



Outsourcing tasks and new methods of financing – the challenges facing external auditors

Introduction to the theme of the congress

Speech by K. Grüter, Director of the Federal Audit Office, Bern, at the 6th EURORAI Congress 21-23 October 2007 in Crans-Montana, Switzerland

In both Switzerland and abroad, all kinds of ways of outsourcing were being applied when in 2004 the OECD criticized its member states for this variety, calling it an „administrative zoo“, reducing transparency of state competencies and responsibilities. In Switzerland, at a federal level such concerns led to a number of parliamentary interventions. In response to these interventions the government drew up standardized principles for managing federal enterprises and outsourcing tasks.

The Confederation no longer fulfils all of its tasks itself, but instead transfers them to institutions and enterprises outside the Federal administration. When outsourcing a task, the Confederation's main goal is to improve the efficiency and cost effectiveness with which it is carried out. The Confederation has outsourced a number of individual tasks in the face of the opening up and liberalization of markets. Once tasks have been outsourced, the Confederation no longer has any short term or direct influence on them. Nevertheless it remains responsible for ensuring that they are carried out. It sees to it that it has the necessary influence by acting as owner of the institution or enterprise entrusted with the outsourced task.

With its Corporate Governance Report of 13 September 2006, the government set out standardized principles for outsourcing and steering federal tasks. The report answers the following questions:

- Which federal tasks are suitable for outsourcing?
- What legal form should be chosen for the institutions and enterprises entrusted with the outsourced tasks?
- What should the Confederation's internal organization with regard to the protection of its interests look like?

Not all the Confederation's tasks are suited for outsourcing. Some require close political monitoring or a high degree of political legitimacy (e.g. tasks of internal and external security). They need to be carried out within the Federal administration, since it is only here that close political influence can be taken. Other tasks are more suitable for being outsourced. Either they are increasingly performed by functioning markets (e.g. telecommunication), or their performance depends highly on either international or scientific or technical prerequisites (e.g. air traffic control). Outsourcing is also required for tasks presupposing a similar degree of independence from politics as the judicial system does (e.g. supervision of the financial market). This means that four different types of tasks can be distinguished:

- *Ministerial tasks*: These tasks include in particular the preparation of political dossiers, but also services of a sovereign nature. Their performance often involves encroachment on fundamental rights. These tasks are not suited for outsourcing because they require a high degree of political steering and legitimacy.
- *Services of a monopoly nature*: These occur in areas such as education, research and culture, where only the basic outlines can be defined by politics. Such services are suitable for outsourcing because the possibilities for exercising political influence are limited. Since these tasks must be carried out with public money, they require close political steering.
- *Tasks related to supervision of economy and security*: These supervisory activities are to be carried out without political influence. They should be outsourced because this ensures the independence the performance of such activities requires.
- *Services in the market place*: These are largely steered by supply and demand. A minimum service continues to be guaranteed by law. They are suitable for outsourcing, since providers need to enjoy a considerable degree of autonomy in order to position themselves successfully in the market.

Each case of outsourcing requires a compromise between the demand for a lean state sector on one hand and for state-guaranteed supply on the other. A decision can only be reached within the framework of the political process.

The Corporate Governance Report shows how the Confederation can ensure a coherent ownership policy in the long term. The Confederation's position as owner can be improved by aiming its 28 guiding principles at the outsourced areas and consolidating them into a task-specific steering model. Secondly, the various roles need to be determined. Within the Confederation it is Parliament, the government and the federal administration which are basically entrusted with the tasks of ownership policy. Vis-à-vis the federal enterprises, the government occupies the function of owner. Parliament, on the other hand, lays down the legal framework and exercises supreme supervision. At the level of federal administration conflicts of interest must be avoided. Parliament and government intend to follow the guidelines of the Corporate Governance Report in future decisions on outsourcing. Areas that have already been outsourced will be brought into line with these basic principles gradually.

Public Private Partnership (PPP) is a method of financing which is becoming increasingly popular. As public funding becomes scarce, communities, cantons and even the Confederation have increasing problems with finance their state tasks. Here the Frankfurter Allgemeine Zeitung has

located a huge potential in Germany and describes such cooperation projects as growth sector with flaws.

PPP can be paraphrased as a new approach based on partnership with the private sector and aimed at improving efficiency or at cooperating in dealing with particularly complex tasks. The precondition for a successful project is a thorough examination of its suitability, the professionalism in its implementation, and the legal framework. It is essential to carry out a meticulous analysis of the project's economic viability and to calculate the risks. These are to be borne by the partner in the best position to calculate, monitor and manage them. PPP is not a miracle cure. Projects the public sector cannot afford by means of conventional financing should not be alternatively financed either. The economic viability of a project must be proven for each individual project and throughout its entire duration. There must be a proportionate and economic distribution of risks among the public sector and the private partner. Public procurement law must be observed and the inspection rights of the external auditors guaranteed.

External auditors, at the interface between politics and administration, have an important role to play in the outsourcing of tasks and in new methods of financing. While it is true that auditors are not exactly the engine of change, they must of course not be hostile to change either. Politics guide and shape the modernization process. They must weigh up carefully which areas should be handled increasingly via the market. The possibly conflicting priorities of market and politics need to be considered carefully each time a task is outsourced. When decisions as to outsourcing and new methods of financing are taken, Parliament relies on an independent opinion. Auditors can play an important role here. They can judge whether the government's decision is justified and well-founded and rests on a transparent basis. They must also insist that the organizational prerequisites have been met and that the managerial instruments are available. In addition, they must make sure that the inspection rights and auditability are guaranteed. On the basis of their experience, external auditors are also in a position to make suggestions concerning the management model, risk management, or issues of liability. Thanks to their independent position, they are predestined to criticize decisions if their purpose is merely the escape from budget or from auditing. External auditors must therefore already put forth their perspective during the preparation of a decision on outsourcing, while maintaining their independence. They must have an interest in making sure that when tasks are outsourced, this is done according to standard principles and in a well-regulated way. The Swiss government's guidelines are thus to be welcomed, for they offer important rules for inspections by external auditors. Even when outsourced tasks are carried out meticulously, the risk for the state as owner increases. More market not only means more opportunities, but also more risks. This attaches even more importance to an independent and objective assessment by external auditors. However, it would be wrong if the increased maneuvering space were to be constrained again through the backdoor of supervisory measures. A successful application of the new management principles requires the political part to take the lead.

Not only in the conception stage, but also during its implementation, outsourcing and new methods of financing have raised new challenges for auditors. If the external auditors also audit the annual accounts of independent public enterprises, annual audit and financial supervision

must be separated. If a private fiduciary company is responsible for auditing the annual accounts, the external auditors can concentrate on financial supervision. The inspection of cost-performance accounting, of the interfaces between public service area and market place, and the checking of reporting or the evaluation of the performance mandate all require new approaches to inspection and new qualifications of the inspectors.

Guaranteeing independent advisory support to the decision makers in government and Parliament and the anticipation of future developments to ensure timely action are indeed the greatest challenges facing external auditors.

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