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**The Use of Contracting Out:
A Case Study of Decision-Making and Organisational Learning in
Local Government.**

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Abstract

One objective of government is to provide services at least cost whilst maintaining or improving service quality. While this may be an important objective, questions are being asked whether services can be provided more efficiently and effectively by the private rather than by the government sector. The shift of service provision from the public to the private sector is known as *outsourcing* or *contracting out*. The objective in this study is to critically examine whether the contracting out of services by local government to the private sector is an efficient management practice.

The contracting out of Parks and Grounds Maintenance services for the City of Kingston in the State of Victoria, Australia, is used as an exploratory *case study* to identify the variables associated with *management decision-making* in the contracting out process. Factors relevant to the contracting out decision such as the criteria used in selecting a contractor; the evaluation of a contractor's performance; and any subsequent changes to management practice relating to the contracting out of the services are identified and discussed.

Political forces were found to be an important consideration in the initial contracting out decision, and the selection of a contractor was influenced by the potential to *avoid costs*. It was also found that under-bidding and associated cost /profit constraints lead to contractors engaging in *non-sustainable environmental practices* which resulted in the degradation of the local government's Parks and Gardens assets. A *sustainable asset management* philosophy as opposed to an avoidable costs approach now underpins the contracting out process to ensure the preservation of such assets. Further, administrative processes have been revised to make tender specifications more prescriptive, critical components of services have been brought back in-house, and management practices have been amended so that a greater degree of control is exercised over contractors' activities.

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Introduction

Competitive tendering is a regime that forces government councils to let private sector companies bid to provide a range of services that would otherwise be provided in-house, while *contracting out* is a practice of outsourcing services once provided by governments on an internal basis (National Office of Local Government 2000; Lanphier & Parker 1997). Attempts to introduce competitive tendering and contracting out of local government services have occurred consistently and continuously across the 1990s in an effort to secure lower costs as well as service improvements. This was clearly demonstrated during the Kennett government era in the State of Victoria, Australia, with the determination of that government to introduce private sector principles into the management of services. It moved to achieve this objective with the amendment of the Victorian Local Government Act in 1994 in which local government councils were required to put at least 20% of their total expenditure to tender. This was to be effected through a process of competitive tendering which was described as *market testing* (Tesdaorf 1996, p.4).

Competitive tendering and the contracting out (CTC) of government services is a management technique that has many rationales including that it may be a less costly way of providing services. The concern is whether this management tool represents a more or less effective way of providing a service relative to the in-house provision of the service.

The focus in this study is to review the development of a contractor relationship between a local government council and a series of private sector contractors that took over the running of the Parks and Gardens Maintenance services of that council in 1996. Drawing upon data collected from interviews with council personnel and information published in the annual report of the council, three aspects of the relationship between the parties are examined: cost-avoidance; management decision making; and opportunities for organisational learning.

We hypothesise that local government managers' competencies are initially challenged by the requirements of a competitive tendering and contracting out regime and that this potentially has adverse consequences for the quality of management decision making. We consider whether the outcome(s) of CTC is conducive to the aim of a cost-avoidance agenda. Lastly, we are concerned with whether organisational learning occurs as the result of experiences as the contract terms and relationships mature. Our conclusion is that there have been few gains for any of the stakeholders in the process, largely due to the complexities involved in managing contractual relationships in this area.

Contracting Out as an Ideology

One of the difficult tasks in analysing CTC theory and concepts is coming to grips with the research focusing on this issue. Whilst the bulk of research on this topic has centred on the experiences of contracting-out in the United States of America (USA) and the United Kingdom (UK), an increasing amount is now being generated from within Australia. This is to be expected, as although contracting and outsourcing arrangements in the private sector are not unusual, the extension of CTC into areas

that have traditionally been thought of as the sole preserve of government is a relatively recent phenomenon in Australia.

The reorganising of government services around contracts has been connected to a management literature critiquing bureaucracy (Kirkpatrick & Lucio 1996). The potential to reduce bureaucratic processes provides a compelling reason for contracting out government services if the result is that management is relieved of the operational aspects and the associated problems of service delivery. In the UK the aim of competitive tendering was to introduce market processes into local government Walsh (1995).

The underlying premise of CTC is that it will improve the efficiency and effectiveness of service delivery. That is, the practice should result in the provision of the same service without an accompanying diminution in service quality. Hence, CTC can be regarded as an ideological stance in which the private sector is assumed to be more efficient and effective at providing services than is government. Osborne and Gaebler (1992, p.45) suggested that:

governments should turn over many of their functions to the private sector - by abandoning some, selling others, and contracting with private firms to handle others.

A belief that competition between private sector bidders or between public and private sector bidders will reduce the *cost* of service provision is often cited as a reason for the adoption of CTC because price is a major determinant of who will get awarded a contract. (Boyd 1994). Russell (1996, p.(i)) suggested that there is now a 'popular belief among politicians that 'contracting out saves 20%' Walker & Walker (2000, p.156) went further, to state that the claim of 20% available savings from contracting out, has become 'part of the repertoire of catchphrases favoured by privatisation advocates'. Bisman (2003) used the *20% rule* to argue that ill-conceived or poorly conducted research have the potential to shape and misdirect policy developers and decision-makers. That the use of the 20% rule has become firmly embedded as a benchmark for cost savings from contracting out was confirmed in an interview conducted by the authors on 16 October 2003 with a representative of the Commonwealth Department of Family and Community Services. 'A cost-saving of 20% is required; if it is only (say) 15%, it is not worth going down that line (*viz.* contracting out a government service)'.

It could be reasoned that CTC is simply a strategy to reduce the size and influence of the public sector. Bailey (2003, p.23) argued that local governments should be as small as possible to avoid unnecessarily high costs of service provision and that local governments could achieve economies of scale if they contracted out their services to large external contractors. Although CTC may have a reducing impact if size is measured in terms of total employees, it is also possible that size if measured in terms of funding may not change and in fact it could increase. This is because services contracted out are not being reduced; they are simply being transferred to an external service provider. Thus the need for funding continues. Consequently, arguments suggesting that CTC is being used to reduce the size of government are not convincing.

Another justification used for CTC is simply that government has questioned whether it should be delivering the services it currently provides. Underlying this fundamental question are the public choice arguments that 'increased competition encourages risk and opportunism, as well as increasing the flow of information and ideas' (Niskanen 1971). There may be no clear need for the government to be the service provider. As long as the service continues and satisfies acceptable cost and quality standards, it would seem difficult to justify a preference for one provider over another. Such fundamental issues as whether government services ought to be free, subject to a co-payment or whether the full cost should be recovered, suggest that the costing of services under a CTC regime adds an important dimension to the contracting out decision – that of the accuracy of the comparative cost-base used.

There may also be pragmatic reasons for the adoption of CTC. For example, governmental responsibility may be able to be shifted by transferring the delivery of services to the private sector. If the service delivered failed to meet the community's expectations the government could blame the service provider. The difficulty with this argument is that even if the government does not provide the service, it implicitly still retains overall responsibility. This onus of responsibility for the provision of the service remaining with government has been well documented by Australian Commonwealth and State Governments (Office of State Owned Enterprises-Victoria 1994; NSW Premier's Department 1993 and Department of Finance 1997).

The Avoidable Cost Motivation for Contracting Out

CTC not only has the potential to change the way government delivers services and the ultimate structure of government. It also affects the nature, extent and importance of *cost* data necessary for informed management decision-making. Cost data is not a generic, value-free, commodity. Rather, it is compiled to meet specific needs of management within an organisation. The quality of cost data not only depends on technical accuracy but in many instances, also on the use of professional and informed judgement in the compilation of the data.

Traditional reasons for the lack of any sophisticated accrual accounting systems, and in particular those capturing cost data, within government agencies tend to be related to the use of the cash-based accounting system (Funnell & Cooper 1998, p.208) and the absence of the profit motive (Guthrie 1998). The adequacy of the cash-based system which has traditionally been aligned with government budgetary and appropriations mechanisms has meant that cost information has not been a normal output of government accounting systems. Accompanying the move to introduce CTC has been a need to revise accounting information systems in order that cost data confirming the allocation and appropriate use of funds, is supplemented with data confirming that the efficient use of funds has occurred.

Geiger (1993) in his investigation of the Examinations Division of the Internal Revenue Service (of the USA) concluded that the introduction of a cost accounting system led to an increased awareness by managers of the types and magnitudes of certain costs. If cost minimisation is to be a significant justification for introducing CTC, then awareness of current costs is a necessary prerequisite for its success. Savas noted (1979, p. 24):

... there is another important difficulty in reducing costs. It is that the costs of particular public programs are not sufficiently well known.

Using CTC simply as a short-term cost-reduction mechanism may have unintended consequences. CTC used within an overall strategic context means that the accounting system must not only be able to provide cost comparisons between alternative providers but it must do so in the policy framework established by policy makers. Lapsley and Pettigrew (1994) suggested that the concept of 'Strategic Management Accounting' (*SMA*), adopted by private manufacturing concerns, could be used by government organisations to provide the cost data necessary for CTC decision-making. Bromwich (1990, p. 28) defined *SMA* as:

the provision and analysis of financial information on the firm's product markets and competitors' costs and cost structures and the monitoring of the enterprise's strategies and those of its competitors in these markets over a number of periods.

One important attribute of *SMA* is that it can be used to benchmark an organisation's costs and strategies with those of its competitors. For example, Lapsley (1994) found that the level of competition within the National Health Service of the UK increased the design and use of costing systems. Further, he suggested that the discipline of the market will necessitate the use of accounting language and techniques for health care that in the past had not been possible. This view is supported by Cooper's (1995) theory of cost accounting system choice that, in an environment of increased competition, there are benefits in utilising more elaborate and complex cost systems. Those competitors with more accurate costing can take advantage of those with inferior information.

Kennedy (1995, p.17) suggested that a 'herd mentality' developed as governments 'charged into outsourcing deals'. The political zeal for the implementation of CTC as a policy tool suggests that commensurate resources are necessary to develop or update accounting information systems sufficiently to ensure that managers are provided with the requisite cost data to make informed and efficient decisions.

Methodology - The Case Study Method

The case study method has been widely used in the study of public administration and policy. It provides an opportunity to reflect on the 'decision-making process and on principles underlying public sector reforms' (Clark & Corbett 1999). The benefits of the method to accounting researchers include that it gives access to the real world of practice and so offers a way of understanding the actual outcome of interaction between subjects and forces in particular settings. The researcher is able to re-model the case by substituting different variables and make theory-driven predictions as to the likely outcome. This may lead to better solutions to problems than may have occurred in the actual case studied. Case study research also enables the researcher to investigate a phenomenon without tight prior definition of expected relationships that are expressed as formal hypotheses.

Glaser and Strauss (1967) argued the value of case study research was in the generation of *grounded theory*, that is, theory, which is constantly challenged and changed by the empirics of the case. Grounded theory is generated inductively from data and so theory and data are seen as having a mutually informing and testing function. Kaplan (1984) argued that a researcher's knowledge of management decision-making was often based not on the study of actual decisions but on stylised models of managerial behaviour. He urged researchers to 'leave their offices' (p.415) and study cases of management practice in innovating organisations, arguing that while the case study method may be more inductive, it could bring greater benefits for the management accounting discipline.

A persuasive reason for conducting case study based research in the context of CTC is that the overall benefits or costs of CTC appear to lack generalisability. In 1995, the then Federal Assistant Treasurer, George Gear, commented that:

there is a need for careful case by case assessment of competitive tendering which depends on the specifics of the situation and that we think that competitive tendering is an instrument that works in some cases and not in others. (Hansard, 9 February 1995).

Hilmer also, in an address to the Economic Society (1995, p.30) stated a view that:

An assessment of effective competition requires a pragmatic analysis of a particular situation rather than a resort to a theory or general philosophy.

More recently, Worthington and Dollery (2000) suggested that the sheer pace of reform in Australian local government has made it difficult for practitioners and scholars to document and evaluate the changes that have taken place. They argued that:

... even comparatively recent ... attempts to analyse the profound changes in Australian local government, like Dollery and Marshall's 1997 edited volume *Australian Local Government: Reform and Renewal*, are already dated ... accordingly there appears to be an urgent need to review trends in local government to keep pace with rapid ongoing development.

Rather than being broadly generalisable, the outcomes generated from entering into CTC contracts tend to be time, function and location specific. This contextual setting may be best investigated using a case study approach. Further, because decisions regarding in-house or external contractors may involve a substantial degree of professional judgement then the *management* of CTC is likely to influence whether or not the strategy is successful as opposed to claims that CTC, as a strategy or policy tool, leads to either failure or success.

The boundaries of the case study conducted for the purposes of this research are as follows. An identification of a service that was subjected to a CTC process initially as a result of political forces was required. Whether, and if so how, a business case was prepared to evaluate in-house provision versus an external contractor's proposal is important to understanding whether an attempt to avoid costs entered into the decision-making process. An identification of the major participants in the CTC decision was necessary in order to conduct interviews with appropriate personnel.

Finally, the basis on which the CTC decision was made, and what further action management deemed necessary to the future success of the contracting relationship was important as it may be indicating organisational learning.

The Research Question

In specifying the major research question the achievement of one objective was sought. That was, to extend the existing literature regarding the consequences of CTC for cost-avoidance, management decision making quality, and organisational learning, by adding a new case study analysis of a service traditionally provided by local government on an in-house basis. On this basis, the major research question is presented:

Is CTC an efficient management method if the objective is to avoid costs?

Criteria for the Selection of the Research Setting

The scope of the inquiry was broad and encompassed government departments, agencies and local government. The main prohibiting factor was gaining internal approval from state government departments and agencies granting access to personnel in order to conduct our interviews. Our initial contact with selected local government units within the state of Victoria local government sector was more fruitful. The City of Kingston local council agreed to allow our interview with relevant staff involved in CTC. The maintenance of parks and gardens was amongst the services contracted out by this council and they had a mixed range of experiences they were prepared to discuss.

Data Characteristics and Collection

Amongst the significant changes introduced by the state government of Victoria in the early 1990s was the amalgamation of local municipalities and councils. Alam (2002) reported that as a result of this structural change the number of local government councils was reduced from 210 to 78. The City of Kingston (*Kingston*) was amalgamated in December 1994 bringing together five former municipalities: the City of Chelsea, most of Mordialloc, half of Moorabbin and portions of Springvale and Oakleigh.

Spanning 91 square kilometres ... it is home to vast tracts of wetlands, numerous parks and recreational ovals, 13 kilometres of unbroken beachfront (from Carrum to Mentone) and has an official designation as metropolitan Melbourne's most environmentally aware city. (City of Kingston 2002, p. 10).

The amalgamation provided a staff base of 140 employees including the parks and gardens maintenance (PAMS) team that consisted of 55 field staff and two administrative staff. Tendering was first used in the contracting out of the PAMS services in 1996.

Both the amalgamation and the CTC regime presented a number of opportunities and challenges for both the Kingston councillors and its PAMS managers. Councillors were faced with a compulsory competitive tendering regime imposed by the state government of Victoria. This provided them with an opportunity to award contracts that would substantially reduce and so *avoid* council operating *costs*. With the introduction of compulsory competitive tendering, cost avoidance was (in hindsight perhaps naively) viewed as evidence of efficient management. Amongst management's challenges, at least in respect to the PAMS service, was to ensure that the new regime should not result in a sub-standard level of service provision or the erosion of the existing environmental asset base than had existed previously under the former five municipalities.

PAMS management were vitally concerned that the existing asset base be sustainably managed. Kingston continues to attest to its commitment to environment protection. This is amply demonstrated in the 2002 annual report that contained numerous comments relating to environmental care and management including the following:

Council supports and encourages strategic land use planning initiatives of high environmental value. Examples are the protection of rare grasslands in the new Epsom Development by the Urban Land Corporation and the magnificent "Waterways" development that is creating urban wetlands. (City of Kingston 2002. p. 12).

The Kingston CTC case had the following broad characteristics. First, expenditure on materials, contracts and other items for the parks, gardens and reserves involved a significant amount of resources representing in 2002 almost 12% (\$5.4m: \$45.8m) of total expenditure on this category of expense. Second, the service contracted out has importance for an understanding of the environmental and natural asset sustainability consequences of CTC. This is an area that did not appear to be well covered in the relevant literature and it is hoped that our study will improve awareness of these consequences and, in so doing, enhance the literature. Third, relevant council officers conducted analytical reviews of the service contracted out on the basis of cost comparisons, the quality of the service provided including environmental concerns, and sustainability consequences and, customer satisfaction. Thus, the onus of responsibility for the provision of the service was not simply shifted via contracting out.

Data Collection Method

One essential aspect of this research study concerned whether relevant cost data was used to provide information for the CTC decision. Immediately, an important paradox became evident. That is, the problem of identifying the best sources of evidence. It can be argued that capturing exactly how decisions on CTC are produced requires making contacts with staff at lower levels of the organisational hierarchy whereas information regarding what information managers believe *is* or *ought* to be available and *used* for decision making will be provided by those higher in the organisational hierarchy. Scapens (1990, p. 264) commented that:

case studies which examine only formal accounting systems run the risk of failing to understand how these systems are embedded within the day-to-day practices of ... managers.

In an effort to reduce this problem two sources of evidence were utilised. They were (1) interview data; and (2) corroborating evidence in public records.

Interviews

An unstructured interview provides an opportunity for interviewees to highlight key issues that the researcher can follow up at a subsequent time. Further, the open ended nature of an unstructured interview allows interviewees to describe key events as well as providing broader insights into the nature of a problem and to expand upon what *they* perceive to be the important issues and unresolved problems rather than be constrained by pre-determined (structured) questions. The interviewee in this way is analogous to an informant. For these reasons, the unstructured type of interview was considered most suitable for the purposes of this study.

Two interviews were conducted and the duration of the interviews was one and a half hours, and two hours respectively. Extensive hand written notes were taken during both interviews and a tape recording was made of the second interview. The interviewee selection was not random as the interviewee needed to have specialised knowledge of the CTC service being investigated. Tremblay (1995, p. 212) argued that this technique is effective when:

defining the essential characteristics of some issue by drawing on the personal experience and understanding of the people involved.'

A second, structured, interview was held in order to confirm, clarify and amplify the background and contextual details provided during the first interview. This approach also enabled further specific details to be acquired on issues relating to the particular service selected for outsourcing, the processes involved and the basis for the initial and later CTC decisions.

Documentation and data analysis

A concern in this study was the commercial confidentiality associated with private sector bids. This concern was addressed by focussing on the basis on which in-house and private bids were evaluated, rather than being concerned with the exact price of the bids. Secondary documentation in the form of information in annual reports was used to corroborate primary (and private) information provided during the two interviews (see Burgess 1990 for an explanation of information sources).

A matrix was developed for use in the interpretation of the interview data. The three themes specified in the research questions (cost-avoidance; quality of decision-making; organisational learning) formed one dimension of the matrix, and the decision taken to award the initial and the two subsequent contracts formed the second dimension. Miles and Huberman (1994, p. 240) suggested that:

there are no fixed canons for constructing a matrix. Rather, matrix construction is a creative- yet systematic-task that furthers your understanding of the substance and meaning of your database, even before you begin entering information. Thus, the issue is not whether you are building a "correct" matrix, but whether it is a helpful one that will give you reasonable answers to the questions you are asking.

The interviewee was asked for information on a number of issues related to CTC process and decision-making. This approach enabled a *variable/case* matrix to be

constructed as shown in Figure 1 that was useful in understanding whether CTC is an efficient management tool for the provision of services by local government organisations.

Figure 1
Variable by Case matrix

<i>Cases</i>	<i>Variables</i>		
	Cost-avoidance occurred	Decision-making quality	Organisational learning occurred
Contract # 1	Yes/No	Low/High	Yes/No
Contract # 2	Yes/No	Low/High	Yes/No
Contract # 3	Yes/No	Low/High	Yes/No

A range of questions was asked in the interview in order to draw conclusions about whether costs were avoided; the consequences (quality) of the management decisions taken; and whether organisation learning occurred as a result of CTC experiences in each case.

Findings from the Case Study

Analysis of the interview data demonstrated that the decision taken and the steps in the evaluation process in respect to each contract occurred as described below. The content of annual reports were analysed in an effort to independently corroborate aspects of the information provided during the interviews.

Contract # 1

- Consultants were engaged to prepare contract specification documents
- Contract put out to tender
- In-house bid based on financial records, compared against external bid prices
- Contract # 1 awarded on the basis of avoidable costs

Discussion

The Kingston case amply demonstrates the potential economic consequences of contracting out government services. Consultants were engaged to prepare specification documents for the PAMS services and these documents formed the basis of the contract that was put out to tender. The contract was subsequently awarded on the basis of the price differential between the in-house and external tenderers. In this way Kingston was able to avoid potential future costs by transferring operating activities to an external party.

The initial in-house bid failed on the basis of the price differential against the two external bids received. The two external bids submitted to Kingston were both lower than the in-house price. Potential savings from contracting out were evaluated on an avoidable cost approach. Thus, future costs that could be avoided by contracting out were the deciding factor in the decision to award the contract. A detailed examination

of past costs of providing the service in-house was not undertaken, thus whether or not the external bid price avoided real costs was not rigorously investigated. Both internal and external providers based their cost on the tender specifications. A fuller examination of the costing approach may have provided a better indication of the efficiency of both the in-house and the external bids.

Experienced contractors either did not exist at the time or (for reasons that may only be surmised) were not prepared to submit realistic bids. The interview data indicated that a degree of scepticism existed in-house regarding the accuracy of the external bids. On reflection the in-house bid was competing in an immature market. Management's choice of contractor may not have allowed sufficiently for this factor. It may be that both external bidders had an incentive to deliberately under-bid, if it resulted in winning the on-going work provided by the contract. Considerable in-house staff expertise existed at the time of the initial bid. By comparison, the external tenderers may have had limited expertise in both the particular service provision and the preparation of tender submissions.

An ex-post *settling up* of costs occurred as the successful contractor could not continue to provide the same quality of service that had been provided in-house. As the realities of appointing a contractor to run the PAMS operation with only 23 field and 4 administrative employees began to be felt, the strain of continuing to meet Kingston's expectations quickly eroded the contractor's profit margins. Ultimately, Kingston had to bear the implicit costs of the deterioration in the level of service impacting on client satisfaction levels, and eroding the asset base (trees, lawns, indigenous remote areas, golf courses etc). Kingston had to initiate a rectification program and substantial resource allocation was undertaken to ensure that sustainable improvements occurred. Thus Kingston had to re-assume a cost associated with providing a service of acceptable quality. This series of adverse events (diminution in quality of service; deterioration of PAMS assets) may be interpreted as indicators of low quality decision-making in the selection of the contractor.

The first contract ran its full term but in 1999 when the contract was re-tendered, Kingston awarded the second contract to a different bidder. Apart from avoidable costs, a number of other factors were associated with choosing the second bidder. They included concerns over the relationship between tender price and quality, dissatisfaction with past service quality, and the knowledge that a mature and competitive market for the provision of parks and gardens and open-space maintenance generally, existed.

A formal audit system was introduced during the term of the first contract. This monitoring process led to the introduction of non-performance penalties thus providing contractors with an economic incentive to deliver the level of quality of service required. Kingston has also withheld monies for non-performance of contract commitments. These events indicate that organisation learning occurred. Further, that this learning was embedded into documented processes in order that it be captured for use in subsequent periods and by other personnel.

Contract # 2

- Contract documents re-specified more prescriptively
- Contract put out to tender

- Consultation with bidders occurred to ensure bidders understood and could meet the specifications
- Contract # 2 awarded on the basis of avoidable costs and service quality assurances

Discussion

Following the tender advertisement a number of potential service providers submitted bids. The successful bidder was a second-generation (previously experienced) contractor and a major open space maintenance provider in the state of Victoria at the time. The bid document submitted for consideration was sophisticated and included schedules of rates based on standardised formulae.

During tender meetings held with the bidders, the pricing of submissions was discussed and bidders were made aware of Kingston's perceptions about the low or high pitch of the bids. The successful second contractor provided assurances that the level of service as outlined in the tender specifications would be met. As it transpired the contractor's equipment was adequate, however, its process of allocating labour to manage the tasks was inappropriate. For instance, the contractor sometimes allocated open-space maintenance tasks to teams that were too small (sometimes only one-person teams). This resulted in a diminution in Kingston's PAMS asset integrity.

The second contract did not run for its full term. The contractor was incurring significant losses in its business operations and as a consequence numerous negotiations were undertaken between PAMS managers and the contractor to ensure that an adequate service continued to be provided. Subsequently, the contractor went into receivership, the contract was re-tendered and was bought out by another organisation. This adverse economic consequence may be interpreted as evidence of low quality decision-making in the selection of the contractor.

As a direct result of its problematic experiences with CTC, in 2002 Kingston brought back a significant portion of the PAMS contract *in-house*.

After a number of years of difficulty in maintaining adequate levels of service, the Council has taken action to bring the management and much of the day-to-day work "in-house". This will result in on-the-ground improvements in levels of service as well as a more *direct responsiveness to customer enquiries*. (City of Kingston 2002, p. 5)

This left only a small portion of the PAMS activities subject to the CTC process.

Contracted services will still be undertaken for grass cutting, and tree maintenance, however their activities will be directly controlled by Council. (City of Kingston 2002, p. 56).

The 2002 annual report of the council now contains the following statement as to objectives in the contracting out of services:

Key strategies and future directions

To ensure the broad objectives for managing a sustainable environment are met Council will:

- Continue to enhance quality of service delivery, through close monitoring and partnerships with contracted service providers.... (City of Kingston 2002, p. 51).

It was also a move that had a significant impact on Kingston's employee numbers engaged in PAMS activities.

Parks and Urban Design: Major highlight from 2001/2002.

Council commenced the transition of new open space maintenance arrangements, from contracted external service provider, to principally Council's own staff. The day to day management of the service will now be fully undertaken by Council, which includes an additional 30 staff also involved with undertaking golf course maintenance, natural resource area management, and maintenance of park infrastructure, horticulture maintenance and litter removal. (City of Kingston 2002, p. 56).

Contract # 3

- Service contracted out was significantly reduced
- Tender documents specified prescriptively
- Contract put out to tender
- Consultation with bidders
- Contract # 3 awarded on the basis of asset integrity and sustainable management

Discussion

An important outcome of past problems encountered by the PAMS management team was a review of the tender process and the revision of the tender documentation. This provides evidence that organisational learning occurred and was successfully captured in documentation.

In the process of compiling an in-house bid in 2002 for the grass cutting and tree maintenance services, the in-house tender preparers toured the City of Kingston and divided up the 680 hectares of land maintained under the PAMS program (in 2002 Kingston had 12 golf courses and 35 reserves and ovals) between major reserves, minor reserves, and street beautification programs. Costing of the bid was based predominantly on the length of time taken to complete specific tasks. Zero based-budgeting was employed: that is costs were built up from zero to a level sufficient to meet contract specifications. The time-based services were thus not difficult to price however, establishing appropriate costs for *Plant and Equipment* assets was more problematic. Notably, computer modelling was employed to estimate prices of some activities, and finance staff was not involved in the preparation of the bid. The in-house bid failed and the third contract was awarded to an external contractor.

Summary and Conclusions

It has been suggested in this study that political forces and the potential to avoid costs may have been the primary reasons for the initial contracting out of Kingston's PAMS activities. Kingston may have been acting opportunistically in timing the initial tendering out of the service to coincide with the amalgamation of five former municipalities into the City of Kingston. This *window* of opportunity enabled Kingston to restructure its operations with the objective of delivering the PAMS service in a potentially more cost effective manner. An avoidable cost approach was used to determine the level of estimated future savings from CTC. The avoidable cost approach, which considers the cash savings from *not* providing a service (in-house),

appeared to meet the needs of management as external tenders indicated that a significant cost associated with providing the service in-house could be avoided if it were contracted out.

Cost avoidance did not result in the level of savings that was expected from CTC in the Kingston case. However, it appears that the adverse experiences from engaging in CTC informed management practice and improved decision-making. As a result of these experiences the preservation of asset integrity and sustainable asset management are now the underpinning philosophies directing the tendering process.

The continuing tender successes of external bidders suggests that the contracting out of the PAMS program may have assisted in maturing the market. Gaining a contract with a major local government provides a significant incentive to external bidders and may help to explain the improvement in the contestability of subsequent tenders. That Kingston learned from its experiences with under-bidding by contractors is clear in the significant work undertaken in re-specification of tender documents which are now far more prescriptive effectively reducing contractors' opportunities to make subjective judgments. This also limits the ability of contractors to effect self-interested wealth transfers that may have adverse economic consequences for Kingston.

A range of important performance indicators is now used to monitor and measure consumer satisfaction levels. For instance the council's 2002 annual report stated that:

Council evaluates its overall performance by measuring the results in ...(key)... areas with the Key Outcomes identified for 2001/02 in its Corporate Plan. (City of Kingston 2002, p. 28).

The following key performance indicator was provided in the 2002 annual report in respect to parks, gardens and reserves.

Key Performance Indicators		
Corporate Theme - Managing a sustainable Environment		
Area	KPI	Result
Parks	90% compliance with audit targets	Not achieved (80%)
(City of Kingston 2002, p. 91).		

These indicators are provided partly in response to political pressures that arose as a result of diminishing service quality. It is not unusual for a council to respond to vocal and vociferous complaints from its constituents. Kingston responded sympathetically to community complaints about the quality of parks and gardens maintenance by setting up an electronic complaints register to which it responds. Kingston now also maintains a log system for work requests, and has developed a 'days outstanding' performance indicator for internal management purposes.

A rigorous and defensible methodology when comparing an in-house bid with external potential service provider still appears necessary. Techniques for making a financial comparison could include the use of accrual accounting, cost allocation and present value analysis, all of which are well recognised and accepted methodologies

in the cost accounting literature. The availability and use of management and accounting theories and information arguably also ought to take a greater role in the selection of services for potential CTC as well as in the evaluation of competing bids and the justification for final management decisions. If the objective of adopting CTC is to avoid costs then it is a necessary criterion that the *base* on which costs are determined, both pre- and post contracting out must be relevant and reliable. Only in this way can managers be provided with accurate data on which to base assessments of the success or otherwise of the contracting out strategy.

An important conclusion that can be drawn from this study is the need to include transition costs associated with contracting-out in an evaluation of external bids. Accurate estimates of cost savings may be very difficult to achieve without a consideration of these costs.

Two cautionary observations can be made. Firstly, a generalised (formulae-based) approach to tender costing may be inappropriate. A tender price developed using this approach may lead to fundamental flaws in pricing that would lead to problems in meeting tender specifications. A tailored approach, suited to the specific needs of the tendering council is likely to be more appropriate. Second, if the bidder uses staff who are unsuitable for the costing task (for instance, staff who are not specifically or sufficiently trained in a pricing process such as arborists or horticulturalists) in the compilation of the bid, the development or existence of price flaws may not be detected.

The concerted effort to adopt CTC as a policy first and to consider the consequences later had an adverse economic and environmental impact on Kingston. The results of this investigation have highlighted the integral link between an accounting methodology (cost avoidance) and its efficacy for CTC decision-making. Of considerable importance is the fact that if accurate costing information is available, decisions based on the criteria of effectiveness and value-for-money are more likely to be made.

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