate, of the company under which they are engaged, and the value of that contract, that would be useful.

**Ms Jay**—Yes.

**CHAIR**—You are in a slightly different position to some of the other agencies that we talk to about this overall outsourcing approach, given that you were already outsourced and it was a matter of transfer for you rather than outsourcing. I am interested to find out from you to what extent you processed this outsourcing agenda within Medibank Private within your own resources, or I think you used Minter Ellison for advice, or to what extent OASITO and Shaw Pittman were involved in your negotiations with respect to your contract with IBM GSA?

**Ms Jay**—As a participating observer, we had two representatives on the OASITO steering committee for the health cluster process. We certainly took advice from OASITO and Shaw Pittman in the process of concluding the outsourcing contract arrangement with IBM GSA.

**CHAIR**—Was that voluntary advice or compulsory advice?

**Ms Jay**—Voluntary from our perspective.

**CHAIR**—But, at the end of the day, as part of the cluster negotiations, were you compelled at least in part to follow the agenda that was being pursued by OASITO and Shaw Pittman, or did you ultimately make your own decision independent from that process in terms of your outsourcing?

**Ms Jay**—We were quite comfortable to be part of that process, which I think might be where you are coming from, Senator. There was certainly expertise that OASITO brought to the process, and certainly which Shaw Pittman brought, and from our own perspective we look to ensure that we had our own independent advice. I mentioned earlier that we had a contract

project manager working on this internally and a team of Medibank Private employees who were also engaged in the process.

**CHAIR**—So you did not necessarily on all occasions take OASITO's advice or Shaw Pittman's advice? You made your own independent assessments of it; is that correct?

**Ms Jay**—Yes. We had employees of Medibank Private participating in the evaluation process—evaluation teams—and they were making assessments from a Medibank Private point of view on the information that was made available to them. We looked to make a decision for Medibank Private that was rational for its business.

**Senator LUNDY**—Could I just ask a question there? Were Shaw Pittman present at those negotiations representing the health group agencies or the department of finance or OASITO?

**Ms Jay**—Shaw Pittman was a consultant to OASITO, and certainly I am aware of the presence of Shaw Pittman representatives at steering committee meetings for the purposes of being able to provide advice.

**Senator LUNDY**—Were they providing advice to you specifically, or were they providing advice to OASITO?

**Ms Jay**—There were times when Shaw Pittman would provide advice and opinions to us as an agency.

**Senator LUNDY**—What was your understanding of whom they were representing—yourselves, the health group or OASITO?

**Ms Jay**—As they were working with OASITO, I saw them as working with the Commonwealth.

**Senator LUNDY**—Was there ever any difference in the advocacy of the position of the health group, or of Medibank specifically, from the interests of OASITO in those negotiations?

**Ms Jay**—There were certainly times during the steering committee process when there were some fairly robust discussions about issues, but, on the whole, it was a successful process.

**CHAIR**—But, at the end of the day, were the concerns that you had in respect of your contract satisfied, or were they subservient to the wider negotiations of the cluster?

**Ms Jay**—We had plenty of opportunities for issues that we wanted to raise to be dealt with.

**CHAIR**—That is not the question I asked. I asked: were your concerns and issues satisfied in the outcome of the negotiations, or were they subservient to the overall negotiations of the cluster?

**Ms Jay**—Yes, they were satisfied.

**Senator LUNDY**—Just going back, you mentioned that issues were robustly debated. Were they issues relating to the bottom line fiscal impact on Medibank and this potential contract, as opposed to the bottom line fiscal impact for the whole of government or Finance or OASITO?

**Ms Jay**—To characterise them, they were more about ensuring that everybody on all sides—OASITO and the members of the cluster—understood the process in all its detail and the next steps in the process to ensure that issues that the agencies had were going to be dealt with at whatever stage we were at in the process. So do not take my ‘robust’ as being negative; in fact, I see that as a very positive thing—the fact that we were able to have those sorts of discussions to make sure that the outcomes were going to be useful to us.

**Senator LUNDY**—Because this whole process was mandatory—effectively, you were locked into it—and because inevitably you were going to be outsourced and you were going to participate in this program one way or another, was there any feeling within Medibank that, with that degree of inevitability that comes with a mandatory program, somehow you were going to find yourself in a less than optimal position?

**Ms Jay**—Medibank Private was a participating observer; we were not compelled to be in the process. We were there in a voluntary capacity, and we believe it produced a good outcome for us.

**Senator BUCKLAND**—Do you have any concerns about continuing down the track of outsourcing?

**Ms Jay**—No.

**Senator BUCKLAND**—Do your staff have any concerns about continuing down the track of outsourcing?

**Ms Jay**—No. We have been very clear with staff across the organisation.

**Senator BUCKLAND**—Have they shown any resistance?

**Ms Jay**—No.

**Senator BUCKLAND**—As you are a volunteer into the system of outsourcing, do you think there will be a revision of where you are and then opting out and going back to the old system?

**Ms Jay**—I cannot see that.

**CHAIR**—Thank you, Ms Jay and Mr McNeil, for appearing before the committee today.

**Proceedings suspended from 10.59 a.m. to 11.17 a.m.**

**KELAHER, Mr James Stephen, Deputy Managing Director, Health Insurance Commission**

**NUM, Mr David, State Manager, South Australia/Northern Territory, Health Insurance Commission**

**THOMAS, Mr Robert Septimus, Executive Director, Vendor Management, Health Insurance Commission**

**CHAIR**—I welcome representatives from the Health Insurance Commission. Mr Thomas, do you want to make an opening statement?

**Mr Thomas**—No, we do not.

**Senator LUNDY**—Can you tell me what proportion of the approximately \$350 million health group contract is attributable to the Health Insurance Commission in dollar terms?

**Mr Thomas**—It is \$250 million.

**Senator LUNDY**—In terms of estimated savings, I made reference earlier today to a table in the audit office report into IT outsourcing that identified groupings of figures. Can you tell me what the estimated savings are under the health group contract that can be attributable to the Health Insurance Commission?

**Mr Thomas**—I do not recall the number precisely. We could provide that on notice. It is probably best that I do not guess that.

**Senator LUNDY**—To put that question into context, my understanding of the overall figure identified was \$54 million, with \$16 million of that for the Department of Health and Aged Care. So it would be somewhere between—now I am testing my own maths—zero and \$38 million. Does that ring a bell; sound familiar?

**Mr Thomas**—The calculation rings a bell, but I think in that \$50 million there was something attributed to industry development, so it is not just an equal split between agencies. But it is best that I look at the numbers and respond to you.

**Senator LUNDY**—Could you also identify what proportion of that figure can be attributed or has been attributed to an increase in tax revenue as a result of corporate taxes?

**Mr Num**—The Health Insurance Commission in fact pays all taxes and charges as a statutory organisation, and so there were no particular tax savings as such.

**Senator LUNDY**—Just to clarify that, prior to entering into the health group contract, did you outsource your information technology?



**Mr Num**—No, we operated completely in-house.

**Senator LUNDY**—So are you telling me that you paid sales tax as part of that in-house operation?

**Mr Num**—Yes.

**Senator LUNDY**—Did you pay any corporate taxes like payroll tax or company tax?

**Mr Num**—We paid payroll tax. We are not subject to tax in that we are not a profit making organisation. We pay payroll taxes and all of the charges associated with staff, so that they were fully funded and so forth.

**Senator LUNDY**—And company tax?

**Mr Num**—That was not applicable to us as we are not a company.

**Senator LUNDY**—I guess the question still stands because there might be a small amount attributable to an increase in tax revenue as part of that calculation. Thank you for that clarification. Can you tell me what the agency cash budget reductions attributable to IT outsourcing were in previous financial years, this current financial year and in the out-years?

**Mr Num**—That calculation was made. I would have to take that on notice. It was part of the estimates process.

**Senator LUNDY**—Yes, that is correct. It is separate from the earlier question that I asked about the estimated savings figure. Can you tell me offhand when the Health Insurance Commission first had their budget deducted in anticipation of IT outsourcing?

**Mr Num**—I prefer to take that question on notice.

**Senator LUNDY**—Did you deploy a clean-break process for staff when you commenced the IT outsourcing contract with IBM GSA?

**Mr Num**—Yes, we consulted with staff when we adopted a clean-break approach.

**Senator LUNDY**—Can you provide me with the figure of the value of the redundancy payments made as a result of taking that approach?

**Mr Num**—We will provide that figure to you. I cannot provide it off the cuff.

**Senator LUNDY**—Can you also provide me with details about the number of staff involved in that transition arrangement including how many were made redundant, how many were retained within the Health Insurance Commission in some capacity—for example, managing or compliance—with the contract? Indeed, how many previously from the department were subsequently employed by the outsourcer?

**Mr Num**—We will get back to you with the detail, but I can give you some broad detail. We identified approximately 170 positions that were in scope and that were designated to be moved, though the number of staff changed over time. Obviously, not all of those positions were filled at the time. We took a deliberate policy not to recruit into positions that we knew were in scope but rather to use contractors, unless it was absolutely unavoidable, so that we would avoid making redundancy payments in that case. Approximately 130 permanent staff, I believe, were offered redundancies.

**Senator LUNDY**—How many of the permanent staff who took redundancies were subsequently reemployed by the Health Insurance Commission on contract?

**Mr Num**—I cannot answer that off the cuff. Are you saying how many of those obtained employment with the outsourcer or IBM GSA?

**Senator LUNDY**—No, reemployed by the Health Insurance Commission on contract.

**Mr Num**—I do not know that offhand. I would need look into that.

**Senator LUNDY**—Were there any?

**Mr Num**—I suspect not because that is contrary to government guidelines.

**Mr Thomas**—To my knowledge, it is none.

**Senator LUNDY**—Okay. How many staff did you retain within the Health Insurance Commission on issues relating to the management of the contract, including compliance, relationships, or coordination roles?

**Mr Thomas**—It would have been approximately 10 people.

**Senator LUNDY**—Have you engaged any consultants or legal firms, et cetera to participate in those contract management, compliance or advisory roles in relation to IT outsourcing?

**Mr Thomas**—Do you mean since the transfer of the contract?

**Senator LUNDY**—Yes.

**Mr Thomas**—We have increased our number of permanent staff and we have some contract people helping us. Yes, we do use some advisers. When necessary, we get extra legal opinion but we have substantial in-house opinion. When necessary, we get additional opinion in the financial area.

**Senator LUNDY**—You mentioned the number of 10 people. Have you increased it from that number?

**Mr Thomas**—Yes, we have. I am advised that before my time that was always the intent. We have 20 people managing that group.

**Senator LUNDY**—In terms of supplementing that advice with legal opinions and so forth, can you provide details of those contracts on notice—the terms, the timing and the nature of advice that they provide to the department in management compliance or any issues related to the IT outsourcing contract?

**Mr Thomas**—We will be happy to do that.

**Senator LUNDY**—On the question of liabilities—I will go to the specifics of the contract shortly—if there were to be a system failure for which a citizen felt that there was a damages claim to be made, who would ultimately be liable for that, the Health Insurance Commission or IBM GSA?

**Mr Num**—That would depend on who was responsible for the failure.

**Senator LUNDY**—Are you telling me that in some circumstances it would be IBM GSA?

**Mr Num**—It could be.

**Senator LUNDY**—For the purposes of the citizen pursuing damages?

**Mr Num**—Yes.

**Senator LUNDY**—How would that be handled in terms of a complaint being made?

**Mr Kelaher**—Because IBM GSA is a service provider to the HIC, in all of the circumstances I can imagine, if something that the HIC is responsible for doing resulted in an issue or a difficulty for a member of the public or one of the providers, then I would expect that the first point of contact would be between that person and the HIC and probably most actions would proceed in that direction. We might then take action against IBM GSA if it were our view that they contributed in whole or in part to that. There may be some aspect that I am not thinking of where there would be a relationship between a person and IBM GSA. It would probably more likely be something to do with their physical occupancy of facilities and someone walking through there, but in most cases I think a member of the public and their medical records would see the HIC as a principal, and we are.

**Senator LUNDY**—On that basis, what is your complaints mechanism, for example, in relation to a privacy breach of citizen's information?

**Mr Kelaher**—A privacy breach of the medical records system could come about in a number of ways. It could be in relation to the activities of doctors, pharmacists or other people. So we do not start from the position that it is necessarily our fault. In fact, many people see the HIC as the place that you would go to make a complaint about privacy in relation to medical matters. So we do have a system for dealing with complaints by members of the public or providers where the complaint is registered and investigated.

We also work very closely with the Privacy Commissioner, who may also be the first point of contact for people making a complaint regarding privacy. I cannot speak about the Privacy

Commission's processes in detail, but I do know that they would make their own decisions about when to contact the HIC and follow a matter through. Periodically, they also have discussions with the HIC about the adequacy and form of our privacy procedures and the way in which we go about recording and investigating any claimed breaches of privacy.

**Senator LUNDY**—In terms of your receiving a complaint, not about that other sphere you described but specifically about your own records management, can you describe the process through which that complaint would be dealt with within the Health Insurance Commission?

**Mr Kelaher**—I am sorry, I cannot. There is a lot of procedural documentation about that. Probably the best thing to do would be to take it on notice and to provide it to you.

**Senator LUNDY**—In terms of this unit of 20 or so people assisting the commission to manage the contract with IBM GSA, have you identified any specific officers that address this issue of privacy and, in particular, compliance with the privacy and confidentiality obligations contained within the contract?

**Mr Thomas**—Senator, I can answer that. We have within our team people who particularly focus on the confidential aspects of people who work within the HIC. Before outsourcing, there were fairly rigorous approaches to this, and they still exist for all employees of the HIC. At the time of the transition to outsourcing, a condition of that transfer in the contractual process was that all people who worked with IBM during the transition and any new people that IBM brought to the contract through its duration would have to conform to the same rigour. That is external vetting. We do it; it is actually our team that reviews IBM's process for each appointment. That is done rigorously with each appointment, and it has been maintained through the almost 12 months of the contract.

**Senator LUNDY**—You mentioned that, before outsourcing, you had a rigorous compliance process in place. Did that involve scrutiny or ongoing auditing beyond the point of engagement of officers within the Health Insurance Commission?

**Mr Thomas**—I believe that that is true, but it was before my time and I cannot speak to that.

**Mr Num**—Certainly, internal audits were done that looked at the access classifications of technical people within the security systems to ensure that people could not amend records, that people had access appropriate to their position and that that was updated and regularly maintained.

**Senator LUNDY**—Using that system as a benchmark, to what degree does the commission apply a similar process now that it has been outsourced, and to what degree has it subsequently become a contracted role within IBM GSA internally?

**Mr Kelaher**—I would like to answer that. Our internal audit regime does not, in that area, differentiate between an employee and a contractor or a consultant. Our starting point for the internal audit of data access and data integrity is all of the possible points of entry and all of the possible points of contact with the data. So we think about, in terms of electronics, the integrity of our Internet and Intranet positioning, the integrity of the data transmission modes from doctors and pharmacists, the integrity of our lines to all the Medicare offices and also the

integrity of access to the identification of the person accessing data and what it is that they are doing with the data. So all of our Medicare office staff, all of the processing centre people, all of our IT people, all of our consultants and all of our contractors are caught in that web, and we do not exclude a particular group of people. We really focus on the data and who might have access to it.

**Senator LUNDY**—Would you do that in-house?

**Mr Kelaher**—Yes. That has not been contracted out.

**Senator LUNDY**—What you are telling me is that it has not really changed from an in-house environment to an outsourced environment?

**Mr Kelaher**—No. I think that, because of technology and more utilisation of electronic communications, we probably do a lot more of that than we might have done two or three years ago. That is not directly related to who is providing the service.

**Senator LUNDY**—What are the parameters to accessing the information technology systems now managed by IBM GSA for the purposes of this exercise? Are there any restrictions?

**Mr Kelaher**—Yes, there are two restrictions. The first is that you must have been through that employment and vetting process, whether you are a contractor, an employee or a consultant. I recently experienced that when my secretary was away a couple of weeks ago and we had a temporary employee come in. She could not get into the system for three days until that checking process was completed. Secondly, the area in which a person works is defined and that is linked to their particular identification. So there are constraints on what access people have to various parts of the system.

**Senator LUNDY**—My question went more to counter-restrictions that IBM GSA may place on the department for accessing the systems that they are managing. Are there any such restrictions?

**Mr Kelaher**—I do not believe it is of that nature. Certainly the IBM maintenance area of our physical facilities is subject to security coding access. I probably would not be able to get in. In terms of access to the data, I doubt that we are precluded from accessing the data that is ours. The constraints are probably more to do with the contractual implications of us getting involved in IBM GSA's administration of our systems in an unauthorised or disruptive way.

**Senator LUNDY**—If you could put a figure on the increased costs of ensuring compliance with security and privacy issues for before and after outsourcing scenarios, that would be useful. For my benefit, can you tell me the proportion of computer systems or information technology that can be characterised as mainframe, mid-range, desktop, et cetera, within the outsourcing contract that you have with IBM GSA?

**Mr Thomas**—The percentage allocation is a very difficult thing to do.

**Senator LUNDY**—Just a vague idea of the proportions would be useful. I am trying to picture in my head what we are dealing with here.

**Mr Thomas**—The HIC has very complex systems. The majority, if not all, of its primary business systems were mainframe based application systems at the time of transition. They are still mainframe based application systems. An organisation of this size—in relation to your question—has a number of systems based on mid-range equipment and, of course, has some 4,000 PCs. That has not changed.

**Senator LUNDY**—In terms of the mainframe systems, can you describe the underlying databases that you manage—for example, of Medicare participants? You mentioned suppliers of health services before. Can you characterise the sort of information that is contained on those varying systems?

**Mr Num**—It is all the information related to operating our program. Probably a very good place to get a description of that—and in some detail as to the extent of those transactions—is from our annual report.

**Senator LUNDY**—To humour me for the purpose of this morning, can you give me a brief description of the sorts of databases that the Health Insurance Commission manages?

**Mr Num**—We operate a number of programs. There is the Medicare program and all of its associated information, including provider information. There is the Pharmaceutical Benefits Program, which has information on pharmacy claims and pharmacists. We operate the Australian Childhood Immunisation Register which has information on the immunisation status of Australian children. We operate the Organ Donor Register. We do processing on behalf of the Department of Veterans' Affairs—so its treatment accounts and payments are held by us. We do processing on behalf of Australian Hearing Services—so its information is held by us. We do practice incentive payments programs—that is, payments to doctors if they reach certain practice goals, if they modify their practice behaviour or undertake accredited training and so forth. There are others as well.

**Senator LUNDY**—That is very helpful. In terms of recent discussion and debate about the privacy of records held by GPs, what are the opportunities, if any, that exist within the Health Insurance Commission for the release of any of the information you have described?

**Mr Num**—There is a defined mechanism for the release of information. It is defined in such a way that it must be released for the public interest and it cannot identify individuals or practices. It is aggregated to a point where it cannot do that.

**Mr Kelaher**—That process is entirely under the control of the HIC. We have a whole branch called something like 'data access and security' which manages the guidelines under which we respond to requests by individuals or organisations in the public good area—for example, the AMA—for access to data. Our IT infrastructure provider has no role there whatsoever. The contract makes it very clear that it has no role there, and the contract also makes it very clear that any breach would result in immediate termination.

**Senator LUNDY**—Have you had any cause to apply penalties in the area of privacy or security to your outsourcing contractor?

**Mr Thomas**—You said 'privacy or security'?

**Senator LUNDY**—Yes. I obviously want to ask the question in its aggregated form as well, but this question relates to any service credits or financial penalties applying specifically in relation to breaches of security or privacy under the terms of the contract.

**Mr Thomas**—The answer is absolutely not.

**Senator LUNDY**—Mr Kelaher, you said that non-compliance in those areas would result in the immediate termination of a provider. You will have to excuse my scepticism here: how bad would a breach in the area of privacy have to be to warrant termination of a \$350 million contract?

**Mr Kelaher**—I will give you a subjective answer, but privacy is the cornerstone of the HIC's contribution to the running of those programs that Mr Num mentioned, and we make that very clear to our staff and any contractors, consultants or whomever we deal with. It is quite clear in the contract. There is no scale. A breach of those clauses relating to privacy and data security would be grounds for immediate termination. We would not want or allow the notion to develop that somehow or other a scale might be introduced or that we might look the other way for a small thing. I think our position is always going to be that, if that were to happen, that would lead to us instigating termination action.

**Senator LUNDY**—Are you able under the terms and conditions of the health group contract to terminate the Health Insurance Commission's component, or would such a termination of contract result in the whole health group cluster contract being terminated?

**Mr Kelaher**—Under the arrangements we entered into, we derived considerable benefit from participating in the health cluster but it was our requirement that we enter into a stand-alone contract with IBM GSA. So, should we need to go down that route, while it might have some implications for other members of the health cluster, we are not contractually precluded from that.

**Senator LUNDY**—Just to go back to the aggregated question about service credits, or financial penalties, can you tell the committee the dollar value of penalties applied to IBM GSA to this point?

**Mr Thomas**—I can answer that in general terms. To this stage it has been in excess of \$500,000.

**Senator LUNDY**—Can you specify the nature of the breaches that have led to those penalties?

**Mr Thomas**—Broadly they have been in three areas. One was a substantial amount of that money for a major mainframe outage in April last year. Of the other two, one is in the area of network availability, where we measure particular points, and the third piece is predominantly in the area of services related to help desk support.

**Senator LUNDY**—Would you be able to take on notice breaking down those areas and any others and attributing the financial penalty applied, and the timing and circumstances surrounding each of those breaches?

**Mr Thomas**—Of course, Senator, I can do that.

**Senator LUNDY**—Thank you. I have a question about network availability. Is that for the network that the staff use, that is, the internal network of the commission?

**Mr Thomas**—As distinct from?

**Senator LUNDY**—I am just asking the question; you tell me. What do you mean by network availability?

**Mr Thomas**—The answer is that it includes internal staff but it is actually our entire network throughout the country. It supports 240 locations.

**Senator LUNDY**—So when that goes down, business stops.

**Mr Thomas**—Or is degraded.

**Senator LUNDY**—How many days or hours were affected by that network not been available or being degraded?

**Mr Thomas**—Your question is related to days, or quantified impact? I do not have that in my head, but some of the penalties can relate to component failures of the network. For example, we could have partial impact on one branch office without affecting any other office at all. But I do not have total numbers of days. It is probably best that I get that detail and provide it to you.

**Senator LUNDY**—Sure. What is the relationship with the *IT Infrastructure Security Framework for Outsourcing* released in 1997 and the operation of the Health Insurance Commission information technology systems? Do you comply with that?

**Mr Kelaher**—I have to confess that I have not read the 1997 guidelines, but my very strong expectation would be that we would not only comply with those but that the HIC requirements would surpass that because of the nature of what we do.

**Senator LUNDY**—It is actually raised in the context of the audit office report, and the audit office makes reference to the way each of the clusters that were audited processed the provisions of that document. I do not know whether it was a directive or a guidance note. But if you could take it on notice and provide the committee with information, that would be useful.

**Mr Kelaher**—Yes.

**Senator LUNDY**—Going back to the protection of information, you mentioned the AMA as an organisation which could, under defined circumstances, have access to some consolidated data or some data from your databases. Under what terms and conditions is that information able to be released and what degree of control and compliance do you have over that information once it has been released under those terms?



**Mr Kelaher**—This is why we have a large branch looking after that. Requests from research institutions, people doing PhD theses, people with a concern about a particular disease—all of those sorts of requests come in to that particular branch. You may be aware that the HIC also runs a very active Internet site. As a result of perhaps a number of concentrations in a particular area of data request, we consider whether or not people's best interest would be served by making that publicly available on the Internet and then maintaining that data. So quite a lot of statistical information about utilisation of Medicare services and other things emanates from a number of requests that have been received internally some time ago, and then we decide the best way to satisfy that is to put it on the Internet.

Other requests that are a bit more ad hoc in nature are dealt with in an ad hoc way. The parameters are that, first of all, we have a process by which a request is received and recorded. It then goes through an evaluation as to whether or not it is in the public interest, and we have guidelines that apply for that. We also have a look at what the stated purpose of the request is and attempt to anticipate what the consequences of satisfying that request might be. For example, sometimes it is quite time consuming, but if someone is doing a PhD into an area that we think could have very large potential, even though it may be quite time consuming for us we might decide that, on balance, public interest would be served by facilitating that. So there are a number of subjective judgments applied. When the information has gone through that particular process and we have decided that it is either will or will not be released, we then advise the person or organisation concerned. Sometimes in that process we determine a charge and we set the charge. They then make the choice about whether they would like to proceed.

We then agree on the conditions under which the information will be released, which are invariably constrained to that particular purpose because we retain proprietary interest in the application of data. We certainly would not want to get into a situation where we appear to be providing data for someone's research which then finds its way into another purpose somewhere else. We put a number of limitations in the way of that occurring. Similarly, with the information we place on our Internet site there are both disclaimers and restraints on the use of that data, certainly cautioning people not to make mistakes in the way the data is used. So we try and achieve a balance in responding to people's legitimate interest in the data, making sure they understand the limitations on what the data can be used for and also placing some limitations of our own on what it may be used for.

**Senator LUNDY**—Thank you for that explanation. Are there any circumstances where you have provided information under an appropriate regime from your perspective and then subsequently discover, directly or indirectly, that the data has not been used for that purpose or that its use has been extended into an additional purpose?

**Mr Kelaher**—I cannot give you a specific example, but I am aware of an example that occurred a little while ago. I should add that we never release individual data; we only release aggregated data. But, yes, I did hear a situation a little while ago where information was made available to, I think, a tertiary institution for research purposes and it was then combined with some more information into a report which that particular institution sold. So we do have a look at how our restraints on use of the data work and we tune those where necessary. What we would not expect to happen, and we are certainly not aware of, is more substantial abuse of the sort of data that we provide. In fact, that is always in our mind when we are looking at what the request is.

**Senator LUNDY**—You can appreciate how pertinent this discussion is to the current debate about the use of personal information, whether it is aggregated data, or to what degree. That is one circumstance. Do you have a penalty regime applying or a process of assessing the nature of the breach and a penalty or sanction regime applying where a breach has been found to have occurred?

**Mr Kelaher**—We do. Probably there is one branch I should mention. I do not think you are looking to go down this route, but clearly there are occasions when people inside the organisation might access data which we do not think they should access. Clearly there is a very serious penalty regime for that. Sometimes that data might find its way into the public arena, so criminal charges and all that sort of thing can occur.

**Senator LUNDY**—You are quite right; that is not the path I want to go down. I am aware that the penalty regime exists.

**Mr Kelaher**—In the case of data that has been properly requested of us and we have decided it is in the public interest that the aggregated data will not cause disquiet among the public for its release, where we have provided it under certain circumstances and those circumstances in our view are breached—for example, a tertiary institution might have obtained information for free from us after some effort, and then we find that it becomes part of something that is sold—we would do a more commercial thing in that particular case and probably ensure that, if there was another request from that particular organisation, that we recovered the lost ground.

**Senator LUNDY**—On this point of using information that has been obtained from you under legitimate circumstances and then there is this process of combining it, consolidating it or building it into even perhaps one field in another set of aggregated data, what opportunity does that leave for you to seek some form of retribution and actually track it?

**Mr Kelaher**—That is an issue which anyone involved in the information area is concerned about. There are only two things I can say on that. Where we receive legitimate requests, the people making the requests often have a very serious interest in the quality of the data, the limitations on its use, the statistical validity of it, and we work very hard to satisfy those considerations. For those sorts of requests I expect that it would be most unlikely that the data would be misinterpreted or misrepresented by them. Once the data then finds its way into circulation—for example, access by other researchers or the data we have put on our Internet site is then picked up by someone and they want to use it for another purpose—all we then do is rely on the basis on which the data was provided, its statistical reliability and all those other things. At the end of the day one of the considerations we have in our minds when we make this information available is whether we think that there is some public good and purpose in people seeing the information.

**Senator LUNDY**—Do you have any control over the input process of that data? Obviously some of that data comes through, for example, GPs, et cetera, where that data could be captured before actually coming to the Health Insurance Commission and consolidated or aggregated in some way, and then be used effectively for purposes outside of your control because it is on its way in to you as opposed to being in your possession and you managing the output.

**Mr Kelaher**—I would like to take that on notice. I am pretty sure that under the acts and regulations we operate under that would be illegal. However, immediately before the information is transmitted to us or what a GP might record on their pad and then pass to someone else we have no control over.

**Senator LUNDY**—Could you take on notice a formal view of the Health Insurance Commission as to that data at that point—that is, information in the possession of the GP—and any obligations they may have as that data then finds its way to you, and whether or not your regime of managing the outputs of that data applies in any way to that point of collection—the GP and the Health Insurance Commission?

**Mr Kelaher**—I understand. The way I would approach that with the HIC would be to ask questions about that channel in relation to Medicare claim information, bulk billing information, the point at which data becomes part of the HIC data collection process, the extent to which we own that data and the control of its use?

**Senator LUNDY**—And what your control and compliance mechanisms are relating to it.

**Mr Kelaher**—Okay.

**Senator LUNDY**—Thank you.

**Senator BUCKLAND**—Mr Kelaher, if I can just take you back to an earlier answer you gave Senator Lundy. You talked about the immediate termination of the contract you had with IBM GSA, if there was a significant breach. I imagine that would be a pretty significant breach of contract?

**Mr Kelaher**—The contract has a list of breaches which fall into the category which would result in immediate termination. A breach of the privacy or data security requirements is one of those. So there is no value judgment applied. It would simply be a breach.

**Senator BUCKLAND**—Could we be provided with that list?

**Mr Kelaher**—Of course.

**Senator BUCKLAND**—But it does raise an interesting question, doesn't it? If there is one of these breaches, who takes over the operation?

**Mr Kelaher**—Mr Thomas has had a think about this, and he will probably correct me. But I believe that under those circumstances the HIC is entitled to move in and take over the direction of the staff in those facilities until alternative arrangements have been put in place.

**Senator BUCKLAND**—Who do the assets belong to?

**Mr Kelaher**—The mainframe assets belong now to IBM GSA.

**Senator BUCKLAND**—So, you move in and take those over? It really worries me if that is the case. If you move in and take them over, you are going to have to pay for those assets, surely, to obtain them? Or do they just forfeit them as part of the contract?

**Mr Kelaher**—The way I read the contract—and Mr Thomas will probably need to clean up my answer—is that it is regarded as an interim step of the HIC disentangling itself from that particular contractor. Our rights under the contract are that we move into the contractor's facilities, take over the contractor's staff and run that process until—

**Senator BUCKLAND**—The assets as well?

**Mr Kelaher**—Yes. Obviously, legal action might then be ensuing all over the place but, in order to continue running the business, that is our right under the contract.

**Senator BUCKLAND**—You are starting to frighten me, to be quite frank. Does this mean, then, that we have another company in the background, similar in size and structure to IBM, just hanging in the wings, waiting for this to happen? Or have you got the facilities yourself at the end of the contract in that transition period between IBM GSA and whatever you are going to do in the future? Have you got your own facilities available and waiting or does it mean that the whole operation of the commission stops until all this ends? What contingencies are in place?

**Mr Kelaher**—We do not consider ourselves captive to any provider or contractor. We start from the position that we have got a commercial relationship that we want to work with IBM GSA, as we have with all sorts of other people, but we do have disaster recovery plans. Part of Mr Thomas's role is to make sure that we have the capacity to be able to run that contract well or change contractors. The contract was highly sought after and we continue to receive a lot of interest from other players in the industry who would like to become involved in that activity. The contract runs for another four years and two months. We also have the capacity to engage other service providers other than the IBM GSA for other activities or supplementary activities. If we put in place a new system, we are not bound to deal with IBM GSA.

**Senator BUCKLAND**—Do you have any of those in place now?

**Mr Kelaher**—We do not.

**Senator BUCKLAND**—How are other companies kept on hold ready to jump into the fray? Does OASITO or someone else hold a stand-by contract with them?

**Mr Kelaher**—I do not think it is so much the contract. It is more that we own all of the data and all of the applications. What we do not own are the computer facilities on which the data is held and the applications run. Other companies around the world in this game do have other facilities. They are capable of putting these together at relatively short notice.

**Senator BUCKLAND**—I do not think I am getting far with you. Senator Campbell or Senator Lundy may be able to extrapolate that a little bit further. I will have to ask you to leave that there because I am getting worried. The potential for litigation, if that did happen—it could happen because we have heard Mr Thomas tell us about breaches or contract failures, whatever, to \$500,000 or so. I think you are going to clarify that for us. Not only are you going to have to

argue against IBM GSA but you have your cluster partners as well who clearly have a very real interest in this. I am very worried about that now. One of my colleagues may be able to take that further. Can I move off that, maybe to allay my own fears and settle myself down. Are there review periods in the contract where you have a regulation review of how the contract is progressing?

**Mr Kelaher**—Daily, also monthly on invoice.

**Senator BUCKLAND**—I am not specific enough. The contract would require that there is a performance requirement of IBM GSA. Is there some time in there when the cluster group get together with IBM and sit around the table and measure the performance to date? Surely that is not on a daily basis.

**Mr Thomas**—There are a couple of answers to your question. The first point is that the HIC has a separate and individual contract with IBM GSA, so it is not cluster related. We do formally measure progress each month, but as Mr Kelaher said, we do actually monitor performance. Perhaps what is more relevant to your question and where you might have been going with that is that at the end of the first 12 months, which is coming up now, we will embark on a formal benchmarking review exercise to look reflectively at performance and costs, to ensure that what was offered at the time of proposing the contract has been delivered and still matches with the best available in the market.

**Senator BUCKLAND**—When the cluster was being formed and you were looking at the contract arrangements, how much input did your department have into the composition of the cluster?

**Mr Num**—I understand the cluster was decided upon by OASITO and we had input in agreeing that in fact we would participate within the cluster.

**Senator BUCKLAND**—How did OASITO get to understand and know your business, as distinct from Medibank Private or anyone else? How did they get to know your business and your service requirements?

**Mr Num**—OASITO, as I understand it—and you would need perhaps to seek direct information from them—were looking to put together a cluster of what they considered an economic size so that maximum economies of scale could be delivered to government by the successful tenderer. They were also looking at commonality of interest, so they brought together the three agencies that were there—in part, Medibank Private, because it was already having services provided by the Health Insurance Commission—and our portfolio partner, the Department of Health and Aged Care.

**Senator BUCKLAND**—Did they send a couple of people over—I might be being a bit simplistic—and say, ‘Go and sniff around and see if you can pick up what this organisation does’?

**Mr Num**—Once we agreed to participate in a tender process, OASITO and their advisers had a very complex set of schedules and a whole process detailed for which we completed information and provided information about all aspects of the way our business functions so

that they obtained an extremely detailed view of how the operation functioned. They did that so that we fully understood and could justify our costs and internal service levels at that point in time.

**Senator BUCKLAND**—I am very basic in the way I imagine things and processes, so treat me gently. When a couple of people came over, did someone walk around hand-in-hand with them and say, ‘We have got this, we deliver this service and we expect this outcome’? Was that done?

**Mr Num**—OASITO were already in possession of information from all agencies, which had been put together by the Office of Government Information Technology prior to OASITO undertaking the IT outsourcing program, where all government agencies had submitted, in some detail, information about their technical infrastructure.

**Senator BUCKLAND**—At the end of the day, after that was done, I imagine OASITO would have put something on the table and said, ‘This is what we believe needs to be in place to deliver the services to your organisation’?

**Mr Num**—No, all of the agencies, along with OASITO, formed a team and undertook the investigations of just what we were doing and how much it was costing, what equipment and infrastructure were in place and what sort of service levels were needed to meet our business requirements. So we had the say on that, as did each individual agency. That formed the basis of a statement of work and that was a critical part of the tender.

**Senator BUCKLAND**—Did you bring in any outside consultants separate from OASITO to help you develop where you should go with outsourcing?

**Mr Num**—We used external legal consultants and external financial consultants to help us develop our cost baselines. The board of commissioners engaged consultants to provide them with independent technical advice as distinct from the advice they were getting from management and OASITO.

**Senator BUCKLAND**—To be very honest, I would like to spend another hour or so on this because it has raised many concerns with me, but I am conscious of the time frames we have. Has outsourcing been a cost-effective process for your agency?

**Mr Thomas**—I think it is really too early to tell that. We are just coming up to the end of 10 months. It is a five-year contract. It would be unusual to be able to tell that at this time. Certainly we are not unhappy with our progress, but I cannot give you a direct answer.

**Senator BUCKLAND**—How much time do you think you would need in operating under the circumstances you are in now before you could give an answer on that? It may be hypothetical, but surely there is a benchmark.

**Mr Thomas**—As I said, the contract is five years. We would expect normally that you would have a good feel of that response in the two- to three-year range, assuming nothing else changed. However, the HIC business is changing and that may impact on our ability to review that, and the timing of our review. But I would think in the range of two to three years.

**Senator BUCKLAND**—Because of the time factor, I need to put a range of questions to you on notice in relation to this. Thank you very much.

**Senator LUNDY**—My understanding is that the general terms and conditions of the contracts provide for technology refreshes, particularly at the desktop and various levels throughout the contract. Could you tell me what the technology refresh provisions are within your contract with IBM GSA?

**Mr Thomas**—Yes, I can. Broadly, it relates to the replacement of desktop equipment, which is primarily PCs. That is each three years, so once in a three-year period it is to be replaced.

**Senator LUNDY**—What is your treatment of the applications development aspects of your requirements? Have you outsourced them?

**Mr Thomas**—No, we have not outsourced applications, and they are unrelated to the contract we have with IBM.

**Senator LUNDY**—What in your view is the relationship between your application requirements and your desktop requirements?

**Mr Thomas**—It is often difficult to separate those two things—

**Senator LUNDY**—Indeed it is, which is why I am asking you the question.

**Mr Thomas**—We do not run any major application systems at the desktop level, but in the delivery of all systems for us we depend on the service provider, and the service provider obligation in that area is to do forward capacity planning and track for us how it is moving and make sure they have the capacity available. I think you know we do not buy PCs anymore, nor do we buy mainframes, but we do have an expectation that the service provider will continue to meet the service levels committed, no matter how our volumes change. To that end it really is not much different.

**Senator LUNDY**—It is not really a question of volumes, though. Do you perceive the technology refresh requirements in relation to desktops as in any way constraining your capacity to upgrade your applications and therefore your service delivery capabilities?

**Mr Num**—They were a continuation of arrangements we already had in place—

**Senator LUNDY**—That does not answer my question either. The question is, has it got the potential to affect your capability to upgrade or improve your service delivery?

**Mr Thomas**—Ten months into the contract, we have certainly not had any constraint by the question you are asking. I think you are alluding to whether we would like to refresh faster or, if we did, are we constrained and unable to do that. It has not impacted at this stage, but we have a choice of when we take those things up.

**Senator LUNDY**—Would you have to vary the terms and conditions of the contract if you wanted to bring forward a technology refresh? I guess that is a euphemism for ‘pay through the nose’.

**Mr Num**—We would have to make additional payments, but I do not believe we would have to make any changes to the terms and conditions. Within the terms and conditions, there is the capability for us to say that we want to bring this sort of class of equipment into this area and to ask the provider to do that. Clearly, if they have leases in place and so forth, there would be compensation.

**Senator LUNDY**—How would a policy directive like government services online affect this whole issue of capability and technology refresh, or indeed technology upgrade, under the Health Insurance Commission’s current IT requirements?

**Mr Thomas**—Before the outsourcing event, the HIC was progressing to support government technology online. The three-year issue is actually not seen as a constraint by us at this stage because, compared to what happens in the marketplace, it is not a bad time frame. There is a lot of discussion, particularly by vendors of PC equipment, that people should do it much faster. But in terms of good economic position, about three years is a good time. We believe we are well positioned to accommodate those changes.

**Senator LUNDY**—Will you be able to achieve the government’s policy objective of government online under the current terms and conditions of your IT outsourcing contract?

**Mr Kelaher**—The HIC is constantly changing its capacity demands, and I have not experienced any constraint on our ability to do that based on a refresh clause or anything else. We are regularly putting in place new servers and upgrading capability, and that refresher clause has never figured in our discussions. My feeling is that the way it has worked in our relationship with IBM GSA is that it might have been a guide to thinking about the impact on service levels: us thinking about our demand for the latest technology upgrades and how that will impact on service levels. It probably has a bearing on workload planning for IBM GSA. But as Mr Num said, when you put in place that change of capacity, if it has a price impact, that is something you have to take into consideration when you are scheduling those changes.

For us it has been more a consideration of demand—by our internal processes or extra transmissions coming into the HIC—leading to a business decision by us that we need to change our capacity. We make the request to IBM GSA and they put the capacity in. At some point, our charge may or may not be affected. Mr Thomas knows the clause, but from memory we also have a fair bit of latitude in small fluctuations in demand for which we do not pay at all.

**CHAIR**—Make this your last question, Senator.

**Senator LUNDY**—You did not answer my question, so if you could I would appreciate it.

**Mr Kelaher**—We are on schedule, if not a bit in front of the government’s online requirements.



**Senator LUNDY**—I will take the opportunity to put some questions on notice, but my final question relates to the mainframe system that you operate. What provisions are there, in the terms of the contract or in plans within the Health Insurance Commission itself, to look at the longevity of the mainframe system? In particular, what provisions within the contract or activities within the commission itself do you have for upgrading the holistic operation—the underlying technology or architecture—of the mainframe system?

**Mr Kelaher**—This was something that the HIC was working on well before IT outsourcing and something that bore very heavily on the board's mind when it got into that outsourcing process: whether or not the HIC's thinking might be adversely affected by a contractual relationship. Today, we are very heavily involved in exactly that: thinking about the mainframe and mid-range environments.

**Senator LUNDY**—Is the commission or IBM GSA thinking about it?

**Mr Kelaher**—No, the HIC is thinking about that. To make sure that the HIC can manage its transactions and deliver the services required of it, we are in regular discussions with IBM GSA about that sort of thinking and telegraphing of moving load from mainframes to mid-ranges and introducing different configurations. Under the contract there are no constraints on doing that. There are financial compensation clauses. If we substantially reduce the volume under management by IBM GSA by more than 20 per cent in any 12-month period—I think that is how the clause works—there is—

**Senator LUNDY**—Isn't that a constraint on upgrading?

**Mr Kelaher**—No.

**Senator LUNDY**—It means that, if you want to do a substantial upgrade and transfer it, you are paying through the nose to do that. I can only interpret that as a constraint through the duration of this contract on your capacity to upgrade your technologies.

**Mr Kelaher**—No. I had not meant it to sound like that. What I meant it to sound like was that under the contract we have the capacity to change the volume substantially away from IBM GSA's management, and there are some financial compensation clauses. I think it was intended to be a balanced equation in that we wanted certainty on costs of service delivery for a defined range of services for the five-year period and both we and IBM wanted to make sure that, if there were substantial fluctuations in demand for usage, the contract provided for financial adjustment either up or down. That is what I meant to indicate, not that there is a constraint on us making those changes.

**Senator LUNDY**—I stand by my interpretation but thank you.

**CHAIR**—That brings this morning's session to conclusion, thank you, Mr Kelaher, Mr Thomas and Mr Num. There was a question taken on notice this morning by the Department of Health and Aged Care in relation to entry-exit costs. It has since provided an answer to that question. That answer is contained on page 46 of a document entitled *IT&T Infrastructure Services: Final Report*, printed 3 September 1999.

**Proceedings suspended from 12.27 p.m. to 1.04 p.m.**

**KAVA, Ms Rosanne Mary, First Assistant Secretary, Corporate Division, Department of Transport and Regional Services**

**KEY, Ms Wendi, Assistant Secretary, Information and Services, Department of Transport and Regional Services**

**NEF, Mr Andrew, IT Contract Manager, Department of Transport and Regional Services**

**SIMPSON, Mr Christopher Michael, Manager IT&T Contracts, Corporate Division, Department of Transport and Regional Services**

**CHAIR**—Welcome. Ms Kava, do you wish to make an opening statement?

**Ms Kava**—No, thank you. We are happy to take questions.

**Senator LUNDY**—What sort of input did the department of transport have into the composition of the cluster or group 5?

**Ms Kava**—The department took a very active role in the composition of the cluster. We actively sought out partners amongst other agencies and in fact approached OASITO indicating that we were interested in finding like organisations. So we were very actively involved in the selection of the other cluster members.

**Senator LUNDY**—I would just like to make reference to the audit office report. Can you tell me what opportunities the department of transport had to respond to that audit office report and the nature of your response to it?

**Ms Key**—The department was an active participant in the formulation of the whole of government response to the ANAO report.

**Senator LUNDY**—That was not really my question. What sort of response did you provide to the audit office?

**Ms Key**—The audit office visited the department on several occasions. We were actively involved with them in the provision of information and in clarifying statements made. It was quite an iterative process for us. Mr Simpson, Mr Nef and myself were all engaged in that process.

**Senator LUNDY**—Once the report had been concluded and obviously was being assessed by the government per se, at what point were you informed that a decision had been taken to make a whole of government response as opposed to a department-by-department or agency-by-agency response to the audit office report?

**Ms Key**—We were not informed that a whole of government response was going to be made, rather we were asked if we would care to participate in the development of a whole of

government response. That was certainly after the final draft stage. We did participate with other agencies in a meeting convened by OASITO. At that meeting we considered our own departmental view in the context of the development of the whole of government response. So it was quite a participatory exchange.

**Senator LUNDY**—What is the normal process in responding to audit office inquiries or audits such as these? How often is there a whole of government response, for example?

**Ms Kava**—I am sorry, I would have to take that on notice. I would assume that often there are agency-by-agency responses, but I really have no direct knowledge of how often there would be a whole of government response.

**Senator LUNDY**—Has the department of transport participated in a whole of government response to an audit office inquiry previously?

**Ms Kava**—We would have to check our records. We are happy to take that on notice.

**Senator LUNDY**—Can you recall any, off the top of your head?

**Ms Kava**—No, I cannot at this stage. I would need to check.

**Senator LUNDY**—Certainly. Can you recall any where you have provided an agency or departmental response to an audit office inquiry?

**Ms Kava**—Yes, I think there would be a large number of audits which the department responded to individually.

**Senator LUNDY**—So a whole of government response is not the norm, in other words?

**Ms Kava**—It probably isn't. But, as I said, I am certainly happy to check in terms of my department's responses to audit office reports.

**Senator LUNDY**—I appreciate the detail, but I think it is a reasonable observation to say that a whole of government response is not the norm. Going back to the participatory meeting that Ms Key described, at what point, in terms of the stage of preparation of the audit office report, did OASITO convene that meeting?

**Ms Key**—I cannot give you exact dates, I am afraid.

**Senator LUNDY**—Could you take that on notice?

**Ms Key**—I could check my records, yes.

**Senator LUNDY**—Can you also provide the memo or notice of the convening of that meeting, if you have that in your records?

**Ms Key**—If I have it, yes.

**Senator LUNDY**—Who else was present at that meeting?

**Ms Key**—There were representatives of all of the agencies which participated in the whole of government response.

**Senator LUNDY**—So it was all of the agencies involved in cluster 3, group 5, and Tax?

**Ms Key**—I am not sure if every single agency was represented. I know that the list of agencies that did sign up to the whole of government response is articulated. I do not have it in front of me, but there is a list of departments that did sign up to that.

**Senator LUNDY**—Was the process of that meeting designed to specifically determine whether or not there would be a whole of government response or whether or not individual agencies wanting to subscribe to if not a whole of government response then a multiagency or OASITO coordinated response?

**Ms Key**—The approach was that, because this was a report on a whole of government initiative, it was sensible to approach the response in that same context.

**Senator LUNDY**—Was that the position presented by OASITO?

**Ms Key**—Yes, it was.

**Senator LUNDY**—So they were advocating a whole of government response to all the participants?

**Ms Key**—Yes, they were.

**Senator LUNDY**—Were any other participants actively advocating that position?

**Ms Key**—My recollection of the meeting was that people there generally supported that approach and thought it was a sensible way to address the recommendations made.

**Senator LUNDY**—Was there any dissension?

**Ms Key**—Not as I recollect, no.

**Senator LUNDY**—I want to make extensive reference to the audit office report. In particular I want to refer to a table which identifies the estimated savings and the comparative column on budget reductions. Can you tell me the disaggregated savings attributable to the department of transport within the group 5 figures nominated?

**Ms Kava**—Do you have a reference or page number?

**Senator LUNDY**—I am just looking for it; I referenced it earlier today. Perhaps while I find the table you could start by telling me what your budget deductions have been over a period of time and extending into the out-years.

**Ms Kava**—Budget deductions in what sense? By the department of finance?

**Senator LUNDY**—By the department of finance.

**Ms Kava**—In the case of DTRS, the amounts calculated were \$394,000 in 1999-2000 and \$764,000 in future years.

**Senator LUNDY**—Was 1999-2000 the first time you had a budget deduction?

**Ms Kava**—Yes, it was.

**Senator LUNDY**—How far does the \$764,000 extend to in the out-years?

**Ms Kava**—I assume it goes to the limit of forward estimates. I am not sure of the extent of it, but I think it is just the normal three years.

**Senator LUNDY**—Are you aware that those deductions will continue to apply beyond the extent of the budget out-years and correlate to the duration of your contract?

**Ms Kava**—My understanding is that the department will be negotiating a pricing agreement with the department of finance within the next year or so, and that will take into account the prices of all our outputs, including of course the cost of IT.

**Senator LUNDY**—I am still trying to find the table I was referring to. What aspects of the savings estimates that were attributed overall to the group 5 contract, minimal as they were, disaggregated and attributed to the department of transport? Did you in fact have any savings estimates attributed to you?

**Ms Kava**—No. The calculation of the savings for the department of transport was basically budget neutral. So there were no savings.

**Senator LUNDY**—I thought that was a prerequisite of this program.

**Ms Key**—The savings were calculated on a group basis and, while there were overall savings for group 5, for our agency it was basically budget neutral.

**Senator LUNDY**—You say ‘basically budget neutral’. Was it budget neutral or were you in fact in the red?

**Ms Key**—The modelling showed that it was less than one per cent.

**Ms Kava**—I think it was less than half a per cent over several years. Five years was the period of the modelling.

**Senator BUCKLAND**—In the red or in the black?

**Ms Kava**—In the red.

**Senator LUNDY**—So you actually went ahead with this IT outsourcing contract, knowing that it was not going to deliver savings to your department?

**Ms Kava**—Savings were certainly one consideration in doing this. As Ms Key has said, the calculation was done on a group basis, so the group still met the requirement.

**Senator LUNDY**—I appreciate that—that has been documented at length, as you know, in the Auditor-General's report. I am specifically interested in your department and what opportunities your department had to assert its position, given you found yourself in the midst of a cluster and were not able to extract any savings from it that were identifiable at the time of signing.

**Ms Kava**—Yes, it is true that there were no savings identified, but, as I have explained, it was pretty close to budget neutral. There were considered to be other advantages to the department by proceeding with the arrangement.

**Senator LUNDY**—I will come to those. Can you provide the figure, no matter how small, by which you were disadvantaged? Did you actually identify that figure?

**Ms Kava**—I think we do have a figure. If we do not have it with us, we can certainly get it to you.

**Senator LUNDY**—I would be very interested in the figure, if you could find it now for me.

**Ms Kava**—I would like to be confident of the number, so if we could get back to you on that.

**Senator LUNDY**—Could you give me a ballpark figure? I am sure it is a figure that you are very conscious of within the department.

**Ms Kava**—In fact that is not the case, but I would estimate somewhere in the order of \$100,000 or so per year.

**Senator LUNDY**—Is that what it is costing you?

**Ms Kava**—That is based on the model.

**Senator LUNDY**—I find that quite extraordinary. Turning now to the Humphry review and recommendations 1 and 2, how do they relate to the roles and responsibilities of the chief executive or the board in accordance with the financial management acts and their responsibilities to discharge their duties under those acts?

**Ms Kava**—The executive of the department is very conscious of the need for cost management for IT services, not just cost saving. With the additional benefits that come with outsourcing, in terms of economies of scale and other elements and access to innovation that would be very costly for the department to pursue in its own right, I think the chief executive would have been quite confident of his position. But I am not the chief executive. In fact the chief executive at that time is no longer with the department.

**Senator LUNDY**—Who was it at the time?

**Ms Kava**—It was Allan Hawke.

**Senator LUNDY**—Who is it now?

**Ms Kava**—Ken Matthews.

**Senator LUNDY**—Can you outline for the committee what the justifications were in participating in a group or cluster knowing that you would incur greater charges—other than non-existent cost savings; in fact a cost increase at the bottom line?

**Ms Kava**—Could you repeat that question?

**Senator LUNDY**—What were the department's justifications in proceeding with the outsourcing not only in the absence of savings but in the presence of increased costs?

**Ms Kava**—The first point is that there is a government policy in terms of IT outsourcing that clearly the department was in a position to adhere to. We were part of a group and there were some synergies involved in being part of that, in terms of opportunities for us as an organisation both now and into the future. As I understand it the department, as a small organisation, was already having difficulties in maintaining a strong presence in terms of technical support on site and would have required quite an investment in future to maintain the sorts of levels of assistance that we would like to have if we are going to be an organisation that is a very effective provider of services to its own staff. An important consideration is that staff actually have the wherewithal to do their work, and IT support is obviously an important part of that. Being part of a larger group and accessing an outsourced provider with stronger links into the technology and innovation side of things provided an opportunity for the department that was taken up.

**Senator LUNDY**—I would like to look a little bit deeper into the detail of those justifications you have just identified, in terms of opportunities now and into the future. You have mentioned the outsourcing vendor being able to provide stronger links into technology and innovation. Are you able to specifically nominate any areas of technology or innovation that you actually have benefited from?

**Mr Simpson**—I think it is more a question of a generalisation. Essentially, one of the main benefits of outsourcing is that you have a group of people now responsible for a specialist area and they are a group of specialists.

**Senator LUNDY**—That is certainly the theory. I am actually asking beyond the generalisation for the specifics.

**Mr Simpson**—We in Transport were operating on an old network operating environment. We did not have relevant skills to move us to a new network environment where product was easily attainable. We were on Banyan Vines as our operating environment. We are now moving, with the assistance of Advantra, to an SOE based on industry standard operating environments. We certainly did not have the experience or necessary skill sets to be able to do that. It was always



something that we were probably going to have to contract in. This provided an opportunity for us to move there.

**Senator LUNDY**—With respect to the change in the operating system underlying your information technology, was that a part of the contract entered into with Advantra that they would move to a new operating system?

**Mr Simpson**—Yes.

**Senator LUNDY**—Can you describe to me the process of transition in moving to that operating system? What issues have occurred and what problems have occurred in the implementation of the standard operating environment, that SOE, that you described?

**Mr Simpson**—There has certainly been some small degree of technical difficulties. There is not a huge wealth of Banyan Vines experience or product available for easy migration, so there has certainly been the involvement of Banyan themselves and Advantra technical staff in developing some of those tools. In the move from the old mail system to the new mail system there are not good tool sets available to do that. Obviously one of our concerns is ensuring that consistency and ensuring that staff have access under the new environment to the same data that they had on Banyan. Change management has been a very rigorous part of the process—communication, training, et cetera.

**Senator LUNDY**—Ms Kava said earlier, from what I could ascertain from her answer, that a couple of the key justifications, if you like, for going ahead with this in the presence of increased costs are overcoming difficulties in tech support and improving tech support. In light of those challenges with the migration from your old operating system to the new operating system, can you characterise that as an improvement in technical support?

**Mr Simpson**—I would certainly categorise it as an improvement in technical support. You certainly could not go into a computer shop and get Banyan expertise.

**Senator LUNDY**—Perhaps I should ask my question differently. I will go back a few steps. Can you tell me whether the move to the standard operating environment from your old operating environment was embarked upon within the schedule provided in the original contract with Advantra?

**Mr Simpson**—There is actually no schedule. It was not part of the transition, if that is part of the question.

**Senator LUNDY**—No, I did not think it was part of the transition. Was a time frame nominated for that migration to the new operating system?

**Mr Simpson**—No, there is not specifically a time frame.

**Senator LUNDY**—Was there a time frame negotiated or understood to be the case within the terms of the contract or in your ongoing communication with the outsourcer?

**Mr Simpson**—During the transition period, several meetings were held. This issue was discussed at length. There was a desire to start moving to the new operating environment within the first 12 months of contract.

**Senator LUNDY**—Keep going. And what happened?

**Mr Simpson**—We started moving the first group in March of last year.

**Senator LUNDY**—Was that within the 12 months?

**Mr Simpson**—Definitely. It was nine months afterwards.

**Senator LUNDY**—What stage is it at now?

**Mr Simpson**—It is getting towards completion.

**Senator LUNDY**—What time was estimated originally for its implementation?

**Mr Simpson**—I think realistically Advantra and the department believed that it would take up to six months.

**Senator LUNDY**—So it has taken 12?

**Mr Simpson**—It has taken 12, yes.

**Senator LUNDY**—Before you moved into that process of migrating it to a new standard operating environment, had you imposed any financial penalties or service credits on Advantra?

**Mr Simpson**—Yes, we have.

**Senator LUNDY**—What was the value of those and for what reason was Advantra penalised?

**Mr Simpson**—The value of the service credits imposed to date for transport represent almost nine per cent of our service charges. They have been imposed largely due to network availability service level, and the remainder would have been made up by help desk related issues.

**Senator LUNDY**—What is the dollar value of nine per cent?

**Mr Simpson**—I will have to take that on notice, Senator.

**Senator LUNDY**—Can you give me a ballpark figure, please?

**Mr Simpson**—I have the percentage; I am not 100 per cent sure of what the actual dollar amount is.

**Senator LUNDY**—We could ask you what your total service charges are to date and work backwards from there.

**Mr Simpson**—I do not have that figure either, Senator.

**Senator LUNDY**—Are you talking a million dollars, half a million dollars, \$100,000?

**Mr Simpson**—It would be between half a million and a million dollars for transport.

**CHAIR**—Ten per cent seems to be very high. How does that compare with other agencies? Do you know?

**Mr Simpson**—I said just under nine per cent.

**CHAIR**—So it is eight to nine per cent. I rounded it up.

**Mr Simpson**—I can only comment from group 5's perspective. That is actually slightly lower than other group 5 members because there was a consistent improvement in transport service levels to the point where the service provider was meeting service levels for transport for a period.

**CHAIR**—But you say we are losing the equivalent of one in 10 working days—that is, one day every two weeks.

**Mr Simpson**—I do not think the equation could be put that way.

**CHAIR**—How would you put it?

**Mr Simpson**—It is not tied to working days; it is tied to a financial amount—the invoiced amount.

**CHAIR**—I understand that; but it is also for service, and the penalty, presumably, is for disruption to service—I think you said—when a network is not available or a main part is not available. How do you measure that? Would that equate to eight to nine per cent of network availability or not?

**Mr Simpson**—Certainly not. The network availability figures are not across the entire department. It may only affect a small number of people at any particular time.

**CHAIR**—But it still has to equate to eight or nine per cent of the network availability. What other elements are involved in it?

**Mr Simpson**—That is not the case.

**Senator LUNDY**—Is it like email? Is it like the wide area networks or the local area networks of transport? Is that what goes down when you have a network availability problem?

**Mr Simpson**—Not the entirety of the network; that is not the case.

**Senator LUNDY**—We are actually looking for some specifics here about what is deserving of a financial penalty. You mentioned network availability and help desk. What are the specific failings in the service agreements that result in those penalties? I would like you to be more specific.

**Ms Key**—There are five individual service levels that we look at every month before we determine the application of a service penalty. Each of those has a particular performance standard attached to it. From figures supplied we can assess whether or not they are meeting those standards. Some months they will do well on LAN availability, for example, and some months they will not, so it is very variable. We had initial problems with help desk, for example, and it is now doing very well. So the complexion changes.

**CHAIR**—What are the five areas?

**Ms Key**—Land availability, help desk—

**Mr Simpson**—Moves, adds and changes—the actual physical movement of PCs or addition of people to the network—problem resolution and password resets.

**CHAIR**—Is there a penalty attached to all of those?

**Ms Key**—There can be, yes.

**CHAIR**—Can you outline how each of those areas would incur a penalty; that is, what would have to go wrong for a penalty to be incurred—for example, in password resets?

**Ms Key**—There are time periods that apply to the achievement of that service level. So if it is not changed within the service levels standard, the penalty applies. That is aggregated over the month of course, so it is not just one password reset that would tip them over the edge but a standard.

**CHAIR**—A series of them?

**Ms Key**—That is right.

**CHAIR**—What about the changes and add-ons?

**Ms Key**—Similarly, there are periods of time that apply to those being done successfully, and the same approach applies.

**CHAIR**—So there would be a period of time from when you put the request in to have someone supplied with a computer to when that is actually done?

**Ms Key**—That is right.

**CHAIR**—These are like performance measurements.

**Ms Key**—They are.

**CHAIR**—Do you have a document that sets out these performance measurements?

**Mr Simpson**—Yes, it is the service level schedule of the contract.

**CHAIR**—Can we get a copy of that if we do not already have it.

**Senator LUNDY**—Could you take on notice providing us with a detailed report on what service credits or financial penalties have applied to which service level outcome—that is one of the five areas?

**Ms Key**—For what period of time?

**Senator LUNDY**—For the duration of the contract. Could you also provide us with a detailed description of the service failing; for example, if it is a LAN—local area network—issue and if it resulted in email services not being available or a server crashing or whether the two go together. I am actually looking for some technical description of the service failure that occurred at the time. How is morale holding up in the department generally with all of this change going on?

**Ms Kava**—I think very well. It is a good department.

**Senator LUNDY**—I guess I admire the spirit of all those involved. It is a very challenging process. Going back to the standard operating environment, to what degree have the challenges being experienced by other departments—and I know you cannot comment on that—in your assessment affected the experience of the department of transport? Do you understand what I am asking? Obviously there have been a number of problems with implementation—with the blow-out in time, for example, of the implementation of the standard operating environment. How much of that is completely outside your control and probably a factor in the challenges occurring within the other four agencies and departments in group 5?

**Mr Simpson**—We are the first department to undergo the SOE change.

**Senator LUNDY**—Really?

**Mr Simpson**—Yes.

**Senator LUNDY**—So you are the guinea pig?

**Mr Simpson**—We are the leader.

**Senator LUNDY**—Yes, I can see why you like to think of it like that. Perhaps you could still answer my question. I think what you have said is part of the answer, so is the answer to the

question: difficulties from the other departments are not affecting you, as such, because you are the leader?

**Ms Key**—Not all the agencies are actually having to go through this process; only DCITA and ourselves have the Banyan Vines environment.

**Senator LUNDY**—Thank you for that clarification.

**Ms Key**—The Telstra roll-out team is assisting Advantra with the implementation of the SOE in both departments at the moment.

**Senator LUNDY**—Thank you for that. I might come back to that point. I would like to actually explore the implications for the department and your contract of the changed ownership arrangements with Advantra. Were you advised when Advantra ceased being a consortium of IBM, Lend Lease and Telstra and became a fully owned Telstra subsidiary?

**Ms Key**—Yes, we were.

**Senator LUNDY**—Could you provide me with some form of documentation acknowledging that formal advice, whether it is a copy of their correspondence to you or a copy of memos within the department?

**Ms Key**—Okay.

**Senator LUNDY**—Thank you. Further, can you tell me whether or not you have been advised of ongoing changes in Telstra's relationship with Advantra—or, should I say, Advantra's relationship with Telstra?—and what the nature of those changes in that relationship is?

**Ms Key**—The most recent one we have been advised of is the change of the Advantra CEO to an executive chairman—Barry Grisdale, who has recently taken over from Craig Cameron—and there has been restructuring of the business as part of that.

**Senator LUNDY**—So Craig Cameron is no longer CEO?

**Ms Key**—That is correct, yes.

**Senator LUNDY**—When did that happen?

**Ms Key**—About a month ago, But I could get that for you.

**Senator LUNDY**—And what about any additional changes in the way Advantra is managed within the Telstra suite of companies?

**Ms Key**—I have some organisational charts that we received recently from Advantra in a newsletter that describe that.

**Senator LUNDY**—Would you provide those to the committee?

**Ms Key**—I would be happy to provide those, yes.

**Senator LUNDY**—In terms of the changing ownership structure and these subsequent changes, what impact, if any, does that have on your contract per se with Advantra—in other words, as party to that contract, et cetera?

**Ms Kava**—I understand there is no impact but we would certainly confirm that for you.

**Senator LUNDY**—Thank you. Can you tell me whether applications development is part of your contract with Advantra?

**Ms Key**—Yes, it is.

**Senator LUNDY**—And it was an aggregated part of the whole group 5 contract, from memory. Is that correct?

**Ms Key**—I am not sure what you mean by that, sorry.

**Senator LUNDY**—I asked if applications development is part of all the agencies involved in the group 5 contract?

**Ms Key**—Not all agencies took that option up.

**Senator LUNDY**—But you did.

**Ms Key**—Yes, we did.

**Senator LUNDY**—Can you tell me what sort of applications development that involves for your department?

**Mr Simpson**—It involves the development and support of all our pre-existing in-house applications and provides us with scope to go to Advantra for new developments.

**Senator LUNDY**—And what are the intellectual property or licensing arrangements associated with the development of new applications under the auspices of this contract?

**Mr Simpson**—The Commonwealth retains the intellectual property rights where the Commonwealth has had any involvement in the development.

**Senator LUNDY**—And what about subsequent innovations? Given one of your reasons for going there in the first place was to tap into technological innovation, what about innovations that Advantra might bring to the table that you subsequently benefit from? What about if there is mutual advancement or technological innovations in association with those products? Do they retain the intellectual property or do you?

**Mr Simpson**—No, the ownership of the intellectual property returns to the Commonwealth at the expiry date.

**Senator LUNDY**—So Advantra can use it for other purposes in between or just in relation to their contract with you?

**Mr Simpson**—I am not 100 per cent clear, so I would like to take that on notice.

**Senator LUNDY**—Certainly. Going back to the issue of savings and the fact that you knew you were not going to derive any, how does that relate to the government's overarching policy—and I just recall Ms Kava's response that one of the overarching reasons you are there is, obviously, that this is mandatory government policy—that savings were in fact specified as a prerequisite to embarking on an IT outsourcing contract. What is your response to that?

**Ms Kava**—My understanding is that the savings are on a whole of government basis rather than a single agency basis.

**Senator LUNDY**—The Auditor-General's report identifies the fact that each request for tendering for group 5, cluster 3, in tax specified 'the achievement of substantial cost savings is a precondition to the awarding of a contract'. The Auditor-General's report identifies that as being a primary objective of the Commonwealth. At what point did you become aware that that was no longer a precondition to the awarding of a contract on an agency by agency basis?

**Ms Kava**—I think, as you read it out, the requirement was savings for the contract. The contract is across all members of the cluster and, as I understand it, the condition was met: savings were obtained for the contract on the basis of the cluster.

**Senator LUNDY**—Right. So are you telling me that your understanding of the government's policy was that savings as a precondition did not apply to individual agencies within a group or cluster?

**Ms Kava**—Not necessarily.

**Senator LUNDY**—But it was a precondition to a cluster prior to the change in policy, which I will come to?

**Ms Kava**—My understanding is that it was a whole of government issue and that in terms of—

**Senator LUNDY**—That is actually a separate issue which I will come to—the whole of government as distinct from whole of cluster or group. I am asking you with respect to the whole of cluster or group.

**Ms Kava**—My understanding is that savings were required for the cluster and not necessarily for individual agencies that may gain other benefits from the relationship.



**Senator LUNDY**—Okay. Thank you. Were you advised specifically of that in the lead-up and negotiation of the group 5 contract by OASITO or any other party involved in those negotiations?

**Ms Kava**—I think that we will have to take that on notice, Senator Lundy. I certainly was not around at that time. I have no personal recollection of it, but we will need to check that from our records.

**Senator LUNDY**—If you could provide any documentation that relates to that specific issue in any way, shape or form, please provide it to the committee.

**Ms Kava**—Certainly.

**CHAIR**—Ms Kava, in terms of the budget—

**Senator LUNDY**—Chair, can I just ask one more follow-up question on that, because it relates specifically to it. I do want to clarify that the situation did change in December 1998 when a letter from the Prime Minister advised all portfolio ministers that:

As general government policy, outsourcing of IT infrastructure services should proceed unless there is a compelling business case on a whole of government basis for not doing so.

The letter is referred to on page 13 of the audit summary of the Audit Office report. I am drawing the distinction between whole of government as opposed to the whole of cluster or whole of group prerequisite for savings, because the Auditor-General's report goes on to analyse the degree to which all whole of cluster savings were in fact deficient overall in the group 5 cluster and contract as well, which, I appreciate, affects you partially, and I may come to questions relating to that shortly.

**Ms Kava**—That letter is very relevant, certainly in terms of any interpretation of what was required. The timing of it was such that it came out well before the cluster 5 evaluation was completed. That would have been part of the documentation that I was referring to.

**CHAIR**—What was the level of efficiency cuts in the department's budget in 1997-98 and contained in the forward estimates?

**Ms Kava**—I gave that figure, Chair. You may have been out of the room. It was the first question.

**Senator BUCKLAND**—Earlier on, you said you are running in the red by about \$100,000 a year. Is that about right?

**Ms Kava**—As I indicated, I would like to clarify that figure.

**Senator BUCKLAND**—I understand you are going to clarify it.

**Ms Kava**—I did provide that figure. It was based on the model—that was the estimate.

**Senator BUCKLAND**—Prior to going into the outsourcing arrangement, was the department running in the red then?

**Ms Kava**—I do not understand what you mean, Senator.

**Senator BUCKLAND**—Are you always running in the red? Is the department always not cost efficient?

**Ms Kava**—No, Senator.

**Senator BUCKLAND**—So it is only since the arrangement with the cluster that you have found yourself not on a par?

**Ms Kava**—We are not running in the red as a department, Senator Buckland.

**Senator BUCKLAND**—Where does the \$100,000 come from? Isn't that counted?

**Ms Kava**—That figure related to a cost model of whether or not there would be savings, specifically on the IT outsourcing exercise.

**Senator BUCKLAND**—Thank you, that clarifies that. In relation to the other cluster members, how does your department perform cost wise?

**Ms Kava**—Costs for IT?

**Senator BUCKLAND**—Yes, costs to your department. There must be some cost savings in outsourcing IT. I imagine that is why it was done. Were there no savings? Let me withdraw that question. I am far from convinced that we have good answers to the costing, so I will go another way.

When someone woke up one morning and turned the lights on saying, 'We are going to go down the road of outsourcing,' what expertise was used to assess the Department of Transport and Regional Services? Did OASITO provide expertise or did they say to you, 'Use your own internal people to assess your needs, your requirements.' What was the process?

**Ms Kava**—I do not think it was a matter of somebody waking up and turning on the light one morning; it was a matter of government policy for us to pursue the IT outsourcing agenda. The Department of Transport and Regional Services was very active early on in finding cluster partners because we were interested in finding other organisations that we could work with in terms of getting benefit out of this particular arrangement.

As my colleague has mentioned, we certainly were in a situation where the technology and even the expertise within the area would benefit from having options outside the department. So, in a sense, we were actively involved in the process of finding cluster partners and working with OASITO as part of a whole range of committees that were then set up, some of them under OASITO's chairmanship. The process of market testing and outsourcing went from there.

**CHAIR**—With due respect, you are not trying to suggest that one day the department of transport suddenly realised that outsourcing would be good, clustering may be very good and it would go along that road? You may have been a willing and active participant but you were

responding to a government initiative, not something that your department specifically sought to initiate.

**Ms Kava**—Yes, I thought I said that at the beginning. I am sorry if that was not clear.

**CHAIR**—You did not make that very clear.

**Ms Kava**—It was in response to the IT outsourcing policy.

**Ms Key**—However, at that time the department was actually outsourcing a number of different components of its IT services in the department, small pieces of it—

**CHAIR**—I think that if you look across the whole of government there was probably outsourcing going on in a whole range of agencies but nowhere near the level within the constraints that were being imposed by the whole of government outsourcing initiative that was being pursued by OASITO.

**Senator BUCKLAND**—When the initiative was put before you that we were going to go down the line of outsourcing, was there any opportunity for you or your cluster to look at an in-house option?

**Ms Kava**—There was not an examination of an in-house option that I am aware of. Again, we understood that was not a possibility, that there was an alternative mechanism of measuring any bids against the in-house provision and that there were cost models provided so that they could actually gauge the cost of providing services in house versus the cost of the tenders. So, de facto, the issue was being taken care of.

**Senator BUCKLAND**—Earlier on you made reference to cost savings as opposed to cost management. For my very simple mind, can you explain the difference between the two?

**Ms Kava**—We recognise that it will not always be possible to create a saving in terms of achieving what we need to do with our IT in terms of becoming a proficient ‘e-organisation’, to use a more modern terminology, but we do want to ensure that we are getting value for money so that we actively manage costs to ensure that is the case.

**Senator BUCKLAND**—What methods do you have in place to measure if you are getting value for money?

**Ms Kava**—There has already been some reference to a range of service levels that were agreed as part of the contract and that provide some measure of value for money. I do not know whether my colleagues want to comment more generally.

**Ms Key**—There are actually two formal opportunities in the contract to benchmark both quality of service and the cost of the service, so as a group we will certainly be using those opportunities to make sure that we are getting value for money.

**Senator BUCKLAND**—Does the contract have a defined life or is it an ongoing arrangement?

**Ms Key**—It is a five-year contract with a two-year option.

**Senator BUCKLAND**—How long before the end of the five years do we start renegotiating?

**Ms Key**—We are looking at benchmarking this calendar year and in year 4. Certainly in year 4 we will be looking to the future and looking at what our options are at the end of the contract life too.

**Ms Kava**—Our focus at the moment is very much on working with the outsourcer in making the contract work effectively. We are interested in forging a partnership to our mutual benefit so that we do receive good service and meet our objectives in terms of having this arrangement in place.

**Senator BUCKLAND**—In relation to the agency you outsourced to, do you have the opportunity to use other services as well?

**Ms Kava**—Yes, we do. It is a non-exclusive contract for all services.

**Senator BUCKLAND**—Do you have any other providers at the moment?

**Ms Kava**—I believe we do for some services.

**Mr Simpson**—We have a contract with a data cabling company. As we were moving premises, we needed an organisation to cable a new building for us. We have an arrangement in place with a service provider for our financial and HR management systems. They are the two main ones. We have another contract with an organisation providing our web hosting services.

**Senator BUCKLAND**—If I can go back to your last answer, Ms Kava, in relation to morale, I think you said it was pretty high at the moment. Does that run right through the department?

**Ms Kava**—I do not know that I have particular expertise in gauging morale. Morale would go up and down in different areas at different times for different reasons.

**Senator BUCKLAND**—If you have not got the expertise, is there a division of your operation that does have the expertise to measure morale?

**Ms Kava**—There are staff surveys that are done on a regular basis. I think they are done once in each two-year period. I do not know that you could say they measure morale, but I suppose in general terms they do. They certainly measure staff views about a range of things. I took Senator Lundy's question to be a general one when I responded to it.

**Senator BUCKLAND**—Measuring morale every couple of years seems to be a long time between drinks. Do you have a human resource department?

**Ms Kava**—Yes, we have a human resources area.

**Senator BUCKLAND**—And do they report to you?

**Ms Kava**—Yes, they do, Senator.

**Senator BUCKLAND**—Do they report to you on staff morale? Or aren't you interested?

**Ms Kava**—Not specifically, but they certainly undertake a whole range of activities that are geared at assisting staff in terms of doing their jobs well. We do not have a measure of morale as such. We have a number of activities that the HR department does, as they do in any organisation, in terms of performance management, opportunities for training and all those types of things.

**Senator BUCKLAND**—Have you outsourced human resources?

**Ms Kava**—No, we have not.

**Senator BUCKLAND**—It seems very odd to me that you cannot give us a very distinct answer as to staff morale if you have got a department reporting to you. Don't you ask the question?

**Ms Kava**—I have not asked that specific question. All I can give you is my impression. We had not run a survey that I can point to that details what morale is at the moment. As I said, we do have periods and areas in the department where morale is high or low depending on what is happening at the time.

**Senator BUCKLAND**—When the outsourcing decision was taken, were there any job losses or cutbacks at all within the service areas?

**Ms Kava**—In the IT area—

**Senator BUCKLAND**—Not necessarily in the IT area, but certainly as a result of the introduction of the outsourcing of IT.

**Ms Kava**—The outsourcing of IT resulted in some staff, specifically in the IT area, taking voluntary redundancies and leaving the department.

**Senator BUCKLAND**—Did that create any angst among the staff? Was taking voluntary packages a matter of 'I can't wait to get hold of one' or 'We are looking for volunteers to take these packages'?

**Ms Kava**—I was not there at the time, but I understand that the people who took packages were quite happy to do so.

**CHAIR**—The response by DOFA to the Auditor-General's report in part stated that the report:

... provides only a limited view that does not reflect the overall quality and rigour of the tender processes and the implementation/transition efforts undertaken for each service agreement. In relation to contract management, the Report focuses heavily on process and documentation and, consequently, encourages an overly process-oriented and literal approach to contract management that may not produce the best service delivery and value for money outcomes for the Commonwealth. It also fails to provide the balanced assessment of the effectiveness of the various processes undertaken.

Given that you were one of the agencies that was audited by the Auditor-General, do you agree with that statement as a response to the Auditor-General's report?

**Ms Kava**—Could you give us the reference for that? It is quite a long passage.

**CHAIR**—Page 27, paragraph 46.

**Ms Key**—The department has really concentrated heavily on developing a sound relationship and even a partnership with Advantra on the delivery of IT management for our staff. We would certainly support that comment. We are very keen to develop a relationship with Advantra that sees them working with us to achieve the best outcome we can for our people. While we have applied service penalties, we do work actively with them on a very regular basis to try and foster sensible and reasonable approaches to resolve problems. We are very keen that we see them as a business partner and that they get involved in active decision making about systems and processes and ideas about where we ought to go in the future. So we very strongly support that comment that there is more to it than black letter type interpretation, that the relationship is critical.

**CHAIR**—What consultations were undertaken with your agency in the development of the whole of government response?

**Ms Key**—We were actively involved in the development of the whole of government response.

**CHAIR**—Did you provide written comments to DOFA on it?

**Ms Key**—We exchanged emails about the draft whole of government response.

**CHAIR**—Did you participate in oral discussions to develop the response?

**Ms Key**—Yes. I participated in a meeting of all agencies which signed up to that response.

**CHAIR**—So you fully support the contents of DOFA's response to the Auditor-General's assessment?

**Ms Key**—Yes, we do. We were very happy to sign up to that response.

**CHAIR**—You were very happy to sign up?

**Ms Key**—We were actively involved in the drafting of the response and quite satisfied with the way—

**CHAIR**—I am pleased that you were very happy. Have there been any lessons you have learnt out of this process? Is there anything that you would now do differently, with the benefit of hindsight?

**Ms Kava**—One clear thing we would probably do differently is have a longer transition period. We had a fairly short transition period of 10 weeks, which was very ambitious. As I understand it, the provider was very confident that they could meet that; but, on reflection, I think that was overly ambitious. We would in future look at a longer transition period. Obviously there are probably disadvantages in having a transition period that is too long, but I think we would find a different balance point. That was the main one for us in our early experience of the contract, that the transition period did make it more difficult.

**CHAIR**—Given your experiences to date, is the view within your agency that you would want to continue with outsourcing of IT or has there been any consideration about bringing all or part of the IT services back in house?

**Ms Kava**—There has been no consideration of a change to our current arrangement. Obviously, as I mentioned earlier, we are focusing very much on the contract that we have, and making that work—and work very well—for us. But we will certainly, through the period of the rest of the contract, be looking closely at performance, service levels and benchmarks. A bit later in the day, we will be looking at options for the future.

**CHAIR**—So you have not discarded the possibility of bringing some of your IT provision back in house?

**Ms Kava**—There has been no discussion of it at all, Senator, so we have neither discarded it nor embraced it. It just has not been considered.

**Senator LUNDY**—Just on that issue, did you establish your cost baselines to establish what your costs for IT were before entering into the contract?

**Mr Nef**—Yes, we did.

**Senator LUNDY**—Were those cost baselines used to establish—applying the OASITO model—your assessments of the outcomes of the contract and savings estimates?

**Mr Nef**—The cost model that we used was the OASITO one. It was used through the evaluation process.

**Senator LUNDY**—You fed your cost baselines into that model?

**Mr Nef**—We did.

**Senator LUNDY**—Have you done an assessment of the outcomes for the department using the model advocated or described by the Audit Office in the Audit Office report?

**Ms Key**—Do you mean subsequently: post IT outsourcing?

**Senator LUNDY**—In light of the Audit Office report, basically.

**Mr Nef**—No, we have not reassessed.

**Senator LUNDY**—Can you tell me what the value of the assets was in your assessment and confirm whether or not they have been transferred to the vendor?

**Mr Nef**—I can confirm that they were transferred. I do not have the detail of the value.

**Senator LUNDY**—Could you take that on notice and also provide details of the entry-exit costs for this contract, including: any one-off transition costs; the value of the purchase of the assets—obviously, that is a critical figure in relation to the financial methodology; what exists within the contract that determines the value of the buyback of those assets at the termination of the contract; and the exit clause that determines the terms and conditions upon which you can in fact exit the contract, either at the conclusion of the five years or prior. I am happy for you take all of that on notice because I appreciate that you probably do not have all that at your fingertips. Can you quantify the redundancy costs associated with moving from an in-house to an outsourced environment?

**Mr Nef**—It was in the order of \$860,000.

**Senator LUNDY**—Were those redundancy costs factored into the financial methodology applied by OASITO and into your assessments?

**Mr Nef**—Yes, they were.

**Senator LUNDY**—Going back to the issue we were discussing earlier about the relevance of the Prime Minister's letter dated December 1998, I am interested in the department's view of the implications of that letter in perhaps opening the doors—or providing the capability—for you as a department to sign up to a contract that effectively cost you more, given that the previous environment said savings were a prerequisite. Any comment on that?

**Ms Kava**—Are you asking me what the department's reaction was at the time to that letter?

**Senator LUNDY**—What was the significance of that letter to your internal considerations of whether or not you were able to proceed with this contract, given you were not achieving any savings?

**Ms Kava**—Given the stage that we were at in terms of the process, the impact was probably not huge on our department because we were moving down the path of clustering and outsourcing anyway. So we were fairly well advanced in terms of moving in that direction in any case.

**Senator LUNDY**—Would you have been able to sign that contract without the prime ministerial letter identifying a shift in government policy?



**Ms Kava**—I would have to take that on notice in terms of obtaining perhaps some legal advice. I do not know the answer to that directly.

**Senator LUNDY**—It might be helpful if I refer you to finding 4.51 in the Auditor-General's report, page 100. It reads:

The Cluster 3 Evaluation Committee and the ATO Financial Evaluation Team both reported that the ranking of tenderers in respect of the cost savings criteria was based on tenderers' *respective NPV savings*.

That is net present value savings. It continues:

In contrast, in the Group 5 tender, the Minister was not provided with NPV analysis of the projected savings. ANAO considers that a consistent approach to the presentation of undiscounted and discounted financial evaluation outcomes in future tenders under the IT initiative would enhance the clarity and completeness of the information provided to the decision maker.

The implication of that is obviously that in some way the financial methodology applied to Group 5 did in fact vary from the others, and the identification of the NPV savings does relate to the identification of savings under that methodology prior to signing. It may have some relevance as you pursue the answer. But I am basically interested in where in this whole process there was a backing away by the government, on an agency by agency, a cluster by cluster or indeed a whole of government basis, on the specific prerequisite of cost savings which was a part of the Group 5 request for tender. At what point was that departed from, on what terms and conditions, and what prompted that departure? I could leave that with you to take on notice, and I look forward to your response.

We may also take the opportunity to place other questions on notice. I appreciate the opportunity to have you with us here today. I have been looking forward to it, so it is unfortunate we do not have enough time. I will place some more material on notice. Thank you.

**CHAIR**—That brings us to the end of the session with the Department of Transport. I thank the witnesses.

[2.19 p.m.]

**COMER, Mr Raymond, Executive Manager, Corporate Services, Civil Aviation Safety Authority**

**ELDER, Mr Robert Stephen, Executive Manager, Government, Industry and International Relations, Civil Aviation Safety Authority**

**MINNS, Mr Michael John, General Manager, Information Management Branch, Civil Aviation Safety Authority**

**CHAIR**—Would you like to make an opening statement?

**Mr Elder**—Just a few brief comments. First, we are keen to cooperate with the committee in responding to the questions you have raised today. Second, we note that a large number of questions on this issue have been placed on the Senate *Notice Paper*, and there will probably be an overlap between the answers we give today and the answers that are provided in response to those questions. Finally, I would like to give an undertaking that we will respond as quickly as possible to the committee's request today that we provide written advice in relation to the role of OASITO in the implementation of the initiative.

**Senator LUNDY**—Within the aggregated figures of the value of the Group 5 contract, can you tell me what proportion of that contract in dollar terms relates to CASA?

**Mr Comer**—CASA's share of the contract value was \$15.6 million in NPV terms.

**Senator LUNDY**—Given that we know the savings figure identified in the Auditor-General's report was minimal for Group 5, can you tell me whether or not any savings were estimated to be attributable to CASA's proportion of the Group 5 contract?

**Mr Comer**—OASITO—it is an interesting name—

**Senator LUNDY**—We all struggle with it; don't worry.

**Mr Comer**—Their savings estimate was \$5.076 million for CASA. That is using the whole of government OASITO model. CASA did its own evaluation of those estimated savings and we came up with some different figures to what OASITO did.

**Senator LUNDY**—Are you in a position to share them with us?

**Mr Comer**—I think it would be sufficient to say that they are less than the OASITO model. We felt that the OASITO model did not take account of some elements of cost that would apply to an agency specifically.

**Senator LUNDY**—You have no idea how many questions this has flooded into my head, but I will try and go through them in some order.

**CHAIR**—Let me give you the bad news. You won't be going beyond 3 o'clock.

**Senator LUNDY**—I know that; I'll try and do it in some degree of order. First of all, I would like to ask you specifically for the figure that you arrived at with your own calculations.

**Mr Comer**—Our figure was just under \$1 million in negative savings.

**Senator LUNDY**—So you believed it would cost you money.

**Mr Comer**—Over the spread of the whole year, we regarded it as a marginal business case for CASA.

**Senator LUNDY**—That did not answer my question.

**Mr Comer**—I think it remains marginal. If you are looking at a five-year contract—

**Senator LUNDY**—I am sure it is marginal, but when you say 'negative savings' does that mean you are incurring additional costs in your estimation close to \$1 million?

**Mr Comer**—Over the five years, that is correct, yes.

**Senator LUNDY**—The next question I have is this: does the model that you applied have parity or is it reflective of the model applied by the National Audit Office in their calculations?

**Mr Comer**—I have not reviewed that model closely, so I cannot answer that question directly. If you want a definitive answer I would have to look at it for you.

**Senator LUNDY**—You may actually answer it when answering my subsequent questions. Could you identify the factors which you included in your calculations or analysis beyond those contained in OASITO's financial methodology?

**Mr Comer**—Bear in mind, Senator, we are talking about an agency specific type business case as distinct from a whole of government business case.

**Senator LUNDY**—Yes.

**Mr Comer**—The items were fairly simple from our point of view. They related to particular insurance requirements that CASA has. They related to what we would regard as non-realizable or non-rebatable corporate overheads. We felt there were additional costs in running the contract management unit which were not contemplated in the OASITO model. And we of course at an agency level do not get any direct benefit from calculations done of competitive neutrality.

**Senator LUNDY**—That was my next question. What proportion of the \$5.076 million estimated by OASITO can be attributed to those competitive neutrality factors which include the corporate taxes?

**Mr Comer**—Of the \$5-odd million that they calculated, it was about \$3 million.

**Senator LUNDY**—Could you provide us with that specific figure on notice?

**Mr Comer**—We could do that, yes. I have just been advised that they are not NPV dollars; they are actual today dollars. So we could do an NPV calculation for you, if you wish.

**Senator LUNDY**—Yes, and, when you provide those answers, could you draw the distinction between them—make it clear if they are NPV dollars or in fact cash terms.

**Mr Comer**—Yes.

**Senator LUNDY**—In terms of disaggregating the Group 5 reductions in budgets, what budget reductions were attributed to CASA in anticipation of IT outsourcing?

**Mr Comer**—Is this is the global amount that the government calculated a few years ago?

**Senator LUNDY**—Yes, I certainly was aware of the figures. The portfolio budget statements identify a specific budget reduction attributable across individual agencies and departments to IT outsourcing as distinct from the government's estimated savings in association with the contract.

**Mr Comer**—Our understanding of the figure is that it was \$145,000 per annum; so an amount that almost gets lost in the rounding, in a sense.

**Senator LUNDY**—And that did not vary across the out years—it was \$145,000 for each financial year?

**Mr Comer**—That is correct, yes.

**Senator LUNDY**—Do your own calculations of being in the red take into account that \$145,000 figure or is that an additional figure to which you are at an disadvantage?

**Mr Comer**—It takes account of that figure; it aggregates out, for example, at about \$725,000 over that full five-year period. So we classified that in our model like an efficiency dividend, if you like.

**Senator LUNDY**—That is important for me to be aware of. In relation to the experience you have had since the contract has been in place—obviously part of Group 5 Advantra is the contractor—we have heard from other agencies and departments involved in Group 5 that there have been difficulties in both the transition and the operation of that contract. Can you tell me, perhaps overall, the financial value of service credits and financial penalties that you have applied through CASA?

**Mr Comer**—We have put IPEX on notice of the application of a service credit. I can get that figure for you. But we have not applied service level credits on a monthly basis. As you are aware—

**Senator LUNDY**—Sorry, can you clarify that—Group 5 or Group 8?

**Mr Comer**—We are Group 8.

**Senator LUNDY**—Sorry, yes. It is just that you said IpeX and I did not think that was Group 5. I take it all back. Let's start again. That actually puts the context of the question in perhaps a slightly different framework. Nonetheless, it does not change my assertion that we have all heard of the contract difficulties that have occurred under the Group 8 contract as well. So my question still stands, albeit I correct the context in which I asked it.

**Mr Comer**—Can I give a general answer and then go to the specifics?

**Senator LUNDY**—Yes, please.

**Mr Comer**—IpeX was what we tend to call a 'box dropper' in terms of its previous experience. It entered into a contract as service delivery provider, so it is our service provider. The last eight months have shown us that IpeX has grown into its contract. As DOTARS mentioned to you, we are in the process, obviously, of building relationships. It would not be accurate to say that we did not have problems. We had a recent case in point where, over the last month, we rolled out our standard operating environment. IpeX has done a very creditable job in that. What CASA did to make sure that that happened effectively and without risk to CASA was to embrace IpeX and make sure that CASA had a management strategy which would mitigate any risk of failure during that critical time for us. At the operational level, we would have to regard IpeX's performance thus far as being satisfactory. That does not mean to say that we do not have some problems. As I mentioned to you, under the terms of the contract you have remedies for service level credits which you can exercise within a 12-month period. We have put IpeX on notice of the application of a service delivery credit for one of the months of that period but we have not applied it as yet.

**Senator LUNDY**—What are the primary service level agreements that you have with your vendor? What are the categories?

**Mr Comer**—Perhaps I will need to take that on notice in terms of defining the categories. By way of a general response, it is up to the agency to ensure that its service delivery credits apply to the most important areas of its operations. So, if you have difficulty in particular areas, there is some scope in the contract to reallocate your service level credits. The initial credit application that we have foreshadowed to IpeX related to the standard of its reporting to us on a monthly basis. To its credit, it has now picked up significantly in that area. It is that sort of mechanism that you would apply but you would do it with some prudent management.

**Senator LUNDY**—Are you finding problems in areas that are not directly related to a service level agreement and, therefore, that can be quantified as far as service credits go? I am struggling; I could ask you a whole series of specific questions about problems that you are confronting, but I am asking you a general question and asking you to nominate other areas where you are experiencing problems. I appreciate the difficulty in that.

**Mr Comer**—I think the highlight for CASA, and quite a watershed in our relationship with IpeX, has been the rollout of our standard operating environment. That is a pretty big issue for us. They have—I think as of last night—virtually completed that exercise, much to their credit. So there are other areas where we would have some difficulty with IpeX in relation to their

corporate capabilities—that is, managing the contract at a higher level. We are working with Ipex to resolve some of those issues as we get further into the contract. CASA will be embarking upon a fairly major business improvement program over the next couple of years and opportunity exists for these service providers. If they do a good job, they can extend the range of their services. If they do not do such a good job, CASA has the option of using other providers. Unlike DOTARS, applications development is not part of this services contract.

**Senator LUNDY**—On that contract management issue, you identified that as an area where you believe OASITO's cost analysis did not really cover your costs. Can you describe what resources CASA is having to devote to contract management and compliance?

**Mr Comer**—Again, just a little history. We had two people full time working with the evaluation team during the whole process: a technical person and a finance person. They then continued with us during the transition period, as we were working up towards the handover period. Where we may have started off with about two people, we are now using around five people to manage that—but, bearing in mind, we have that bit of a ramp-up at the moment because of the standard operating environment roll-out. We hope that we could bring that figure back once we get through that process. So, yes, we have even exceeded the original estimates that we put on it, which were higher than OASITO, but we saw that as good risk management from CASA's point of view.

**Senator LUNDY**—On the question of your technology being outsourced, I understand that there is no mainframe associated with the group 8 contract. Can you describe, as far as your mid-range and desktop systems go, the service outcomes of that technology? For instance, what database systems do you operate and, presuming they have national application, what is the extent of a wide area network, if it in fact exists—those kinds of issues? I am asking for an overview of what these computers actually do and what services they provide to CASA.

**Mr Comer**—What we outsourced was what you might broadly describe as our basic IT infrastructure. So Ipex provide us with things like PCs, printers, data communications, mid-range type applications.

**Senator LUNDY**—They are like servers—big computers.

**Mr Comer**—That sort of thing, yes. Line of business type applications which sit on mid-range type devices would also be in their bailiwick. But as we develop new line of business applications, CASA will do that within its own right, whether it uses insource staff or outsource staff.

**Senator LUNDY**—You said that applications development was not part of it.

**Mr Comer**—It is not part of Ipex's contract. That is right. We would use providers as we best saw fit in that situation.

**Senator LUNDY**—If you have a failure of a service level outcome in that mid-range area, can you describe what that failure means to your staff and to your business outputs as an agency? You might have to find a useful example for me to give substance to what you are going to say.

**Mr Comer**—We have applications at the present time which contain the databases for registration of aircraft, pilots, the certificates that various operators have, and those sorts of things. If, for some reason, we were not able to get access to that data, it would certainly impede the efficient operation of our business. So it is very vital to us that we have high levels of service from Ipex. In CASA's situation, we have some line of business applications at the moment which are what we call 'legacy systems'. They have a risk element in their own right, and part of the business improvement program that I mentioned previously to you is the replacement of those old legacy systems. That will mean upgrading our databases and upgrading our line of business applications.

**CHAIR**—Is there any intellectual property associated with these legacy systems?

**Mr Comer**—If you would classify databases as intellectual property, yes.

**CHAIR**—They are on the market.

**Mr Comer**—So we retain control and ownership of that intellectual capital, if you like.

**CHAIR**—So the legacy systems are intellectual capital. What about new operating systems that may be developed as part of this outsourcing of your IT? Who will have the intellectual property rights over that?

**Mr Comer**—The systems upon which they will run would most likely be Ipex systems. So we would have the same relationship with Ipex in relation to that.

**CHAIR**—You have operational systems as well operating out in the field. Who does the monitoring of aircraft movements?

**Mr Comer**—That is an Airservices function. An example of what would typify our business where an IT system might be relevant, would be if you wanted to become a pilot or you wanted to register your aircraft or you wanted to run a charter operation—that is, you wanted an airline business—you would come along to CASA and you would make an application for that authority or that licence or that permit. We would then process that through our system. Our business is totally different from an insurance company or a banking agency or something like that. Our business is mainly information management; that is our critical business. We must have access to information when we want to process those applications that we receive. So it is not a complex IT environment.

**Senator LUNDY**—You mentioned legacy systems and the business improvement program. Did the contract that you signed as part of group 8 constrain your capability as a department to deal with those legacy systems?

**Mr Comer**—I do not believe so. The proof will be as we get them installed. There is opportunity for Ipex to extend their operations to take account of that.

**Senator LUNDY**—That is my point: to deal with the legacy systems you are effectively having to pay more and expand Ipex's role. It was not actually built into the original contract, was it?

**Mr Comer**—That is correct.

**Senator LUNDY**—If you did not take that business decision to engage in a business improvement program, you would in fact be constrained because it was not programmed in as part of the group 8 contract.

**Mr Comer**—It would be an arguable point as to whether Ipex would provide that service more cheaply or otherwise than any other provider. As they are our service provider at the present time one would normally expect that they could be more efficient in responding to our needs compared with us having to go to another outsource provider.

**Senator LUNDY**—That was not quite where I was going with it, but I appreciate you making that point. The point I want to make is that the business improvement program was not anticipated or factored in at the signing of the contract.

**Mr Comer**—That is absolutely correct.

**Senator LUNDY**—How much more is that going to cost you if you proceed down that path—perhaps in percentage terms, because you probably still talking about costs?

**Mr Comer**—That is a very hypothetical question. Let me explain where we are at with that program. We are at the detailed planning stage.

**Senator LUNDY**—I will let you off the hook. I will follow it with interest.

**Mr Minns**—I do not want you to get the impression that implementation of our business improvement program is necessarily going to increase our cost structure with Ipex. We are primarily talking about replacing legacy systems, so that when we retire those systems they get retired from the contract as well and that cost is then removed. Then we introduce a new system with its own cost structure. So it may actually be that we have cost reductions rather than cost increases. Our legacy systems are relatively old and are relatively costly to maintain. I do not want you to have the impression that our business improvement program is necessarily going to increase our cost structures.

**Senator LUNDY**—I accept that point. I guess it depends on how much cost you are actually incurring because of the age of your legacy systems.

**Mr Minns**—Correct.

**Senator LUNDY**—Perhaps you could tell me what the proportion of the value of the contract is specifically attributable to the maintenance of those legacy systems, as opposed to anything else?

**Mr Minns**—In rough terms, approximately 50 per cent of our payments are associated with our mid-range systems, and 50 per cent are associated with desktop support. Of those mid-range systems—I am being very general here—probably 50 per cent of that again is what I would term to be legacy systems.



**Senator LUNDY**—It is from that area that you hope to derive efficiencies through a business improvement program?

**Mr Minns**—Correct.

**Senator LUNDY**—I will watch with interest in that regard. What is your understanding of the entry and exit costs of the group 8 contract?

**Mr Minns**—Entry costs?

**Senator LUNDY**—Have you quantified the transition costs of going into this contract, in any aggregated way?

**Mr Comer**—We prepared the business case relevant to that, but I am not sure I am addressing your question.

**Senator LUNDY**—I do not think I am wording it very well; I think that is probably why. Perhaps I can start by asking you to quantify what you saw as your redundancy costs with the transition from in-house to outsourced contracts.

**Mr Comer**—We had, I think, 11 staff who chose to take the option that was provided to them under the in-scope classification that applied to them. As you are probably aware, that was a clean-break arrangement. We could give you the figure of the redundancy payments if you wish, but I do not have them with me.

**Senator LUNDY**—We have already talked about where they fitted in with your calculations.

**Mr Comer**—Yes.

**Senator LUNDY**—Would you also tell me the value of your assets that were transferred under the terms and conditions of the contract when you did your baseline cost analysis?

**Mr Comer**—We would have to take that on notice. I think it was somewhere less than \$2 million.

**Senator LUNDY**—Have you identified a figure for the buy-back of assets at the termination or end of the contract?

**Mr Comer**—The termination provisions have a few options in them, as you know, so we could exercise some options in relation to that. There has been an almost fascinating debate about finance leases and operating leases and the like.

**Senator LUNDY**—Indeed there has.

**Mr Comer**—That debate still rages, although I think 30 June will mark the cut-off point for the debate.

**Senator LUNDY**—Is that actually in dispute within the Group 8 contract—whether a finance or operating lease is actually in place?

**Mr Comer**—There are divergences of opinion, yes. We classified it as an operating lease in our financial statements last time. The thrust of the argument would suggest that it is going to turn around by the time this balance sheet gets prepared.

**Senator LUNDY**—I will certainly follow that with interest. Is there any litigation occurring in that regard at the moment?

**Mr Comer**—I do not believe it is a litigation type issue. It is more of an accounting type issue.

**Senator LUNDY**—So is the dispute between yourselves and the department of finance or between yourselves and the vendor?

**Mr Comer**—Put it this way: you have ANAO with a view, you have the department of finance with a view and our accounting staff have a view, so the three views are still—

**Senator LUNDY**—Do your accounting staff align themselves with either ANAO or OASITO, or do they have their own view?

**Mr Comer**—I think the answer lies in the fact that we classified it as an operating lease in the last balance sheet. But it is not an issue, I would suggest, that you would die in the ditch on in the sense of how it would show up in your balance sheet.

**Senator LUNDY**—Only that it affects how you exit out of the contract.

**Mr Comer**—It may and it may have risk connotations to it.

**Senator LUNDY**—And direct cost implications.

**Mr Minns**—The cost implications for us would be if we insourced the services again. Under a termination event, if we transfer to another supplier there is no cost implication for CASA. Similarly, if we roll the contract over with our current supplier after the initial term, there is no cost implication for CASA. We have had a consistent policy to outsource this type of service, so it is not in our strategic direction to re-insource, so it is not a question that end of termination payments really come into our consideration. Having said that, however, in the process of making a decision those scenarios were certainly presented for consideration and the costing implications were also considered between the various tender options that we had.

**CHAIR**—What would happen if you changed your provider?

**Mr Minns**—In what way?

**CHAIR**—What impact would that have?

**Mr Minns**—As for an end of termination clause, in terms of money for us, I do not believe it would have any impact because we would simply roll the previous service provider's assets into the new service provider's structure and they would pay for those assets. That is my understanding of the mechanism for moving from one provider to another in the event of a termination clause.

**CHAIR**—Could you take that on notice and confirm that for us?

**Mr Minns**—I certainly can.

**Senator LUNDY**—The whole issue of exit clauses and termination clauses was canvassed in the Humphry review. Recommendation 4 of the review reads:

When current IT outsourcing contracts expire, there is little benefit in mandating that agencies adhere to their existing groups. Within the overall government policy to outsource, agencies should exercise their own discretion on how to approach re-tendering or contract renewal.

What are your intentions to date, if any, on disaggregating yourself from the wider Group 8 contract?

**Mr Comer**—That is an interesting question, Senator. We are a group of eight which do not have any particular business connection or common strategic direction. But, at a very simplistic level, you would assume that a cluster agency has better buying power than a smaller agency like CASA. So I think we would look very seriously at being able to leverage with other people. You might choose different partners perhaps, but I think you would always seek to cluster yourself in some way to get the maximum buying power.

**Senator LUNDY**—The next question I have relates to the risk assessment that you have obviously taken very seriously as an agency and that you have done yourself. To what degree would those economies of scale that you were alluding to—that is, the essential advantage of a cluster contract—offset or override some of the disadvantages and the challenges that you have identified through this whole process? I am trying to get a measure of its status.

**Mr Comer**—If you were taking a greenfield business case approach, it would be fairly evident, as you analyse the options, where the savings and risks were. In our business cases, we have very clear risk management strategies and we cost those risks. So you would cost those against the benefits and then look at the overall result. IT is a problematical area—we all know that—as things are rapidly changing. When we hopefully get our business improvement program completed, we will be in a much better situation to roll all that forward. At the present time, we have a mixture of legacy systems and other systems. If we can bring all the jolly things together and then move forward, we will have a much better basis for doing those assessments.

**Senator LUNDY**—Going back to the fact that you did your own cost analysis, did you have an opportunity to present those findings to OASITO prior to the signing of the Group 8 contract?

**Mr Comer**—We certainly had many debates about it, yes.

**Senator LUNDY**—So they were aware of your assessment of your situation?

**Mr Comer**—OASITO were aware of it and, I should say in their favour, they did not necessarily agree with us.

**Senator LUNDY**—This question is along the same lines as the questioning of the Department of Transport and Regional Services—I do not know if you were present—about the relative impact on an individual department within the Group 8 contract. Can you tell me whether or not the requirements of the Financial Management Act regarding the department's own assessment of the political prerequisite of this whole exercise, the policy prerequisite, of identifying savings were dealt with, addressed or at least raised formally with the Department of Finance and Administration or OASITO in any way and, indeed, what their response was?

**Mr Comer**—There was significant discussion right through. I was a member of the steering committee associated with the evaluation process. At all times, we made our position very clear on what we felt should go into a cost model, which we then had independently assessed by our chartered accounting firm to make sure that our internal assessments were not unduly biased. So we looked at those sorts of things. At the end of the day, I guess it became a matter of opinion as to whose figures were the most correct.

From an agency perspective, I think there are specific costs that you must take into account, because they affect your bottom line. That was the position that we took and, as your previous discussions with DOTARS indicated, there was a whole of government aspect to all this. We accepted that that was the case. There were a number of almost intangible benefits to CASA, as a small agency, in going to outsourcing. We took those into account when we voluntarily joined into the cluster arrangements. We did not go unwillingly into that process. Those sorts of things go to having a much more focused attitude towards IT costs by your staff, because you have got a very direct service arrangement and you have more consistency. We had more capacity to refresh our equipment through an outsourcer than we had within our own funding. So there were a number—

**Senator LUNDY**—That was the theory, anyway.

**Mr Comer**—Yes, that was the theory.

**Senator LUNDY**—It did not shape up like that under your model, but anyway.

**Mr Comer**—I am not sure that I have answered your question now.

**Senator LUNDY**—I think you have gone some way to answering it. You say you went willingly into this process. Was that before or after you realised it was actually going to be a cost rather than a saving for the agency?

**Mr Comer**—It certainly was before that, Senator.

**Senator LUNDY**—So you went willingly in, thinking that there were going to be beneficial outcomes in cost terms, found yourself in the process, conducted your analysis, had it independently verified and found that there were not going to be those benefits. Did you make representations at any point to extricate yourself from group 8 and perhaps argue a small agency case?

**Mr Comer**—We looked at all those options, Senator. The issue that was facing all agencies at the time was the whole of government issue and what role in the final analysis of those costs at that level—things like industry development costings—provided. So they were persuasive in the end when the result might have otherwise been a lot closer.

**Senator LUNDY**—Was anyone from CASA involved in the options committee and therefore had a role to play in the industry development considerations?

**Mr Comer**—CASA was not involved in the options committee, but we were briefed on the results of the options committee.

**Senator LUNDY**—So, once again, it was a case of the interests of the whole cluster or group overriding that of the individual agency?

**Mr Comer**—That is, I think, a fair assessment, because the government's policy was very specific. It was a whole of government assessment.

**Senator LUNDY**—Whole of government or whole of cluster with respect to your contract?

**Mr Comer**—I am not sure whether it does not get to be a rhetorical argument—

**Senator LUNDY**—Yes, I am not sure either at this stage, but that is why I wanted to ask the question: what is your understanding?

**Mr Comer**—I do not think that there is a simple answer. I think that it has a bit of both in it, to be honest. It would certainly have regard to the whole of government and, as in the case of group 8—based on OASITO's assessments—there were savings for all of the agencies. So it did not really become an issue in that sense.

**Senator LUNDY**—Thank you very much. We may take the opportunity to provide more questions to you on notice. I appreciate your comments at the beginning of this session about providing them to us at the earliest possible convenience. Thank you.

**CHAIR**—I think that brings the session to a conclusion. Thank you very much.

[2.59 p.m.]

**STOCKDALE, Mr Paul, Consultant, IT Newcom**

**WELSH, Mr Brendan Cyrus, Managing Director and Consultant, IT Newcom**

**CHAIR**—Welcome, Mr Welsh and Mr Stockdale. Do you wish to make an opening statement?

**Mr Welsh**—No, thank you, Senator.

**Senator BUCKLAND**—You did not make an opening statement, but could you just explain a bit about your company to me, because I am a little in the dark?

**Mr Welsh**—We are consultants specialising in the field of sourcing of information technology. We sometimes get involved in outsourcing decisions. Companies these days have to make a lot of decisions regarding sourcing of IT services—whether they insource or outsource. The company has been going for four years. I started the business and we now have 11 consultants. We are actively engaged in advising clients on how to outsource IT functions and implement and manage those decisions.

**Senator BUCKLAND**—Can you tell us why you think the IT outsourcing policy that has been implemented over the last few years is so problematic? Could you go into depth as to why you think there are difficulties with it.

**Mr Welsh**—The outsourcing decision per se for any organisation is a decision led from the strategy perspective. Usually people approach the outsourcing decision with benefits in mind. The proper way of doing it is to assess what those business benefits are—if there are any business benefits—and make a decision after that analysis has been made. If there are some perceived business benefits, it is a matter of trying to implement those decisions in accordance with a planned methodology.

**Senator BUCKLAND**—Have you been approached by any of the government agencies to assess their approach to outsourcing?

**Mr Welsh**—We were not involved in any of the decisions run in connection with the whole of government IT outsourcing initiative.

**Senator BUCKLAND**—When you approach an agency or an organisation to consult with them and give them advice, do you only look at the management practices and cost savings involved or do you go into the whole organisational structure?

**Mr Welsh**—Typically the decision to outsource is made for a number of reasons. One of them is the perception of there being some cost efficiency, but the other two reasons are for the buying in of expertise and for improving the focus on core business. They are the three major reasons that organisations give for outsourcing or looking at outsourcing their IT function.

**Senator BUCKLAND**—I think your submission indicates that the objectives set down by the government for outsourcing were a bit unclear and ambiguous perhaps.

**Mr Welsh**—We have been tracking this issue with the whole of government outsourcing initiative for quite some time. When the ANAO report came out it was clear that the initial objective of saving costs was foundering somewhat. We were more looking at it from the perspective of some of the lessons that we can learn out of that investigation in terms of advising our clients—that is where the initial interest arose from. This business is about learning lessons—it is new in Australia—and that is how our interest was initially raised.

**Senator BUCKLAND**—Have you spoken to any department or agency about the clustering arrangements that have been brought in?

**Mr Welsh**—No.

**Senator BUCKLAND**—And you have not been approached by any of them?

**Mr Welsh**—We were not approached by any agency as part of that IT outsourcing initiative.

**Senator BUCKLAND**—Do you have an opinion on that that you would like to share with us?

**Mr Stockdale**—Could you restate the question?

**Senator BUCKLAND**—Do you have an opinion on the clustering arrangements for outsourcing government agencies?

**Mr Stockdale**—The clustering arrangements are uniquely a government issue. We have seen on the commercial side a number of organisations looking at what is called a shared services model where a number of organisations get together to see whether it is possible for them to share costs and also to leverage economies of scale by having a shared infrastructure. Usually in those circumstances there is a business imperative that is causing those organisations to focus on that kind of a model. My impression from the federal government environment clustering was that it was more a question of trying to find agencies that had sufficient requirements in common to achieve some economies of scale. That is a reasonable objective to set but obviously it was quite difficult to implement.

**CHAIR**—Mr Welsh, you said in your submission to the Humphry review that over the past few years IT Newcom had been asked to review major IT outsourcing contracts and had experienced relationship problems. Can you tell us about a few of those, just to give us a feel for the types of areas?

**Mr Welsh**—What we see typically at the initial phases of an outsourcing relationship of a similar type in the whole of government outsourcing initiative is difficulties during the transition phase. There is a whole lot of change going on during that phase and it requires incredible commitment of both organisations to make the relationship work. If that commitment is not there during the initial phases of the transition period, it is very difficult to remedy the relationship.

**CHAIR**—What are some of the IT outsourcing contracts that you have been involved with, major ones?

**Mr Welsh**—I would not like to reveal client confidences, if that is okay. I am happy to give that evidence in camera.

**CHAIR**—I suppose it does not matter. I am only asking that question to get a feel for the degree of expertise you have in this area.

**Mr Welsh**—Sure. The size of the transactions ranges from \$20 million total cost to \$1 billion.

**CHAIR**—So fairly significant.

**Mr Welsh**—Yes.

**Mr Stockdale**—And they typically would be with large financial institutions, the top 10 companies. These are the organisations in the commercial sector which have been focusing on outsourcing. That would be the typical client that we would be dealing with.

**Senator BUCKLAND**—Do you go beyond the finance sector into companies looking at manufacturing and looking at services provision?

**Mr Welsh**—Yes. We have acted for clients in the financial services arena, transportation, manufacturing and also some semi-government organisations.

**Senator BUCKLAND**—In the cost structure of providing the IT service, do you go into human resources? Do you go into vendors or people you can buy your machinery from and service agencies?

**Mr Welsh**—Typically, we manage the process of outsourcing, if an outsourcing decision is made from the planning stage right through implementation. We get involved mainly in the service description area, the description of service levels and also the costing models. We also take an active role in the contract negotiation phase.

**CHAIR**—I want to come back to your submission to the Humphry report. In that you have a diagnostic model.

**Mr Welsh**—Correct.

**CHAIR**—Has that diagnostic model been a process of development out of your involvement with some of the IT outsourcing activities that have taken place in the private sector?

**Mr Welsh**—That is correct, Senator.

**CHAIR**—This is not something you developed before that; it is something that has evolved out of your experiences being involved in helping to manage outsourcing?



**Mr Welsh**—The initiation of that diagnostic model is that we sat down one day and we listed 56 typical problems that we see when we come across the implementation of outsourcing decisions. We grouped those problems into certain categories, and that is how we came up with that model. We decided to work on risk mitigation strategies to address those particular problems.

**CHAIR**—In terms of the IT outsourcing within the public sector, the whole of government approach to IT outsourcing, have you had enough knowledge of it to be able to compare it against your diagnostic model? Have you been able to identify where the deficiencies were in the process?

**Mr Welsh**—Based on our experience in acting for government clients, there are common themes that emerge in most outsourcing transactions. There are some particular issues surrounding government decisions, such as some of the financing issues, the neutrality associated with costing. But these are more about management issues, and I do believe that a lot of the management issues that arise in the commercial sector do arise in the government arena.

**CHAIR**—Yes, I appreciate that. I am not necessarily trying to put you in a position of being specifically critical of the process. You have developed a diagnostic model about how to deal with these issues. What I am trying to get a feel for is whether, if you overlaid your model on the government approach or OASITO approach in terms of the clustering arrangements, you could identify the deficiencies in the approach. Or did it in broad terms follow the sort of outline that is identified here in your diagnostic model?

**Mr Welsh**—My understanding of the process adopted by OASITO is that there has been significant effort—I have been sitting through the evidence today and it has been confirmed today—in addressing the legal risks and the financial risks. A lot of attention has been given to the front end of the transaction, as we call it. It seemed to us that the implementation of the arrangement was largely left to the agencies, and they are working very hard to try and manage those relationships. But any good outsourcing transaction requires a focus on all three: legal, financial and operational management type issues need to be addressed initially.

**CHAIR**—So you have to actually deal with them as an integrated approach rather than seeing one as being more relevant or important than the other. And your feeling is that in terms of the OASITO approach there was too much focus on getting the contractual financial type benefits right and not enough on the overall implementation of the outcomes?

**Mr Welsh**—There is certainly a lot of attention given to those particular aspects. It is difficult for us to comment on their focus on the management side of things.

**CHAIR**—But do you think that might have been because of the imperative to achieve cost savings, because cost savings were an integral part of the process—the so-called efficiency dividend?

**Mr Welsh**—Our anecdotal evidence, based on the deals that we have been involved in, is that cost savings—I am speaking about our experience—were usually typically a major part of a business case but sometimes, depending on the deal, those cost savings do not eventuate. Sometimes they do; sometimes they do not.

**CHAIR**—Presumably sometimes they are greater than what you initially expect.

**Mr Welsh**—I am not too sure I have ever seen that.

**CHAIR**—That may be true, but there is always a potential for it to occur. But it is not the only factor you should allow to drive the agenda in terms of outsourcing; there are a range of other factors as well. How important to this whole process working is the commitment by, for example, in these circumstances the individual agencies to their identified outcomes in the process? In a sense, I am referring to what they identify as being the things they want as being the driver of outsourcing as opposed to their being, I suppose, subjugated into a broader agenda within the clusters.

**Mr Welsh**—It is absolutely critical to meeting the business objectives of an outsourcing arrangement that there be senior executive buy-in to the process. To the extent that that might have been subjugated by a clustering process there would always be a risk of that happening, particularly if there is not a grouping according to industry or like for like—

**CHAIR**—Synergies?

**Mr Welsh**—Correct. I think that would be critical to the success. You can have a great outsourcing contract, but, if you have not got the wherewithal and the desire to manage it or make sure it delivers business benefits, it will not happen.

**Mr Stockdale**—It is also true to say that, in a number of the commercial arrangements, the feedback that we get during the contract implementation process is that those challenges face people in the commercial environment as well and that the end users still find themselves frustrated that this arrangement has been entered into but all of their needs are not necessarily being satisfied in the process. So this problem exists in the commercial sector as well. It is a challenge for the people who are putting these transactions together and implementing them to make sure that that is not lost sight of. The name of the game is to make sure that the end user gets a better service at the end of the day.

**Senator LUNDY**—In relation to the actual agency buy-in, as it was characterised in the Humphry report, you have taken the time to reflect on the importance of that. I am wondering on what basis you made those observations, given that, subsequent to the provision of this review, there was quite a degree of debate in the press about the validity of the claims emanating from some portions of the government that in fact there was not executive buy-in.

**Mr Welsh**—I observed those claims. To the extent that an agency was not bought into the process, it would be difficult, I imagine—based on our experience with other arrangements—for that supplier to effect the value it needs to effect in order to deliver a good service if the executives are not bought into the process.

**Senator LUNDY**—Do you base your observation in your analysis just on that public debate? I am trying to find out if you have any source of information upon which you have based your analysis beyond the public debate about this. Have you spoken to agencies or departments? Or can you provide us with the source of data if you have conducted your own survey specifically about chief executive or executive level buy-in to any outsourcing strategy?

**Mr Welsh**—We have conducted some research in the marketplace. We commissioned an organisation, Woolcott Research, last year. That research involved 20 organisations with significant outsourcing transactions. That research is being compiled; it is in draft form at the moment. One of the things that I undertook as part of the survey was to make sure that the participants got the results first, but I am happy to make relevant information available.

**Senator LUNDY**—In the opening paragraph of your correspondence to the committee, you mention a survey. You say:

Currently, IT Newcom is sponsoring a survey obtaining feedback from major organisations that have outsourced their information technology ...

Is that the survey you are referring to?

**Mr Welsh**—Yes.

**Senator LUNDY**—Do you have specific questions in that relating to chief executive and executive level support of the initiatives?

**Mr Welsh**—We have a series of questions that go to the nature of the relationship that is necessary to effect a good outsourcing arrangement.

**Senator LUNDY**—In making that commitment to provide the participants with that information first, is it possible for this committee to get a hold of the results of your survey and the subsequent analysis? When is it likely to be completed?

**Mr Welsh**—I got a draft of it yesterday. The Woolcott organisation is in the process of finalising it now. So I would suggest in the next month or so.

**Senator LUNDY**—That would be useful. You were talking earlier about the proportion of these IT outsourcing contracts that do result in cost savings. There has been a range of international studies done in this area. To what degree do you make your assessments or conduct your research benchmarking Australian outcomes against those international studies and international analysis of the success rate of savings derived from IT outsourcing?

**Mr Welsh**—There is a lot of research available overseas as to why organisations outsource, the benefits they are seeking to achieve and the actual benefits they realise, but there is no such research in the Australian marketplace. It was difficult for us because the vendors have different service delivery models that operate in Australia as opposed to the service delivery models that operate in the US typically. I did not think that that research was relevant in terms of the Australian marketplace so that is why we decided to commission this survey. We have covered the full life cycle of the outsourcing relationship from the planning phase to the renegotiation phase. There is a series of questions dealing with that—why do you outsource and what did you actually achieve in the outsourcing process? Quite often the benefits you actually achieve are not the benefits you actually thought you were going to achieve.

**Senator LUNDY**—I guess I asked the question to see whether you are in a position to give the committee an indication of how Australia compared with the relative results on IT

outsourcing, given that we know internationally there is probably an aggregate less than 50 per cent realisation of savings across a range of contracts.

**Mr Welsh**—It really varied; some organisations that went in with a cost imperative are meeting those imperatives and some organisations that went in with a cost imperative are not meeting those imperatives. It was quite interesting to see the results of the survey. What was also interesting to us was the general satisfaction with the arrangements. Most of the organisations that were polled were satisfied with the arrangement, which did surprise us actually.

**Senator LUNDY**—What proportion of deals that you have been involved in have involved an equity deal in terms of the outsourcer and their client as opposed to direct cost for fee service?

**Mr Stockdale**—Very few of them I think. In my previous life I was general counsel for IBM GSA. I was very heavily involved with the joint venture with Lend Lease and Telstra, so I am familiar with that model, if you like. But we have not seen too many examples of that in the last few years. As I say, we have seen these shared services models coming forward. People are looking for ways to share costs across organisations within an extended enterprise.

**Senator LUNDY**—Where are you based?

**Mr Welsh**—In Sydney.

**Senator LUNDY**—I am curious. I am looking at your figure 1 on page 3 entitled ‘An integrated model of management (based on model by Rimmer and others 1996)’. Can you extrapolate on that source—who are ‘Rimmer and others’?

**Mr Welsh**—It is a best practice model. It is a gentleman in our organisation who did an MBA with some lecturers in Melbourne and one of them was Rimmer. So it is the best practice model they developed about five years ago.

**Senator LUNDY**—Is that still relevant as far as you are concerned?

**Mr Welsh**—Yes, it is. We have applied the diagnostic model that we have put together to the outsourcing context, as I indicated to Senator George Campbell earlier. We sat down one day and listed the 56 problems that we came up with, based on our experience in outsourcing transactions, and tried to group those. We applied the diagnostic to a few organisations and it seems to be one way of trying to work through the maze, because it is sometimes very difficult. When you are six months into a transaction and you have got some problems, where do you start? That is the issue.

**Senator LUNDY**—One final line of questioning: have you had the chance to familiarise yourself with the competing financial methodologies used by OASITO and the Audit Office report?

**Mr Welsh**—No, I have not, Senator.

**Senator LUNDY**—I was going to ask you some questions about your views on it. Do you have a financial methodology for comparing the cost baseline within either public or private organisations against a net present value style model post outsourcing?

**Mr Welsh**—Yes. It is one of the important elements of the planning stage. It is base casing both the SLAs and also the existing costs.

**Senator LUNDY**—So you have your own methodology that you deploy?

**Mr Welsh**—It is an input based cost model that works from the ground up and it is quite complex. It requires sophisticated—

**Senator LUNDY**—Can you characterise it as either financial or operating lease, as far as hardware is involved?

**Mr Welsh**—It depends on what the customer wants. Some customers want to retain asset ownership; some customers want to buy a complete service. It is a matter of just cutting and dicing that.

**Senator LUNDY**—I do not like to give you any work, but I would be genuinely interested in any observations or views you had about the comparative quality of the financial methodologies of both OASITO and ANAO, appreciating that this is an ongoing debate. If you have the time, I would like for you to look at both those models and provide the committee with details as to how they compare with yours. Obviously, the nuts and bolts of it is: is your model closer to the Audit Office model or closer to the OASITO model and why?

**Mr Welsh**—There are two people within our organisation that work on our cost models and I am happy for them to have a look at those—if we can get access to them.

**Senator LUNDY**—Just a few pages of comments would be most welcome. I would be interested in your views.

**Mr Welsh**—Yes.

**CHAIR**—In the interests of efficiency, Senator Buckland can have the last question. I am about to shut down at 3.30. I have a plane to catch.

**Senator BUCKLAND**—It is only a short question. Senator George Campbell took you part of the way through this. You talked about shared services and how your company has operated: you share services as opposed to clusters. Then you talk about the objectives. Do the objectives of each participant in the shared service or in the cluster need to be the same to make the system work and be cost effective for all parties?

**Mr Stockdale**—I think that the concept of the shared services model is economy of scale. The idea is that if you get three or four organisations to pool their requirements, the unit cost of providing the service should come down. That is the fundamental principle behind it and that, as I understand it, was the principle that was behind the clustering. In a shared services model, the

organisations who are contributing to that shared service usually have individual contracts with the supplier and in those contracts they try and make sure that the unit cost that they pay reflects economies of scale. There are individual negotiations but the underlying assumption is that they will get a cheaper service if they pool their requirements with the requirements of other organisations. That is very similar to some of the comments we heard from the CASA people. These are usually relatively small organisations and they are saying that on their own they would not be very efficient providers of service and that they would not get a very good service from a vendor because they are too small a customer. If they pool their requirements, they are hoping that they will get a better service at a better price.

**Senator BUCKLAND**—Thank you very much.

**CHAIR**—Thank you, Mr Stockdale; thank you, Mr Welsh. That concludes the public hearing. The next public hearing of the committee has been scheduled for Thursday, 15 March 2001. The committee has set Thursday, 22 March as the date for answers to questions taken on notice today. Those interested in following the inquiry should refer to the committee's Internet page, which will provide information about the progress of the inquiry on an ongoing basis. Thank you.

**Committee adjourned at 3.30 p.m.**