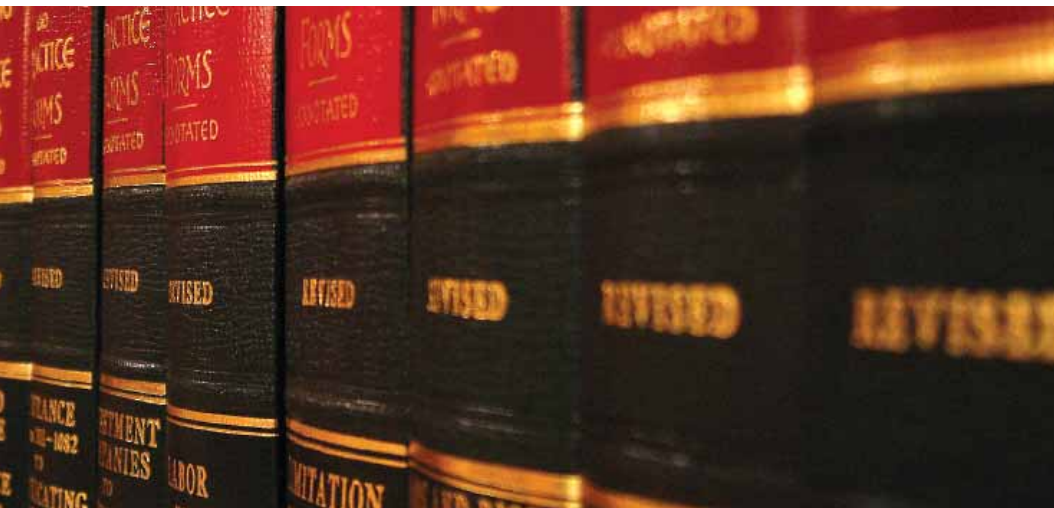




Legal Services Arrangements in Australian Government Agencies



Better Practice

August 2006

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Foreword

Effective management is critical to public sector entities' ability to meet their policy and service delivery responsibilities. Although obtaining appropriate legal services is only one of the many management issues facing all agencies, legal services have particular significance. This arises because legal services can be vital to Commonwealth interests; legal issues pose risks that may not be readily foreseen; and legal risks can escalate unexpectedly if not managed, with consequent cost escalation.

Accordingly, good management in this area is important for the agency and the Commonwealth as a whole. The Government requires agencies to ensure that their legal services arrangements are handled efficiently and effectively and that their management practices achieve this result.

Reflecting an increased focus on legal issues, additional agency functions and an expanding volume of legislation in recent years, agencies' expenditure on legal services has been rising. This expenditure continues to be of interest to the Parliament. Agencies are now required to disclose their legal services expenditure publicly each year.

This guide is the latest in the ANAO's series of better practice guides on a wide range of agencies' activities. The guides are intended to promote good management, inform agencies of better practice principles, and to serve as benchmarks for use in future audits.

This guide is intended as a reference document for people responsible for legal services in Australian Government agencies. Its guidance is based on sound practices observed in some agencies during the ANAO's audit of legal services arrangements (Audit Report No.52 2004-2005) and good practices identified since then.

As with most activities of this nature, there is no 'right' approach. It is for each agency to consider whether practices described in the guide are relevant to its own situation and whether to adopt them, modified as appropriate, or not to adopt them.

Finally, I would like to thank the agencies and individuals who assisted in developing the guide.



Ian McPhee
Auditor-General
August 2006

INTRODUCTION

Australian Government agencies may need legal services for any of a variety of reasons: to meet administrative, legislative or policy objectives or to protect Commonwealth interests. Legal advice can provide assurance that the way an agency has acted, or proposes to act, is legally appropriate, within the scope of its powers, and that legal risks are being adequately managed.

Legislation and the law generally are necessary features of the administration and accountability of government, underpinning the broad range of government functions, from social welfare, education and defence, to regulation and enforcement. In addition, a significant body of law governs the operating environment of agencies for their day-to-day management.

An earlier guide for agencies emphasised the importance of legal issues:

Legal issues can be both routine and novel. The consequences of failing to address them can be dramatic – vast amounts of money can be spent defending actions, remedying problems or paying damages; Governments, Ministers and their advisers can be embarrassed. The severity of the consequences may bear no relation to the complexity of the legal issue raised.

Legal issues are not a discrete part of the activities of managers and staff in the public sector – they are integral to the nature of their work.¹

A recent guide on supporting Ministers also states that it is important for APS employees to understand the legal framework in which they work.²

Since 1999 the operating environment for the Government's legal services has been predominantly decentralised. Subject to certain restrictions set out in the Attorney-General's *Legal Services Directions 2005*, each agency is free to choose how its legal needs are met. Agencies are also free to decide the level of resources to apply to meet those needs and must weigh up expenditure on legal services against other resourcing priorities.

The Directions make each agency responsible for ensuring its arrangements for legal services are handled efficiently and effectively. This guide endeavours to assist agencies meet that responsibility.

Preparation of this guide was prompted by the ANAO's 2004-05 audit report on legal services arrangements.³ A survey conducted as part of the audit found that agencies' expenditure on legal services was substantial and growing in real terms.

The audit report concluded that the quality of agency management of legal services was variable. Some agencies were efficient and effective in the way they procure and manage legal services. Key features of this included a strong, informed, client-focused coordination point for legal services; an ability to adjust arrangements to suit changing needs; active risk management; and appropriate systems to monitor workload, expenditure and knowledge management. However, the ANAO also found that a number of agencies require improvement in these areas and made recommendations to assist them.

The ANAO's audit methodology, particularly selection of agencies for participation in the audit and survey, was informed by the Tongue Report on agencies' legal services.⁴

Arrangements for obtaining legal services should be managed to get the best value from them. This guide aims to help agencies adopt better practice in managing their legal service arrangements, including arrangements for planning and reviewing those services.

¹ Management Advisory Board and Management Improvement Advisory Committee, *Legal Issues: A Guide for Policy Development and Administration*, AGPS, Canberra, October 1994, pp 1 and 10.

² Australian Public Service Commission *Supporting Ministers, Upholding the Values: a good practice guide*, Canberra 2006. p. 45 (available at <<http://www.apsc.gov.au/publications06/supportingministers.htm>>).

³ ANAO Audit Report No.52 2004-2005 *Legal Services Arrangements in the Australian Public Service*, June 2005 (available at <<http://www.anao.gov.au>>).

⁴ Sue Tongue, *Report of a Review of the Impact of the Judiciary Amendment Act 1999 on the Capacity of Government Departments and Agencies to obtain Legal Services and on the Office of Legal Services Coordination*, Attorney-General's Department, Canberra, June 2003.

The guide begins by drawing attention to requirements in the *Legal Services Directions 2005* and the role of the Office of Legal Services Coordination (OLSC). It then draws on some of the better practice legal services arrangements observed by the ANAO during the audit and since then. These are summarised at the end of the guide.

The guide does not attempt to repeat the wealth of detailed guidance about achieving better value purchasing of services (from both internal staff and external providers) already available to agencies. Nor does it seek to cover the technical detail of issues on which it is more appropriate for OLSC to provide guidance.

The ANAO appreciates the contributions of staff of the following bodies for their assistance in preparing this guide:

Australian Customs Service;
Australian Government Solicitor;
Australian Taxation Office;
Department of Communications, Information Technology and the Arts;
Department of Education, Science and Training;
Department of Employment and Workplace Relations;
Department of Immigration and Multicultural Affairs;
Department of Transport and Regional Services; and
OLSC.

The ANAO also appreciates the assistance provided by legal consultant Mr Dale Boucher.

I. Legal Services Directions and OLSC

Better practice principles

Ensure the agency and its legal services providers are aware of their responsibilities under the *Legal Services Directions 2005* and have due regard for OLSC guidance. Adopt appropriate compliance monitoring.

1.1 Legal Services Directions

The *Legal Services Directions 2005* make an FMA agency⁵ chief executive responsible for ensuring that the agency's arrangements for legal services are handled efficiently and effectively and that it adopts appropriate management strategies and practices to achieve that.

The Legal Services Directions are issued by the Attorney-General under section 55ZF of the *Judiciary Act 1903*. First issued in 1999, they have been revised and reissued. They set out requirements for sound practice in the provision of legal services to the Commonwealth and provide a means to manage, in a whole-of-government manner, legal, financial and reputational risks to the Commonwealth's interests.

The Directions apply to FMA agencies and, in some situations, to other Commonwealth bodies.

The Directions give FMA agencies the freedom to manage their particular risks, which agencies are in the best position to judge, while providing a supportive framework of good practice. They outline government policy on agencies' conduct of legal services and have the force of law.

Advising agencies on the interpretation and application of the Directions is a function of the Office of Legal Services Coordination (OLSC), an office in the Attorney-General's Department.

Agencies must comply

Agencies must comply with the Directions. Accordingly, agencies need to know how the Directions apply to them and how their legal services are affected.

Agency staff should be informed about the Directions, made aware of how they affect their day-to-day activity, and have ready access to the current Directions as well as any relevant agency-specific guidance.

Staff involved in tasking external legal services providers should be aware of restrictions that apply to certain types of services or matters and of other requirements such as the need to consult or share advice with other agencies in certain circumstances.

External legal services providers should also be aware of the Directions. The agency should manage compliance monitoring of external providers in their contract and relationship management processes. It is not enough to specify that the external provider adhere to the Directions, although this is an essential step.

The Directions require certain legal work, known as 'tied work', to be performed by particular Government providers, such as the Attorney-General's Department or the Australian Government Solicitor.⁶

The new Directions strengthen requirements about reporting breaches of the Directions.⁷

⁵ An FMA agency is an agency subject to the *Financial Management and Accountability Act 1997*.

⁶ *Legal Services Directions 2005*, paragraph 2 and Appendix A.

⁷ See OLSC Guidance Note No.3 of 2006 *Reporting breaches of the Legal Services Directions 2005*.

Agency responsibility

The Legal Services Directions 2005 make an FMA agency's chief executive responsible for ensuring that:

- the agency's arrangements for legal services, especially any litigation for which the agency is responsible, are handled efficiently and effectively;
- appropriate management strategies and practices are adopted so as to achieve compliance with these Directions;
- the agency's legal services purchasing, including expenditure, is appropriately recorded and monitored and the agency, each year, makes records of that expenditure publicly available;
- lawyers (whether AGS, the Attorney-General's Department, private lawyers, counsel or in-house lawyers) providing legal services to the agency are aware of, and are required to assist in ensuring that the agency complies with, these Directions (including compliance by legal services providers with these Directions through contractual arrangements wherever possible);
- any breaches of these Directions are remedied, and details reported to the Attorney-General or OLSC;
- any matters required to be approved by the Attorney-General or the Attorney-General's delegate are raised promptly; and
- any matters of which the Attorney-General or OLSC is required to be informed are notified promptly.

The chief executive must give OLSC each year a certificate setting out the extent to which the agency has complied with the Directions.⁸

1.2 Office of Legal Services Coordination

OLSC is responsible for administration and policy in relation to Australian Government legal services. This includes administration of the *Legal Services Directions 2005*.

OLSC Guidance Notes assist agencies to comply with the Directions, procure legal services and deal with legal issues efficiently and effectively. For example, Guidance Note No.2 of 2005 concerns model clauses on compliance with *Legal Services Directions 2005* for inclusion in tenders and contracts. Guidance Note No.1 of 2006 provides a checklist of new obligations in the revised Directions.

Guidance Notes and other publications are available at OLSC's website,⁹ which is part of the Attorney-General's Department's website.

⁸ *Legal Services Directions 2005*, paragraph 11.2.

⁹ <<http://www.ag.gov.au/olsc>>

2. Defining legal service needs

Better practice principles

Identify nature, scope and volume of legal service needs. Prepare business case from identified needs to gain agency management agreement on its legal services arrangements.

2.1 Types of agencies

Agencies vary in size, structure and function. Despite the differences it is critical that an agency can identify and protect its interests when it obtains legal services. There are two elements that all agencies should consider in procurement and management of their legal services. The first is that an agency's senior management has strategic input into the agency's approach to meeting its legal services requirements. The second is to have an '*informed purchaser*'¹⁰ who coordinates the agency's legal services arrangements and who can assure senior management that those services provide value for money.

Apart from the strategic involvement of senior management and the role of the '*informed purchaser*', there is no 'one size fits all' legal services model. That said, agencies with larger legal services spending tend to operate an internal legal unit, supplemented by external services; other agencies tend to purchase their legal services externally.

2.2 Strategic input

Legal services are likely to give better value if the agency's senior management agrees on broad, or strategic, rules for obtaining legal services and gives guidance on the purchasing model that best suits the agency. Rules and guidance should be prepared after the agency has considered the following points:

- who are the main stakeholders/primary client(s) (e.g. the Minister, the agency chief executive);
- does the agency have an *informed purchaser* with ongoing responsibility to identify and protect the agency's interests, and is the responsibility concentrated in a single position or shared across several positions;
- what are the agency's legal services needs, and which have priority;
- how does the agency's risk profile and approach to risk management affect the provision of legal services;
- what level of resources will be allocated to purchasing legal services, and who will control these resources;
- how the purchasing model should best take account of the agency's operational structure (i.e. devolved or centralised);
- does the agency compare the relative value of legal services purchasing options; for example, by weighting the importance of the following elements:
 - *easy access to general advice and other services*
 - *access to strategic, high-level advice or services*
 - *timeliness of advice or services*
 - *retention of in-house legal knowledge, capability and expertise; and*
- do senior managers need periodic reports on legal risk and trends in legal services and costs of those services.

¹⁰ The meaning and role of the term *informed purchaser* are dealt with in detail in Chapter 4.

Agreement at the strategic level on these points and on the relative weighting of purchasing options should provide the context in which the *informed purchaser* delivers the agency's legal services. When considering these issues, senior managers would benefit from a clear understanding of relative full costs of legal services options, noting that the *value* of a particular legal service is not necessarily the same as the cost of that service.

2.3 Defining agency legal service needs

Before an agency decides on its legal services model, its decision-makers should understand:

- the nature and scope of the agency's legal risk and legal services requirements at both the broad operational level and at a specific project/program level;
- the capacity of the market to deliver the required legal services; and
- the costs and benefits (including the risks) of different approaches (in-house unit with panel of external providers; outsourced in-house unit; panel of external firms managed under contract by agency; etc).

The steps below, in conjunction with Chapter 3, should assist the agency to adopt better practices that suit its circumstances.

Step 1 – identifying legal service needs

Establish the scope of the agency's legal services needs and decide whether the agency would gain better value for money from an in-house legal unit, external lawyers or a mix of both in providing the particular services the agency requires.

Points to consider:

1. An in-house legal unit may add significant value through the strategic involvement of the chief lawyer in the agency's 'board of management' and its other decision-making forums.
2. An in-house legal unit may have particular expertise in advising on agency-administered legislation. Equally, if the agency has had a longstanding arrangement with a law firm to provide legal services, the firm may have expertise from its understanding of that legislation.
3. An external provider may have particular expertise in advising on commercial law or specialist fields of corporate law practised by commercial lawyers, but not necessarily accompanied by an in-depth understanding of the Commonwealth's accountability framework and requirements.
4. Certain 'tied work' must be performed by specific Government providers - see chapter 1.
5. Under the *Legal Services Directions 2005*, paragraph 5, litigation would normally be conducted by external law firms and counsel. It may be appropriate for external lawyers to be instructed by in-house lawyers in more complex and sensitive cases.
6. Any specific legal skills or areas of expertise that the agency requires, and does not have in-house and cannot easily gain.

Completing the following table could assist agencies in making an initial assessment of the most appropriate legal services model for their particular circumstances.

Type of legal services needed	Current level of services (a)	Expected future level of services (b)	Current market expertise for the services (c)	Level of risk to agency (d)
Legal advice on agency administered legislation				
Legal advice to support agency management functions				
Commercial or contract law/legal agreements				
Litigation				
Constitutional or other work 'tied' under Legal Services Directions				
Other legal services				

Notes:

(a) Could be measured as \$ spent and/or hours of work purchased or % of total legal work.

(b) May be higher, lower or static, but should be quantified.

(c) In-house, external or both.

(d) Including consequences of poor legal services. Low risk and minor consequences = 1; high risk and major consequences = 10. See also Chapter 6.

Step 2 – costing in-house legal services

Once the agency has decided on the proportions of its legal services that would (all else being equal) be better performed by either an in-house unit or external lawyers, the agency should analyse the relative volume of services and calculate the cost (including relevant on costs) or hours of in-house and external legal services. Clearly, this approach is based on services consumed, which may or may not reflect the appropriate mix to meet future needs.

The cost of an in-house unit can be calculated by aggregating direct and indirect salary costs and relevant agency overhead costs. Chapter 5 provides a worked example of costing an in-house legal unit.

The optimal in-house legal unit structure will depend on the nature of the agency's legal service needs and the volume and complexity of the legal services required.

Step 3 – comparing purchasing power

The next step for the agency is to assess what the equivalent amount of financial resources required to maintain the in-house legal unit would purchase from external legal providers. This is done by comparing the resources needed for the in-house unit with the purchasing power that these resources would have in procuring external services for the same work.

The purpose of this analysis is to contribute to a consideration of the purchasing power of financial resources appropriated for legal services. It involves comparative costs but 'cost is not the only determining factor in assessing value for money'.¹¹ Other factors, concerning the scale, size and operating environment of the in-house legal unit, will also have to be taken into account. The level of professional support and mentoring, along with possible differences in the management of internal and external units, are also relevant factors, beyond the direct financial cost. (See also requirements for competitive neutrality adjustments in Chapter 5.)

Step 4 – assessing risks

There are two broad categories of legal risks: *legal risks to the agency's ability to deliver programs and services*, and *risks to the agency's ongoing ability to obtain quality legal services*.

Legal risks to the agency's ability to deliver programs and services may include risks of failing to advance a policy position due to inadequate legal advice and ineffective management of administered legislation. The sensitivity of a matter, its importance to the agency's outcomes and the complexity of the legal solution required are also factors for agencies to consider in making sourcing decisions.

Risks to the agency's ongoing ability to obtain quality legal services may include duplication of advice between internal and external providers, failure to adhere to the *Legal Services Directions 2005*, and inconsistent or unsatisfactory service.

The agency should assess the extent of its legal risks in terms of likelihood and consequences and identify appropriate management or mitigation strategies. The solution in some instances may be to outsource and, in others, to build in-house expertise. Chapter 6 deals with legal risks in more detail.

Step 5 – bringing it all together

An agency's legal service needs can be met through a range of possible approaches. These may include establishing and maintaining an in-house legal unit (either staffed by agency employees or on contract from an external provider), supplemented by specialist expertise through arrangements with external providers (such as a panel of law firms, register of interested firms, and/or barristers), exclusive use of outsourced legal services or variants/combinations of these approaches. Such variants may include short-term secondment of external legal resources for a specific project or long-term contracting of a specific individual for a particular role (for example, General Counsel). These approaches are discussed in Chapter 3.

Given the costs of operating an in-house legal unit, it may be difficult to justify development and maintenance of an in-house legal unit where an agency expected a low ongoing demand for legal services. Where there is sufficient volume of legal services to warrant establishment of an in-house legal unit, two further factors become relevant: required expertise and legal risk. In situations where the required expertise is readily available from external providers or the consequences of failing to address all legal issues arising from matters are significant, an agency may prefer to maintain a panel of providers rather than establish an in-house legal unit.

Common reasons given by agencies for outsourcing or insourcing legal services are discussed in Chapter 3.

¹¹ Department of Finance and Administration *Commonwealth Procurement Guidelines*, January 2005, paragraph 4.4.

After defining its legal services needs and identifying the most appropriate model to meet those needs while managing legal service risks, the agency would consider developing tender specifications and requirements. Better practice requires that careful analysis of the agency's legal service needs (in terms of geographic spread and types of legal services) should precede the preparation of tender documentation for legal services. Chapter 8 comments on tendering issues.

Guidance on purchasing and outsourcing legal services

Purchasing Legal Services

The Attorney-General's Department (Commonwealth), in its document *Purchasing Legal Services*, provides Australian Government agencies with general guidance on some of the issues relevant to the acquisition of legal services, particularly through competitive tendering and contracting (CTC) processes.

The document provides guidance under the following headings:

- When agencies need legal services;
- Who can provide legal services to the Commonwealth;
- Government policies and the acquisition of legal services;
- Identifying the need for legal services;
- Choosing a legal services provider;
- General requirements on legal services providers and agencies;
- Reviewing in-house legal services providers;
- Role of the Competitive Tendering and Contracting Branch; and
- Role of the Office of Legal Services Coordination.¹²

Guidelines for Outsourcing Government Legal Work

The Attorney-General's Department of NSW, in its *Guidelines for Outsourcing Government Legal Work*, assists NSW agencies in deciding the circumstances in which legal work should be contracted out; in the tendering process including documentation, evaluation of tender bids; and in managing the relationship once external legal providers have been selected.

The guidelines follow eight key steps:

1. justification;
2. planning of the process;
3. design of tender documentation;
4. design evaluation process;
5. comparative evaluation of tender bids;
6. contracting with successful tenderers;
7. management of the ongoing relationship; and
8. evaluating performance.

The guidelines indicate that obtaining value for money means ensuring that the benefits received equate with costs paid and that assessing value for money means considering evaluation criteria such as:

- the provider's experience and its knowledge of agency needs;
- continuity in the provider's team;
- qualifications and experience of lawyers providing the legal services;
- reliability; and
- timeliness in providing services.¹³

¹² Attorney-General's Department (Commonwealth) *Purchasing Legal Services* (available at <<http://www.ag.gov.au/agd/WWW/agdhome.nsf/AllDocs/56FA9DFD542710BDCA2570A50083C1AA?OpenDocument#when>>).

¹³ Attorney-General's Department of NSW *Guidelines for Outsourcing Government Legal Work* (available at <http://www.lawlink.nsw.gov.au/lawlink/lms/ll_lms.nsf/pages/lms_publications>).

3. Funding and sourcing legal services

Better practice principles

As part of preparing a business case for legal service needs, consider assessing agency's underlying demand for legal services by means such as internal charging, and assess advantages of various legal service insourcing and outsourcing options.

3.1 Assessing demand for legal services

Agencies have many ways of assessing their underlying demand for legal services. Some agencies do so by means of internal charging for individual services or annual internal charging for specified internal legal resources. Other agencies finance the in-house legal unit corporately to ensure that price is not an impediment for line areas to come forward with possible legal issues.

The 2004-05 ANAO audit found that, for agencies with a sufficient, ongoing demand for legal services, better practice tended to involve a corporately-financed legal unit (possibly an individual in the case of a small agency) acting as a 'triage' point for deciding whether to obtain legal advice on a particular matter and, if so, whether to obtain it in-house or externally. A possible exception to this approach may occur where agency line-area staff well understand legal risk and can readily recognise a need for legal services when it arises.¹⁴

The key issue for the agency is to be able to identify the sources and drivers of legal service requests in order to monitor agency demand for legal services, and plan and manage its capacity to meet necessary demand.

Charging approaches

The merit of these approaches depends on the legal services model in operation and the risk profile of the agency. Some of the pros and cons of the different approaches are summarised in Table 1.

Table 1 – Charging approaches for legal services

Model	Pros	Cons
Internal charging for individual services	<p>Provides a budgetary incentive (and discipline) for legal services to be sought only when necessary. Makes costs transparent.</p> <p>Where line areas well understand their legal risks, can lead to a robust basis for determining underlying demand for legal services, and need to change legal services or approaches to managing those services.</p>	<p>If legal risks are not well understood by line areas, can lead to a disincentive to seek legal services (which may compromise the agency's ability to manage its legal risks).</p> <p>Implicitly assumes that line areas are <i>informed purchasers</i>.</p> <p>Requires resources to administer internal invoicing and payments.</p>

Table continued over page

¹⁴ During the ANAO audit of legal services arrangements in 2004-2005, no audited agency could demonstrate that all of its staff well understood legal risk.

Model	Pros	Cons
Annual internal charging for specified internal legal resources	Administratively simpler than charging for individual advices. May work best when combined with time recording and matter management systems, so that management analysis of workload can better inform purchasing decisions.	As line areas are forward purchasing internal legal resources, there is a risk that 'supply will create its own demand'. The line area 'ownership' of legal resources can be an impediment to the agency quickly redeploying internal resources to meet emerging priorities.
No user charging	No impediment to seeking legal services. Works effectively when line areas well understand their legal risk and the role of legal services. Does not require resources to administer a charging regime.	Relies on internal legal unit to represent agency's broader interests and to act as a strong control point to assess legal service requests and to avoid over-servicing. May be abused as a 'free good'.

Source: ANAO

Resourcing decision for each agency

Decisions on the extent to which legal services are resourced, and how they are resourced, are for each agency to make individually. The demand for legal services varies considerably across agencies for a number of reasons. The nature of the agency's functions, the extent of change to the legislation it administers, the service delivery model used (for example, the extent of outsourcing of other corporate functions) and the nature and level of litigation can all have an impact on the level and type of legal services procured. Additionally, some of these factors may vary across agencies due to potentially different organisational cultures, including appetite for risk and their strategies to manage and mitigate legal and other risks.

When a legal issue arises, the agency should decide whether it raises a routine legal question that can be answered by earlier advice available in the agency or whether it is a new issue. If the latter, the agency can decide whether the legal question might best be answered by the in-house legal unit or external legal advisors. It is desirable for agencies to have someone with skills and experience appropriate for making such decisions to avoid delays in taking appropriate action on legal issues and duplication of earlier legal advices.

3.2 External or in-house legal services

Should an agency's demand for legal services increase, the agency should consider whether to create or expand an in-house unit or further outsource to meet the new level of demand. Issues to consider here are whether the increased demand results from only a temporary need for specialised skills or a continuing need for general skills and whether the activity in question is critical to agency business. The agency would also face this issue if the nature or composition of its demand changes. For example, it may require more legal services in preparing instructions for draft legislation; advising on legislation; negotiating, preparing and managing agreements and contracts; collecting debts; or litigation in court.

Whatever the agency's situation, its decision on sourcing of legal services should be based on a business case that makes best use of available objective data on the agency's present and likely future needs for legal services. This should also be reviewed at regular intervals.

Reasons to outsource or insource

The 2004-05 ANAO audit survey¹⁵ found that the most common reasons for *outsourcing* were that external legal service providers have specialist expertise in the various areas of concern to the agency or can draw on resources to undertake large or complex tasks, and that it meets litigation requirements at paragraph 5 of the *Legal Services Directions*, mitigates agency risk through independent services and helps the agency manage uneven workloads. Some agencies also perceive that external providers have faster turnaround times and lower costs.

On the other hand, the audit survey found that the most common reasons for *insourcing* legal services are that an in-house unit has a better understanding of the agency's business, specialist expertise in the agency's legal needs and no conflict of interest. The in-house unit is also considered to be readily available and part of building and retaining corporate knowledge. Some agencies also perceive lower costs as a reason for obtaining legal services in-house. The volume of legal services required by a small agency may be insufficient for a law firm to offer attractive rates or to establish legal corporate knowledge of the agency that generates a commercial return to the firm.

Another perspective in comparing the two approaches is that outsourcing creates a largely 'variable' cost basis for legal services whereas insourcing commits the agency to a largely 'fixed' cost base.

In-house unit with panel of providers

The model most commonly used by agencies with medium to large legal services needs is an APS-staffed in-house legal unit supplemented by a panel of external legal providers. The in-house unit focuses on legal work that generally involves administration and interpretation of the agency's administered legislation. The panel provides services when excess demand arises and when there is a need for specialist services and litigation work unsuitable for the in-house unit. The arrangement gives flexibility and seeks to gain both insourcing and outsourcing advantages as described above.

In-house legal unit with out-posted general counsel

Some agencies have an APS-staffed in-house legal unit supplemented by an 'out-posted' general counsel and access to a panel of legal services providers.

The out-posted general counsel is a senior lawyer with expertise in areas of law of concern to the agency. The general counsel is made available to the agency on contract from a legal services provider. The agency and its legal unit benefit from the contract general counsel's continuing close links with the external provider's legal resources and with wider legal issues that may affect the agency. The general counsel is available to 'second counsel' in-house advisings.

In the agencies adopting this approach, the financial cost of this arrangement was higher than that of employing an in-house general counsel but it was adopted because of the advantages indicated above.

Externally provided in-house unit

A number of agencies, having had longstanding APS-staffed in-house legal units, replaced their unit with an in-house unit provided on contract by an external legal provider. The advantage seen by those agencies was in keeping the in-house function fresh, expert and focused on serving agency needs. Under this arrangement the agency has ready access to the (externally-provided) unit, which in turn has ready access to the provider's legal resources and training. The unit is brought closer to the practical issues of the agency's decision-making processes. The contract can be subject to review in the normal way. The arrangement can be supplemented by a panel of firms that can advise the agency on more complex issues.

¹⁵ ANAO Audit Report No.52 2004-2005 *Legal Services Arrangements in the Australian Public Service*, pp 46, 47.

Having the external provider locate a unit in-house encourages the provider to establish a body of expertise in the agency's legal issues. It also makes it easy for the agency to seek oral advice when written advice is not needed. It does not reduce the desirability for the agency to have an *informed purchaser* to coordinate requests to the in-house unit and the panel and to retain corporate knowledge of the agency's legal issues to assist the agency when renewing the in-house and panel arrangements.

One agency that adopted this model had assessed that there was a higher dollar cost of outsourcing the in-house legal services function but that it represented value for money. It assisted the agency to manage risks associated with succession planning and with refreshing the in-house unit and ensuring its continued professional development.

In such circumstances, it is better practice for the contract with the law firm to provide for clear transitioning in and out of the arrangements, and to ensure that the agency can leverage its existing legal advices should the provider change in the future. This can assist in managing the risks of a single provider developing monopolistic expertise in the agency's legal services business.

A risk with this type of arrangement is that the agency may omit to maintain a capacity to assess and manage its own legal risks, if this function has been centred on the single external provider rather than on the *informed purchaser*. Where this type of arrangement is made the agency should keep a perspective on issues that have arisen in the past and are likely to arise in the future. In this sense, ownership responsibility for understanding and managing its own legal risks may not ever be able to be outsourced, even if the agency were to continue with an externally provided in-house unit arrangement.

Seconding external lawyers

The three models above can also accommodate secondment of external lawyers for short or long terms.

Sourcing: a decision for each agency

Whether to outsource is largely governed by the nature and scope of the legal services required by the agency. For many small agencies, it is simply not cost-effective to maintain an in-house legal unit. For larger agencies, the absence of an *informed purchaser* (which may or may not be an in-house legal unit) could pose a significant risk to the cost-effectiveness of the legal services provided.

The foremost consideration is to identify the nature and scope of legal service needs, having regard to the circumstances and operating environment of the agency. Secondly, an agency should decide who can provide best value for money to meet those identified needs. For example, an agency with a legal workload driven almost exclusively by interpretation of its administered legislation is likely to be well placed to capture the marginal cost benefits of ongoing legislative interpretation through developing in-house expertise.

In such cases, subsequent issues tend to build on previous advices, and there is often no broader market for legal advice on an agency's own administered legislation. The alternative would be to pay one or more external providers to develop and retain that expertise, who can at the same time capture the marginal cost benefits of that knowledge, and potentially monopolise this expertise.

It is beneficial for agencies to ensure, however, that in-house expertise in a particular area of law or legislative interpretation does not become inappropriately fixed on historical or narrow interpretation or disconnected from relevant developments in other areas of law. It may be appropriate to consider occasional use of external legal advisers to provide a comparison or fresh insight or to second counsel in relation to specific, major issues.

4. The informed purchaser

Better practice principles

Appoint an *informed purchaser*: an individual (or group), with good knowledge of agency 'business' and the law and legal practice, who is to coordinate legal service arrangements; link strategic decisions to their daily implementation; and ensure the agency obtains value-for-money legal services.

4.1 An important role

It is better practice in legal service arrangements for an agency to have an *informed purchaser*: an identified person or unit to act as a coordination point in the agency for obtaining legal services. The coordination point should actively manage the provision of legal services and understand the business needs of the agency and relative strengths and weaknesses of potential legal service providers in the market.

The *informed purchaser* is the crucial link between decisions taken at the strategic level (noted above) and the execution of strategy at the day-to-day business level. The main responsibility of the *informed purchaser* is to deliver quality, value-for-money, legal services to the agency.

Without an *informed purchaser* acting to protect its interests, an agency is less likely to meet its obligations to achieve value for money from purchasing arrangements. As noted above, the position and responsibilities of the *informed purchaser* in the organisation should be clearly established by senior agency staff.

The *informed purchaser's* interests are more likely to be better aligned with the agency's interests if they are employees of the agency. Regardless of who employs the *informed purchaser*, the person (or people) in that role should have ability and experience sufficient to achieve outcomes that assure senior agency staff that the agency's interests are being capably and strongly protected.

An experienced legal services purchaser is not necessarily an *informed purchaser*. The number of legal services purchasing transactions is not the best guide to establishing whether a purchaser is truly informed. Although a particular purchaser may have long been responsible for obtaining legal services from internal or external providers, it does not necessarily follow that the purchaser can obtain the most cost effective services for the agency.

4.2 How to be an informed purchaser

Whatever its purchasing model, an agency, as with any purchase of goods or services, should protect the Commonwealth's interests when purchasing legal services. Some agencies do this by requiring that the in-house legal unit, as an *informed purchaser*, be the *first point of contact* for staff seeking legal services. The unit decides whether legal services are needed, what the legal issues are and how the question should be framed. Provided it can do so on the basis of a wide knowledge of the agency and legal service providers, the unit can make such decisions as an *informed purchaser*.

The unit is also well placed to identify whether the issue has been covered in previous advice and, if not, whether legal advice should be prepared in-house or by a particular external provider (based on the required expertise, timeframe, cost and knowledge of the market).

A focused approach

As such, the agency's in-house legal unit, as an *informed purchaser*, is best placed to understand the agency's business and the context of the request for legal services. It has a capacity to identify the most appropriate provider and to 'translate' the request into appropriate legal questions. Such a unit is usually

better placed than line managers to assess the cost of individual matters in terms of value for money and to challenge the charging and service bases of a firm's invoices.

The purchasing expertise and value to the agency of the *informed purchaser*, whether a lawyer or not, can be enhanced by being attentive to the agency's needs and the legal services market and by networking with counterparts in other agencies. The aim is to bring to the task of purchasing legal services a professional, focused approach and management expertise commensurate with the legal services requirements of the agency. A provider firm who appoints a partner or lawyer as the agency's main contact point in the firm is effectively establishing an 'informed seller' as the counterpart of the *informed purchaser*.

Minimum knowledge needs

At a minimum, the *informed purchaser* should have a good knowledge of the Commonwealth legislative framework and the following legislation and its impact on the agency:

- *Public Service Act 1999*;
- *Judiciary Act 1903 (and Legal Services Directions 2005)*;
- *Financial Management and Accountability Act 1997/ Commonwealth Authorities and Companies Act 1997*;
- *Auditor-General Act 1997*;
- *Freedom of Information Act 1982*;
- *Privacy Act 1988*; and
- agency-specific legislation.

It would also be useful to have a working knowledge of relevant areas of law, including tort, contract and corporations law. Often, it would be an advantage to have had experience as a practitioner providing legal services to Government internally and externally.

The Office of Legal Services Coordination (OLSC) can assist the *informed purchaser*, as can experienced chief lawyers, Government networks and professional associations such as the Australian Corporate Lawyers Association (ACLA).¹⁶

ACLA In-House Lawyers Practice Manual

Produced for the information of ACLA members, the ACLA In-House Lawyers Practice Manual would be useful for any agency's *informed purchaser*. It includes chapters on the following topics:

- in-house lawyer member organisations;
- the changed role of the in-house lawyer;
- ethical responsibilities of in-house lawyers;
- what are in-house lawyers worth;
- managing the in-house unit;
- practice management - tips and tools;
- selecting external lawyers; and
- managing external lawyers.¹⁷

¹⁶ ACLA website is <<http://www.acla.com.au/>>.

¹⁷ The manual is available at <http://www.middletons.com.au/corporate_lawyer_guide/>.

General Counsel Roundtable

At least one agency also subscribes to the General Counsel Roundtable, an American-based program of the Corporate Executive Board. It is a world-wide network of executives providing a shared-cost research model for identification and sharing of best practices of General Counsel. Services include strategic and short answer research, quantitative benchmarking and on-line services, including a toolkit of legal practice implementation support tools and templates.

4.3 Knowledge and coordination

Case study – coordination of legal services

During the 2004-05 legal services audit the ANAO observed that an audited agency's in-house legal unit was not the agency's central control point for obtaining legal services. Agency staff were encouraged, but not required, to approach the unit when considering whether to seek legal services. However, the unit was generally regarded by line area staff to be more of a bottleneck than a facilitator. As a result, line area staff tended to deal directly with external panel providers for legal services.

This particular agency was not centrally capturing the purchased advices to check their consistency or for their possible future use. Nor could it provide assurance that external legal services were necessary and cost effective. The agency's line area managers purchasing the external services did not necessarily understand: the implications of the *Legal Services Directions* for their matter; the relative strengths and weaknesses of individual panel firms; or contract arrangements with the external providers (including the hourly rates charged by different firms). Nor were they aware whether the agency had previously purchased services of the kind they were seeking. As a result, purchasing decisions were not necessarily made by *informed purchasers*.

Informed purchasers of better practice agencies are likely to have good coordination and control processes in the legal unit and to foster a strong focus on providing a high quality and timely service to agency staff seeking legal services. This is especially relevant in those cases where there is more than one legal unit in the agency.

An ongoing task

Better practice agencies should have well coordinated arrangements for purchasing external legal services such that one or more *informed purchasers* (usually in the internal legal unit) act daily on the agency's behalf. This should include ensuring that legal services are purchased by staff who are aware of the agency's standing arrangements with external providers (including agreed rates) and government policy requirements in the area concerned.

An agency with insourced services, where an external provider provides lawyers on contract to work on-site at the agency, should have a contract that protects the agency's interests and is managed by a sufficiently *informed purchaser*. If the external legal services provider is responsible for deciding the nature and scope of legal services for staff in the agency and the spread of work to other firms on the agency's legal panel, an *informed purchaser* can represent the agency's interests to avoid conflicts of interest in the management of legal services.

As indicated below in *Value for money - knowing the market*, in Chapter 8, the *informed purchaser*, to be effective, should have a thorough knowledge of the legal services market.

5. Costing and reporting legal services

Better practice principles

Management decisions on sourcing of legal services are based on full costing of internal services. Legal services purchasing, including expenditure, is recorded and monitored. Expenditure data is publicly available.

5.1 Costing for management decisions

As part of a business case to an agency's executive to assist in making decisions on resourcing legal services, the agency should cost its legal services. The purpose of reporting the cost of legal services is to assess accurately the level of appropriated resources applied to the legal services function.

A management decision to vary the mix of internal and external providers based on estimated costs should be informed by business cases that are in turn based on full cost information. For external provider costs, the quoted price or agreed hourly rate generally reflects the full cost of services. A full costing would also include costs of establishing and managing the relevant contract with the provider.

Full costing of internal services requires collating data on employee salaries, salary-related overheads, accommodation, training and development, practice management systems, IT systems and other corporate overheads such as recruitment and staff management. To calculate the full cost of work done by internal staff, some form of time recording and matter management is necessary so that a comparison of the costs of internal and external service options is credible. Business cases based on reliable information may also help to demonstrate that, as a cost centre, a legal unit can provide value to the agency.

A business case can be constructed from data gained from time recording, introduced at least for a limited period or on a targeted basis. Time recording would be ongoing only if there is an identified purpose.

Although there is no standard costing methodology, agencies may find that Finance's cost-recovery guidelines¹⁸ are relevant to their situation. A worked example of a costing, developed by the ANAO, is included in this chapter for reference purposes.

Competitive neutrality adjustments

Competitive neutrality requires that certain government business activities not enjoy net competitive advantages over their private-sector competitors (or potential competitors) simply by virtue of their public-sector ownership. Treasury and Finance guidance states:

The business test criteria operates to exclude from competitive neutrality those government functions which are Budget-funded service delivery activities where there is no distinction between the purchaser and provider of the service. For example, notional charging of Budget-funded corporate support or other services is not considered to be charging for the purposes of competitive neutrality. Where an agency decides to market test its corporate services, its baseline costs should notionally include all relevant competitive neutrality adjustments.¹⁹

¹⁸ Department of Finance and Administration *Australian Government Cost Recovery Guidelines*, July 2005 (available at <<http://www.finance.gov.au>>).

¹⁹ See The Treasury and Department of Finance and Administration *Australian Government Competitive Neutrality Guidelines for Managers*, February 2004, p.9 (available at <http://www.finance.gov.au/finframework/fc_2004_01.html>).

OLSC and costing

Guidance by the Office of Legal Services Coordination (OLSC) provides that, when an agency requests the Attorney-General's approval to use an in-house lawyer for litigation, a factor relevant to the Attorney's decision is whether the agency can conduct the litigation at a lower cost than if it engaged external solicitors, taking into account accrual accounting and, where relevant, competitive neutrality principles.

OLSC has asked agencies to support such requests with information about the costs of using in-house lawyers and external legal services providers and information on how the agency's legal services area costs its services so that there can be a proper analysis of costs and benefits.²⁰

5.2 Recording and disclosing legal services expenditure

From time to time the Parliament has requested information on agencies' expenditure on legal services, both external and internal.

In 2004 OLSC asked agencies to identify the basis on which their figures were collated, to avoid erroneous comparisons when reporting legal expenditure. OLSC recommended that the approach to calculating internal and external legal expenditures be consistent by including 'add on costs' either for both internal and external expenditure or neither. That is, if external expenses include daily rate payments for barristers and solicitors and disbursements to cover their travel and accommodation, internal expenses should include salary and related staff overheads.²¹ Expenses relating to barristers (counsel) should be distinguished from expenses relating to solicitors.

The *Legal Services Directions 2005* require agencies to record and monitor their legal services purchasing, including expenditure, and to make records of that expenditure publicly available after each financial year.²² This underlines the need for good record-keeping and management of legal services purchasing.

5.3 Requirements for annual reports - consultancies

The Government requires that agencies' annual reports include a summary statement of the number of consultancy services contracts let during the year and the total expenditure on consultancy services during the year. The agency is also to make available annually a list of consultancy contracts let to the value of \$10 000 or more and the total value of each of those contracts over the life of each contract. This disclosure requirement includes legal services consultancies.²³

Identifying consultancies

The Department of Finance and Administration has issued guidance on identifying consultancies for annual reporting purposes. This guidance is to help agencies determine more accurately and consistently whether particular procurement arrangements for provision of services are in the nature of a consultancy or whether they involve a non-consultancy contract.

Legal services consultancies

The guidance says that agencies procure a range of legal services, such as contract development, legal audit and probity advice, legislative drafting, provision of general legal advice and litigation services. Some contracts for legal services will involve consultancies and others will involve non-consultancy contracts. The guidance indicates that officials should consider each contract for legal services to ensure that their assessments are appropriate. The guidance gives illustrative examples of legal services consultancies and says:

²⁰ Office of Legal Services Coordination, Guidance Note No.3 of 2005, *Use of in-house lawyers for court litigation*.

²¹ OLSC email 16 December 2004 to Heads of Australian Government Department legal units and nominated contact officers.

²² New paragraph 11.1(ba) of the Legal Services Directions. See OLSC Guidance Note No.2 of 2006 *Reporting legal services expenditure*.

²³ Department of the Prime Minister and Cabinet, *Requirements for Annual Reports for Departments, Executive Agencies and FMA Act Bodies*, June 2006 (available at <www.dpnc.gov.au/guidelines/index.cfm>).

Officials will therefore need to consider each contract for legal services on a case-by-case basis to ensure that their assessments are appropriate. When reporting particular legal services contracts as consultancies, agencies should be aware of the need to describe such contracts in a way that does not result in a waiver of legal professional privilege. This can be achieved by developing appropriate generic descriptions for categories of legal services such as advice, drafting or litigation, rather than providing the specifics of each contract which may, if too much information is provided, constitute a waiver.²⁴

5.4 Full costing of in-house legal services

Better practice is to capture and monitor data on the full costs of agency legal services, including the costs of an in-house legal unit and, if applicable, the costs of managing a contract for legal services.

Case study – costing legal services

ANAO noted in Audit Report No.52 2004-2005 that an audited agency costed its internal legal services and developed charge-out rates for its internal lawyers using a model that included salary, a loading for salary-related expenses and variable, or direct, overheads and fixed, or indirect, overheads.

The salary rates reflected the relevant salary points (from the agency's workplace agreement), and levels of staff. This enabled the agency to calculate the full cost, as well as apply an hourly rate, based on a specified level of 'billable' hours per year. The agency included a figure of 1210 billable hours for junior and senior lawyers and 1100 hours for principal lawyers and general counsel for this purpose.

These annual hours reflected the agency's expectation of 5.5 billable hours per day for junior and senior lawyers and 5 hours per day for principal lawyers and general counsel, over 220 working days per year. The result of this approach was that an internal legal resource could be fully costed, as well as the 'marginal cost' per hour/day for work that could be given to external providers. The hourly rate was calculated by dividing the full cost by the number of productive hours.

The salary-related loading was based on 25 per cent of salary for each staff member, to make provision for superannuation and long service leave, etc.

The variable overhead included the provision of IT, professional development and workers' compensation insurance (the agency's average contribution per employee to Comcare).

The fixed overhead included the total estimated cost of the provision and maintenance of the legal unit's law library, administrative support staff, apportioned costs of accommodation and rent, furniture and fittings, communications (phone and facsimile), office expenses (stationery, photocopiers, consumables, etc), travel, and a provision for annual recruitment costs for the legal unit.

The ANAO considered that this costing model represented a comprehensive and appropriate approach to assessment of that agency's internal legal costs.

Capturing data on the full costs of an in-house legal unit should include aggregating the following items:

- direct salary costs;
- indirect salary costs (superannuation, leave entitlements);
- direct overhead (costs of desks, computer, stationery);
- indirect overhead (apportioned rent, electricity, etc); and
- legal unit overhead (specialist software licences, cost of law library).

Table 2 sets out a worked example of calculation of the annual cost of an in-house legal unit.

²⁴ Department of Finance and Administration, *Procurement Guidance: Identifying Consultancies for Annual Reporting Purposes* July 2004 (available at < http://www.finance.gov.au/ctc/identifying_consultancies_for_.html>).

Table 2 - Worked example of legal unit annual cost – \$

Level	Direct salary (a)	Indirect salary (b)	Direct overhead (c)	Indirect overhead (d)	Legal Unit overhead (e)	Total
Lawyers APS 3-6	48 000	12 000	7 600	30 000	2 500	100 100
	55 000	13 750	7 600	30 000	2 500	108 850
	60 000	15 000	7 600	30 000	2 500	115 100
Senior Lawyer EL1	85 000	21 250	7 600	30 000	2 500	146 350
Principal Lawyer EL2	95 000	23 750	7 600	30 000	2 500	158 850
General Counsel SES Band 1	150 000	37 500	7 600	30 000	2 500	227 600
Total						856 850

Source: ANAO

Notes:

- (a) *Direct salary* costs should be calculated by reference to agency workplace agreements or other salary information, and may vary significantly from those included in this example.
- (b) *Indirect salary* in this example is 25% of direct salary. This is a useful indicative amount but may vary between agencies according to proportions of staff on different superannuation arrangements (eg PSS and CSS), and leave arrangements in relevant agency workplace agreements.
- (c) *Direct overhead* in this example comprises average cost per employee of provision of corporate IT (\$3000) and professional development (\$3500) and an estimate of the per employee Comcare premium (\$1100). Amounts will depend on the circumstances of individual agencies.
- (d) *Indirect overhead* includes legal unit portion of agency office expenses, communications expenses (eg telephone and facsimile), agency furniture and fitout, accommodation/rent and support costs. Support costs include the cost of administrative support for the legal unit (eg administrative support/paralegal staff, including the executive assistant to the general counsel) and the estimated annual cost of recruiting for the legal unit. As support costs per employee reflect the total cost of administrative support divided by the number of in-house lawyers, this amount will be affected by changes in the total number of in-house lawyers.
- (e) *Legal Unit overhead* ($\$15\,000/6 = \2500 per lawyer) includes costs specific to the legal unit, such as developing/maintaining a law library and software/database systems for knowledge and matter management purposes, divided by the number of staff – in this example, six.

In the above example the in-house lawyers were estimated to provide a certain number of 'billable hours' each year: for example, lawyers and senior lawyer 1210 hours each; principal lawyer and general counsel 1100 hours each. These annual hours indicate that the full annual cost of \$856 850 for the in-house unit would have purchased 7040 hours of legal services. This would equate to a 'blended' hourly rate of \$122 for the in-house lawyers in this example.

Where agencies expect staff to work an average of 7.5 hours per day, a billable rate of 5 to 5.5 hours per day would reflect a lawyer's need to spend non-billable time on supervision, professional development, administration, team meetings, etc. In any event, the hourly rate of \$122 incorporates the cost of non-billable hours, as it is derived from the total full-time salary and related costs of employing the in-house lawyers, rather than the proportionate costs of the lawyers' billable hours.

Total resourcing for the in-house unit can then be divided by the relevant hourly rates of various panel firms to assess the purchasing power (measured in hours of legal services). The agency could apply a weighting factor, if appropriate, to adjust for possible differences in productivity/efficiency between the in-house and external lawyers.

This methodology provides for broad comparisons in purchasing power between an in-house unit and external providers. If used to estimate funds potentially available under a total sourcing approach, it would require modification; for example, to exclude particular cost factors in the agency's overhead (eg rent and building fitout) that would remain as part of its total cost overhead, or to include costs of managing a contract for an outsourced legal function.

Internal targets

The discussion above does not imply a need to set internal targets for billable hours for individual lawyers. Internal and external legal costs can be compared without such targets. This can be done by examining the full costs of the in-house function over an historical period (eg. the last financial year) and comparing it with the cost of external provision over the same period. This approach can be used to assess direct comparators, such as the 'blended hourly rate' and the 'average cost per matter' of the internal and external providers. Decisions can thus be made about the appropriate balance between internal and external provision of legal services appropriate for individual agencies.

5.5 Use of costing data

Using this methodology the agency can calculate the total marginal cost of employing additional internal legal resources and assess whether the workload could be more cost-effectively managed through external or increased internal servicing. Some agencies may apply different percentages to some variables (for example, their indirect salary costs and expected billable hours) but the methodology provides a sound basis for comparing the cost of internal and external legal services. This approach provides a full cost basis for comparison, and enables productivity-based measures (through the calculation of billable hours) to be considered.

The item 'legal unit overhead' per lawyer should be recalculated if the number of lawyers changes. Thus, in the worked example above, legal unit overhead per lawyer, \$2500 (\$15 000/6), would result in a different per lawyer figure if the number of in-house lawyers changes, as the fixed costs should be re-apportioned per lawyer.

This model can provide management with some powerful decision-making information, particularly when combined with a sound understanding of trends in legal services needs. Cost is, of course, only one dimension. Service productivity and quality are other considerations. However, by quantifying the level of financial resources being applied to legal services, the costing data can provide a sound basis for agency management to assess the range of factors that contribute to achieving value for money from its legal services. The relative weighting that an agency may apply to cost as one of the factors when considering value for money is a matter for that agency to decide, based on the nature and scope of its identified legal services needs, and the risks to manage in obtaining or providing legal services.

6. Managing uncertainty and risk

Better practice principles

Identify, assess and manage the agency's legal risks to program delivery and its legal services risks (risks to its ongoing ability to obtain legal services).

Agencies are required to manage risks²⁵ that affect their ability to deliver their mandated functions and services. To help manage particular risks, agencies often draw on legal advice and other services offered by both internal and external providers. Although external legal service providers can assist agencies to manage legal and other risks (such as reputational risks), responsibility for the risk, as with any other aspect of the agency's operations, cannot be *transferred* to the external provider. Whatever the arrangements for risk management and legal services purchasing, the agency remains responsible for its own risks.

6.1 Legal risks to program delivery

There are two broad categories of legal risks. The first is **legal risks to the agency's ability to deliver programs and services**. Agencies' responsibilities and activities vary widely, as will risks to their programs. Potential impacts of legal risks (if any) may be identified in management forums and program-specific discussions or as part of regular agency risk management. Whatever processes are used, the outcome is more effective when all relevant staff (including the *informed purchaser* of legal services or other legal staff) participate in the process.

When legal risks are identified the agency should decide how to manage them and then implement risk mitigation. Depending on the issue, the *informed purchaser* should at least be involved in, or responsible for, developing a strategy to manage identified legal risk.

If an issue is significant, senior management should agree on a risk management strategy, especially if it requires extra resources. Regular reporting of the impact of legal (and other) risks on an agency's programs and services helps the agency to keep risks, and their treatment, under review.

The sensitivity of a matter, its importance to the agency's outcomes and the complexity of the legal solution required are also factors for agencies to consider in making sourcing decisions.

Examples of legal risks to program delivery

Legal risks to an agency's ability to deliver programs and services may include:

- breach of contract requirements or failure to comply with prescribed procedures;
- litigation over a particular policy or issue;
- failure to advance a policy position due to inadequate legal advice;
- failure to take into account whole-of-government implications in adopting a policy position;
- ineffective management of administered legislation;
- incorrect exercise or application of statutory powers or responsibilities and consequent risk of litigation; and
- fraud.

²⁵ In this context risk is 'the chance of something happening that will have an impact upon objectives. It is measured in terms of consequences and likelihood'. See Standards Australia, *Risk Management AS/NZS 4360:2004*.

6.2 Risks to legal services

In the second broad category are **risks to the agency's ongoing ability to obtain quality legal services when it requires them**. Strategies to address these risks should take account of the agency's strategic decisions on the total resources to be applied to legal services and the extent to which the services are to be insourced or outsourced.

An agency's formal risk management processes should provide an opportunity and framework for identifying risks to the agency's ongoing ability to purchase quality legal services when it requires them and devise appropriate solutions. Competent internal staff management and capable external provider relationship management, combined with robust quality control and knowledge management systems, will help agencies to manage these risks.

Examples of risks to legal services

Risks to an agency's ongoing ability to purchase quality legal services may include:

- failure to adhere to the *Legal Services Directions 2005*;
- over-reliance on a specific individual in a panel firm or the in-house unit for specialist legal advice;
- duplication of service between internal and external providers (including inadvertent multiple purchasing of the same advice);
- dissipating legal work over too many providers or concentrating it on too few;
- inadequate attention to succession planning or professional development of in-house lawyers;
- loss of legal corporate memories with staff turnover;
- breaches of confidentiality or loss of legal professional privilege;
- a provider's actual or potential conflict of interest;
- failure to take all relevant issues (including whole-of-government issues) into account in legal advice;
- legal services provided late;
- insufficient expertise by a provider to meet agency needs;
- insufficient familiarity by a provider with current commercial practices or legal developments, or agency-specific policy imperatives or considerations;
- failure of a provider to detect, monitor and report on issues of significance to the agency, or of the agency to inform the provider of such issues;
- inconsistent legal services from different providers given to different areas of the agency;
- inconsistent litigation/representation services given by different providers;
- over-charging or over-servicing by a legal services provider;
- potential threats to the agency's capacity to claim legal professional privilege over particular legal services;
- lack of agency staff skilled in managing arrangements for obtaining required legal services;
- not knowing or controlling agency in-house legal service costs; and
- not keeping track of legal advices and other services obtained.

7. Using in-house legal services

Better practice principles

Use in-house lawyers to best advantage.

Adopt comprehensive staff management policies (e.g. training and succession planning).

Measure quality of legal services against agreed standards (e.g. through regular feedback).

Implement quality assurance methods (e.g. second counselling and knowledge sharing).

7.1 In-house advice and professional status

In-house lawyers and corporate management

If appointed, an in-house lawyer or legal unit can be an important part of the agency's corporate management and risk management. Their strategic linkages to the rest of the agency may give them an advantage in understanding the agency's business operation. An in-house lawyer's attendance at the agency's major management meetings is also an extension of the agency's risk management even if he or she is not there for strict legal advice. These might be meetings of the audit committee, executive management or meetings to consider big projects. The value of their presence at such meetings depends on trust and their relationship with the rest of the agency.

In-house legal advisers, while assisting agency management and serving line management, should remain professional and impartial in the advice they give, in order to maintain their professional independence.

The value of in-house lawyers can extend beyond assisting the agency to perform its functions. They can help one group in the agency better understand another group's perspectives and they can help in managing external legal providers. From their more detailed knowledge of the agency's functions they can also create value by identifying scope for legal policy changes and promoting them, to the benefit of the agency and the Commonwealth. In-house lawyers may help ensure that legal issues are considered in addition to the numerous other issues that agencies should take into account in dealing with matters of concern.

There is also potentially significant value in the chief lawyer's close working relationship with the chief executive. Based on mutual trust, this relationship can result in ongoing strategic advice and the use of the chief lawyer as a 'sounding board' by the chief executive to ensure compliance with acceptable public sector governance standards. The chief lawyer's concern is to protect the agency's interests, which he or she can do in a more general way than can an outside legal adviser.

Legal professional privilege

From time to time an agency's legal unit may be asked to advise management on a difficult situation arising from policy or administration. A lawyer can assist a manager by distinguishing legal issues from policy or other non-legal issues. The lawyer may also add value by helping the client focus on non-legal issues arising from legal advice. Often the client needs only to have those issues made clear.

The OLSC advises that agencies should be able to maintain claims for privilege where required. Recent decisions in the *Vance* case have focused attention on the desirability of practising certificates and professional independence in the provision of in-house legal services.²⁶

²⁶ Office of Legal Services Coordination Guidance Note No 1 of 2004, revised 30 August 2005, *Legal professional privilege and in-house legal advice*, available at <http://www.ag.gov.au/agd/WWW/agdHome.nsf/AllDocs/20484A94BEAD44E8CA2570A800033202?OpenDocument>.

7.2 Staff management issues

Staff management

Legal services are essentially a knowledge product. Accordingly, good management of the people who produce the required services is crucial. Good management of in-house lawyers requires the establishment and maintenance of a 'legal professional culture'. This includes, but goes beyond, issues of quality assurance and deals with professional self-recognition in the in-house legal unit.

For internally provided legal services, aspects of staff management include:

- recruiting to match staff capability and experience with agency needs;
- managing and measuring performance against agreed standards;
- identifying and helping staff meet training and development needs;
- developing and implementing policies to encourage necessary staff retention;
- succession planning (including for the *informed purchaser*); and
- identifying and managing under-performance.

Recruiting to replace staff who have left is expensive and time-consuming, not only during the recruitment but also in the time taken for new staff to develop a sound understanding of agency business. The agency's performance agreements with supervisory staff should provide for attracting and retaining staff. Permitting staff to sign their own advising work, with prior clearance of significant advisings, may also help to retain staff. This of course should be balanced against the risks involved and supervisor control and accountability issues.

Conflicts of interest

Under the APS Code of Conduct an APS employee 'must disclose, and take reasonable steps to avoid, any conflict of interest (real or apparent) in connection with APS employment'.²⁷ The ANAO considers that agencies should have generic procedures to manage employees' conflicts of interest and conflicts of role.²⁸

A particular conflict of interest may arise where in-house legal staff have a relationship with an external legal services provider. This can occur particularly where the agency deals in specialised areas of law with mobility of lawyers to and from the private sector. Depending on the particular circumstances, an agency could consider, for example:

- quarantining agency legal staff from involvement with an external legal services provider, for an appropriate period of time, if they worked with that provider; or
- requiring approval for agency legal staff to have any involvement with an external legal services provider if a close family member works for the provider.

Project management skills

Lawyers are often tasked by senior management with preparing complex legal advice or pursuing a difficult case in a short time period with limited resources. For in-house lawyers such work can have significant implications for the agency. It may involve supervising staff and instructing external advisors.

In essence this is project management, which is the application of knowledge, skills, tools and techniques to a range of activities in order to meet task requirements. Project management focuses on producing a defined output by a certain time, to a defined quality and with a given level of resources so that planned outcomes are achieved. It helps to improve productivity.

²⁷ Section 13(7) of the *Public Service Act 1999*.

²⁸ ANAO: Public Sector Governance: Guidance Paper No.6: *Conflicts of Personal Interest and Conflicts of Role*, July 2003, Figure 6.1 (available at <<http://www.anao.gov.au>>).

Agencies may consider providing their in-house lawyers with formal project management training to help in completing work on time and to required standards. Project management skills could complement tools such as matter management systems in managing legal service workloads.

7.3 Client feedback and quality assurance

Client feedback

Quality of service provided by internal staff can be measured by means of agreed performance measures. It can also be measured by seeking feedback from internal clients on whether their legal service needs have been met, and this can contribute to performance management and quality assurance processes.

Feedback from internal clients, both positive and negative, should be made known to internal staff at appropriate intervals. Feedback systems should be well targeted and do not need to be complicated to be effective. They should be easy to use by both the client and *informed purchaser*. Irrespective of design, the most effective feedback systems are those that are used routinely.

A feedback form could seek brief client comment on the services rendered. For instance, were the services timely and cost-effective? Was the lawyer accessible and did they have regard to any changing client needs? If the services included provision of advice, was it competent, relevant, useful, understandable and 'second counselled'?

Quality assurance

Appropriate *quality assurance* processes will help ensure internal service meets required standards. The *informed purchaser* should have, or have access to, sufficient technical expertise for the quality assurance function. Quality service may be assisted by implementing steps such as the following:

- sufficient coaching and supervision of new staff;
- second counselling processes (where appropriate);
- knowledge sharing to keep internal staff up to date on agency priorities and issues by means of regular meetings and circulation of relevant information and reports;
- knowledge sharing to keep internal staff abreast of legal developments affecting the agency by circulating significant precedent advices and litigation outcomes and discussing their implications;
- knowledge management to enable staff to gain advantage from the agency's legal knowledge base and to provide consistent service (see chapter 11); and
- systems to capture feedback from internal clients on internally provided services.

8. Purchasing external legal services

Better practice principles

Match tender requirements to the agency's identified legal service needs.

Purchase legal services by means of value-for-money arrangements made on the basis of a sound understanding of agency needs and legal services market.

Consider establishing provider panels and packaging legal service needs.

8.1 Requirements and the market

Principal statutory requirements

As with any purchase, an agency must meet certain statutory requirements. Principal requirements relevant to purchasing are as follows:

- The chief executive of an agency must manage the affairs of the agency in a way that promotes efficient, effective and ethical use of the Commonwealth resources for which the chief executive is responsible. (Section 44 of the *Financial Management and Accountability Act 1997*.)
- An official performing duties in relation to the procurement of services must have regard to the *Commonwealth Procurement Guidelines*.²⁹ An approver of a proposal to spend public money must be satisfied that the proposed expenditure is in accordance with the policies of the Commonwealth and will make efficient and effective use of the money. (*Financial Management and Accountability Regulations 1997*, regulations 8 and 9.)
- Value for money is the core principle underpinning Australian Government procurement. This requires a comparative analysis of all relevant costs and benefits of each procurement proposal throughout the whole procurement cycle, or 'whole-of-life' costing. (*Commonwealth Procurement Guidelines*, section 4.1.)

An agency's legal services purchasing requirements and information should be up to date, consistently described and proactively disseminated. They could be linked to, or included in, other purchasing requirements in the agency's *Chief Executive's Instructions*.

Value for money - knowing the market

As indicated in Chapter 2, the Attorney-General's Department's publication *Purchasing Legal Services*³⁰ provides agencies with general guidance on some of the issues relevant to the acquisition of legal services, particularly through competitive tendering and contracting (CTC) processes. See also ANAO's better practice guide on selecting suppliers.³¹

The *informed purchaser* should have a good knowledge of the legal services market and how it might best meet the agency's needs. When assessing external provider options, the *informed purchaser* needs expertise and experience to assess:

- external provider behaviour drivers;
- which external providers (individuals and/or firms) are best placed to meet the agency's needs for particular legal services³²;

²⁹ Department of Finance and Administration, *Commonwealth Procurement Guidelines - January 2005* (available at <http://www.finance.gov.au/ctc/commonwealth_procurement_guide.html>). See also Department of Finance and Administration *Guidance on the Mandatory Procurement Procedures - January 2005*, Financial Management Guidance No.13 (available at <http://www.finance.gov.au/ctc/mandatory_procurement_procedure.html>).

³⁰ Attorney-General's Department *Purchasing Legal Services* (available at <<http://www.ag.gov.au/agd/WWW/agdhome.nsf/AllDocs/56FA9DFD542710BDCA2570A50083C1AA?OpenDocument#when>>).

³¹ ANAO *Selecting Suppliers: Managing the Risk, Better Practice*, October 1998 (available at ANAO's website <<http://www.anao.gov.au/>>).

³² Agencies engaging counsel should comply with *Legal Services Directions*, Appendix D: Directions on Engagement of Counsel.

- which form of payment (hourly rates, daily rates, blended rates or fixed price quotes) provides the best value for money for the agency on each occasion;
- the likely cost of a particular service (i.e. whether quoted rates or fixed price quotes are reasonable);
- whether external services are of acceptable quality; and
- the impact on the agency of developments in the market, including the movement of key individual providers between firms (i.e. from an on-panel firm to an off-panel firm).

An understanding of these issues will influence decisions on purchasing arrangements that best suit the agency's needs. Many options are available to agencies, including standing or *ad hoc* arrangements with a panel of providers or with individual providers, or secondments of staff from external providers to supplement or replace internal capability for a short term or for longer periods.

Tendering

After defining its legal services needs and identifying the most appropriate model to meet those needs while managing legal service risks (chapters 2, 3 and 6), the agency should consider the development of tender specifications and requirements for external legal services.

There are a number of publications that provide guidance on the tendering process. Agencies should ensure that legal tender specifications reflect the expected needs for legal expertise. Tender specifications should avoid limiting the range of firms eligible to tender, for example by requiring tenderers to have expertise in areas which are not relevant or a presence in all capital or major cities. Unless there is a clear business need for these requirements, such requests for tenders may restrict the field of eligible tenderers unduly to large, national firms with potentially high cost structures. At the same time, there is a danger that smaller/mid-size firms with a capacity to provide value for money legal services to the agency may be excluded from consideration.

Careful analysis of an agency's legal service needs (in terms of geographic spread and types of legal services) should precede the preparation of tender documentation for legal services.

The risk of an agency requiring a particular area of legal expertise could be adequately managed by non-exclusive panel arrangements or by having a sub-panel for that area of expertise.

The firm's perspective³³

Law firms have much in common but each is different in skills, industry knowledge and technology. Value to firm and client is likely to be maximised when the client can match what it needs with the firm's business strategy. A firm will seek to assess whether what the client wants is a single transaction, commodity management of similar transactions or a long-term arrangement. A firm's greatest business risk is a lack of workflow from a client to whom the firm has allocated resources. Predictable workflows improve the prospects of lower hourly charge-out rates. A firm may see more value in predictable work than in work that is occasionally large but generally unpredictable.

Surveys of law firms and the legal services market

A number of specialist consultancy firms, professional associations and the media conduct periodic surveys of law firms and the legal services market. Reports and results from these surveys can assist agencies in better understanding the environment and issues facing the legal industry and its providers.

³³ Source for this section was *The economics of large law firms: Impacts on how government purchases*, seminar notes by Corrs Chambers Westgarth, lawyers, 2004.

8.2 Panels and packaging

Provider panels

A panel of legal service providers, established by value-for-money assessment of competitive tenders, gives agency staff ready access to a range of external expertise. Standing offer panels are a useful way to ensure an agency can meet its ongoing needs for legal services.

Panel duration is often for around three years with options for extension. The reason for this is that, once the panel is set up, retesting the market annually is unlikely to bring benefits that would outweigh the time, cost and resources of testing the market again.

If its volume of legal work justifies having a large panel, the agency should consider carefully the most appropriate approach to allocating the work among the panel firms, having regard to the *Commonwealth Procurement Guidelines* (including requirements regarding panels) and associated guidance.³⁴ There are a number of valid approaches, including allocating work based on particular areas of expertise, and sharing similar work among panel firms to ensure that the agency does not become overly reliant on a small number of firms.

By disclosing statistics to its legal panel firms on their average costs and completion times, an agency can promote competition among the firms. This can assist in reducing costs for the agency and raising the standard of each firm's performance. At the same time, panel firms are aware that they may have their proportion of work reduced if the agency can obtain better value for money elsewhere.

Note, however, that to establish a panel of numerous providers of general legal services may lead to disappointed expectations by the panellists if the agency has little call for their services. Establishing a large panel may also simply postpone difficult decisions in assessing tenders to a time when the agency needs to select a particular firm quickly for an immediate legal task. Establishing a large under-utilised panel may also expose the agency to claims of unreasonable commercial behaviour.

Case study - national and regional panels

One large agency has found it effective to establish different types of panel arrangements for different services, in addition to its in-house service provision. In its debt litigation area, where there is high volume work focused in regional centres closest to debtors, it has a panel made up of one national provider and nine regional providers. The agency requires providers to provide routine services for a fixed fee up to a certain number of court 'return dates' which experience indicates is sufficient to complete matters in most cases. The agency recognises, however, that providers have their own commercial realities, so the arrangement allows for work beyond the fixed threshold to be charged at a different rate.

For its commercial advice panel, where regional services are less critical, the agency has a panel of a small number of national providers.

Another relevant distinction is in the way that external providers deal with internal 'clients'. For its high-volume low-complexity debt recovery work, the agency's in-house legal branch effects referrals from business teams to external providers who then deal direct with collections case officers. For commercial and employment law services, the in-house legal officer effectively acts as client of the external provider.

Packaging legal services requirements

It may be appropriate to 'package' the agency's legal services requirements. For instance, does the agency require discrete bundles of services that could be purchased differently from *ad hoc* external services? Does

³⁴ Department of Finance and Administration, *Commonwealth Procurement Guidelines - January 2005*. See also *Appendix B: Panels* in Department of Finance and Administration *Guidance on the Mandatory Procurement Procedures - January 2005*, Financial Management Guidance No.13.

the agency require regular services that could best be provided by external providers for a fixed fee? How might the agency gain advantages from its negotiating strength if it needs high-volume services or significant services or needs to engage in lengthy litigation?

When making decisions about how to 'package' that agency's legal services requirements, and which provider is best placed to provide services for the agency, the *informed purchaser* may take into account factors such as:

- the availability of specialist expertise;
- the provider's depth of understanding of the agency's business;
- the provider's ability to meet required deadlines;
- relative full costs of providers;
- conflict of interest issues;
- nature of the matter (e.g. if high-level, large or complex);
- expected volume of various categories of legal work;
- key stakeholder comfort level with particular providers; and
- compliance with government policy.

Case study - advice on new law

Several years ago an agency was faced with administering new legislation in a contentious area of government involvement in business activity. It decided to obtain early advice on this untested, specialist area of law. Anticipating litigation on the new law, the agency engaged senior counsel to prepare advice on the Commonwealth's position and the options that would be open to it in the expected court action. The agency's legal expert worked closely with senior counsel in preparing the advice.

This has proved to be a good investment for the agency. Although expensive and time-consuming to prepare, the extensive opinion provided by senior counsel has served the agency well as the basis for advising the Government and briefing counsel in the various court actions which subsequently occurred. The in-house legal unit developed expertise in this area of law that was not available off-the-shelf in law firms.

The original advice, and a pro-active approach since then, has enabled the agency's legal unit to remain at the forefront of this area of law. This gives it an advantage in choosing private legal service providers to assist the agency in dealing with the issues which continue to arise.

9. Negotiating a fee

Better practice principles

Consider the full range of fee options appropriate to the nature, scope and volume of services required, including volume rebates and learning discounts.

Ensure a clear understanding between client and provider on the nature and scope of work and agree on the basis for charging.

9.1 Scoping the task

Once an agency has selected a panel of law firms, or an individual law firm, and agreed on hourly rates for legal tasks, the issue of the time needed, or the lump-sum fee, for a particular task arises. This is a matter for negotiation and is usually best handled by the agency's *informed purchaser*.

Better practice for agencies involves developing a mutual understanding with the panel firms on general expectations when handling everyday matters, including the time generally taken to clarify, research and advise on matters that fall clearly within a firm's expertise. From time to time, uncertainty about the scope of a particular task and the amount of work needed to complete it may arise. In these circumstances the *informed purchaser* could negotiate a specific fee.

When negotiating a fee for a particular task, whether a fixed price or hourly or daily rate, the *informed purchaser* should scope the task carefully and appreciate the nature of the legal work involved. This is to try to avoid having the firm, as an 'uninformed seller', protect itself by increasing the fee to encompass a contingency factor in case the task proves to be bigger than expected or needs to be re-done if the firm misunderstood what was required.

An agency should avoid a situation where, because of uncertainty about the amount of work involved in a particular task, the firm quotes a fee range; for example, 'the fee is likely to be \$6000 but in all likelihood not more than \$10 000'. If the agency accepts this offer, it should not be surprised if the actual fee is \$10 000 because the agency had implicitly agreed to that as the upper value of the task and the firm has then felt free to put in the work up to that amount of fee. This underlines the desirability of careful scoping of tasks at the outset by an *informed purchaser* knowledgeable in legal work.

While seeking to protect the agency from lengthy, costly legal services, the *informed purchaser* will at the same time appreciate that, for the law firm, providing legal services involves risks to both the firm and the agency which the firm can mitigate only by doing a professional job that necessarily takes time.

When accepting work and providing confirmation or an estimate of the fee, an agency should ask the firm to provide an estimate of the time needed to complete the work; confirm the availability of key personnel to perform the work; and state the nature and estimated amount of any expenses, costs or disbursements to be charged separately. Quoted prices for legal work should be inclusive of GST.

The remainder of this chapter concerns various billing options.

9.2 Billing basis

Billable hours

Law firms' general practice is to charge for service according to the time spent, using hourly charge rates. Inputs of time (ie. billable hours) should never be more important than outputs or outcomes but, in a well managed partnership between an in-house *informed purchaser* and an external firm, billable hours can provide an efficient measure of the 'right pricing'.

Nevertheless there have been concerns about billable hours. In response to such comments, the NSW Government established the Legal Fees Review Panel. The Panel's discussion paper and subsequent report on lawyers' costs and time billing analyse complaints about fees, consider the issues and outline billing options.³⁵

Individual rates

Individual rates are simply the specified hourly or daily rates that a firm might charge for the services of each of its lawyers or paralegals. Some firms may agree to charge a standard rate for each lawyer at a particular level in the firm (for example, \$450 per hour for a partner, \$250 per hour for a senior associate and \$120 per hour for a junior lawyer). Some firms may have a specific charge-out rate for each lawyer or selected individuals (usually with specialised skills or knowledge) in the firm. In all cases, agency purchasers of legal services should be mindful of the contracted hourly rates for the firm and/or the individual lawyer when seeking legal services.

Blended rates

Instead of charging for legal services at the hourly or daily rates of particular individuals who work on the agency's matters, a firm may offer to charge on the basis of a blended rate that combines the individual rates. The blended rate will depend on the firm's assessment of the proportions of expertise expected to be required for the agency's matters.

If a firm's hourly rates are \$450 for a partner, \$250 for a senior associate, \$120 for a junior lawyer and \$80 for a paralegal, it might offer a blended rate of \$200 per hour for the agency's matters. This would imply that the firm expects the agency's legal work to involve more paralegal and junior lawyer time than senior or partner time. Conversely, a blended rate of \$350 per hour would imply that the firm expects more partner involvement in the legal work.

Either way, there would be a financial incentive for the firm to delegate as much of the agency's work as possible to its lowest level staff, as the *effective* hourly charge-out rate for junior staff in this example would be higher than their individual hourly rates. Conversely the *agency* would gain if the work was generally more complex than the firm expected, as the work would require more partner time, charged at hourly rates well below a partner's charge-out rate.

An agency would receive value for money if the blended rate gives it access to whatever of the firm's expertise is required on its matters. The blended rate would give value for the firm if it can delegate the agency's legal work to more junior staff wherever possible. A blended rate carries risks for both parties if the nature, scope and complexity of the agency's legal matters are uncertain. In any event, calculating the average hourly rate from the firm's individual hourly rates (in this case \$900 divided by four levels, giving an average rate of \$225) enables the agency's *informed purchaser* to compare the offered blended rate with the possible mix of inputs from the law firm.

Generally, blended rates should encourage firms to have work done at a level no higher than necessary and can provide predictability of costs over the term of the panel (provided they are set over this term). They can aid in checking that there has been no 'over-servicing', by comparing overall and average costs between periods within the term during which a blended hourly rate applies and by looking at a set number of matters in each period (provided the sample is sufficiently large and that the nature of the matters has not changed between these periods).

Volume rebates

An agency spending large amounts on external legal services may seek to negotiate volume rebates to apply at certain thresholds. For example, the agency's contract with a law firm might provide for normal

³⁵ Legal Fees Review Panel *Discussion Paper: Lawyer's costs and the time billing*, November 2004 and *Report: Legal Costs in New South Wales*, December 2005 (available at <<http://www.lawlink.nsw.gov.au>>).

hourly fees up to 3000 hours of legal work a year but with a rebate, or retrospective discount, on fees for all work if the total exceeds that amount of time.

Alternatively, the contract might provide for a premium on normal fees up to 3000 hours of work, but with the premium rebated from all work once the total hours exceed that amount of time.

Such arrangements are a further value-for-money issue for an agency and a firm to consider in negotiations if the agency is reasonably sure about the volume of legal services it needs in the year ahead.

Activity and event-based billing

Activity-based billing involves charging a client per activity by the lawyer, such as writing a letter, making a telephone call or reading a file. As with hourly billing, this method of payment can be seen as a disincentive for efficiency.

Event-based billing breaks a matter up into 'stages', such as primary dispute resolution, litigation and pre and post-hearing. The lawyer is paid for stages of work completed. Event-based fees could provide greater certainty about costs for clients, and also enhance development of practice techniques based on quality and efficiency rather than the time spent on a matter.

For the firm, however, it can be difficult to predict costs beyond the next stage of a matter. To attempt to do so may involve including contingencies that result in higher charges than under hourly billing.

Capped fees

For some agencies there may be an advantage in capped fees arrangements for external legal services. Capped average price arrangements may be appropriate for some legal advisings and litigation work (but possibly not for short *ad hoc* oral advices or certain litigation disbursements). Caps could be on a notional basis and calculated at the end of the financial year, although the agency may choose to receive say monthly schedules of bills so that it can monitor value for money throughout the year. Amounts paid in excess of the cap are refunded to the agency at the end of the financial year. Any matters outside the capped arrangements are charged at hourly rates.

Each party to a capped fees arrangement needs to see it as advantageous to itself. Thus an agency would see benefit in cost certainty and encouragement of efficient service provision, whereas the provider would expect to recover costs on an unexpectedly costly legal task over the longer term of its relationship with the agency.

Annual or periodical fees

Where there is a relatively well known need for legal services, such as for a single lawyer or a team, another option may be to negotiate an annual or other periodic service fee. Factors to be considered in such an arrangement would include the number and levels of the lawyers provided, their average expected productive time for each day or week, the scope of their duties and the fees to be charged.

The basis of fee charging should not simply be the arithmetical extrapolation of the number of hours worked. This is because the agency should be able to expect some discount for the certainty which an arrangement of this type will provide for the external provider in terms of recoverable time, as well as a recognition of the advantages which it will provide to do other flow-on work for the agency which is not covered by the single lawyer or contracted team. The agency, through its *informed purchaser*, should always maintain overall control of the provision of its legal services and should not cede this to the external provider.

Combined billing arrangements

Depending on the nature, scope and volume of an agency's external legal services, billing arrangements may be based on a single method (eg hourly billing) or a combination of methods (for example, hourly billing for one-off or *ad hoc* services, event-based billing for dispute resolution processes, and capped fees for high-volume, standard process transactions).

The key to obtaining value for money through billing arrangements is to understand the agency's legal service requirements and identify the most cost-effective method or combination of methods, for charging for those requirements.

10. Managing relationships

Better practice principles

Adopt relationship management methods that include sufficient reporting and monitoring.

Ensure there are clearly understood service delivery standards and immediately query any unsatisfactory services.

Implement agreed protocols for interaction between providers and clients.

Implement performance measures (including regular feedback).

Discuss regularly the overall relationship with external providers.

10.1 The *informed purchaser's* role

Whatever the arrangements, the *informed purchaser* should manage the relationship with internal and external providers to gain best value for money for the agency. In particular, if legal services from an external provider will be far more expensive than if provided in-house, the *informed purchaser* should be able to assure senior managers that extra *value* from the external service is worth the extra cost.

Mutually agreed and understood protocols for interaction are the basis for effective management of relationships between an agency and its external legal service providers. The *informed purchaser* is usually responsible for overall management of the relationship for the agency, which can decide whether anyone else is authorised to instruct external providers. They should be left in no doubt about who in the agency is authorised to instruct them.

Accordingly, the agency's relationship management should include reporting and monitoring processes that enable it to measure the performance of external providers against agreed standards.

Contract management skills

Underlying the relationship with an external provider is the formal contract, managed preferably by the *informed purchaser*. On the basis of its better practice guide on contract management³⁶, the ANAO reported on selected agencies' management of business support service contracts. The report commented on a considerable lack of training for contract managers and noted that, as a consequence, agencies may not be achieving contract objectives efficiently or effectively. The report further supported the benefits for agencies in ensuring that staff with contract management responsibilities are given relevant and adequate training and supporting guidance.³⁷

10.2 Service delivery standards

When designing service delivery standards and other protocols, agencies should consider measures to reduce the likelihood of over-servicing, such as limiting unnecessary attendance at meetings and being aware of situations where the provider might over-research a question.

Agencies are entitled to expect a high standard of service delivery from their external providers. They can help themselves by clearly communicating their needs and expectations to the providers. Service delivery expectations agreed and understood between agencies and providers include those for:

- quality of services (including response times);
- quote format and inclusions, noting that all quotes should include GST³⁸;

³⁶ ANAO *Contract Management: Better Practice Guide*, February 2001 (available at <<http://www.anao.gov.au>>).

³⁷ ANAO Audit Report No.37 2004-05 *Management of Business Support Service Contracts* (available at <<http://www.anao.gov.au>>).

³⁸ See 'GST-inclusive pricing' at Australian Competition and Consumer Commission website <<http://www.accc.gov.au>>. The ACCC considers that all-inclusive pricing for products and services, including any applicable GST, is best practice and prudent risk management.

- content, layout and timing of invoices;
- what, if any, expenditure limits trigger separate reporting;
- any agency-specific requirements (such as whether the agency accepts draft advice);
- who is authorised to instruct the external provider;
- quality assurance processes; and
- adherence to the *Legal Services Directions 2005*.

Scrutiny of invoices, client feedback and ongoing attention to the progress of individual matters (especially large, complex or ongoing matters) will all help agencies to assess whether external providers are performing to these agreed standards.

Paying invoices

Monthly invoices sent by email rather than by post help agencies meet Government policy requirements to pay invoices in 30 days.³⁹

In assessing the validity of charges submitted by external legal service providers the agency should check (at least a selection of) invoices to ensure that:

- the invoice does not aggregate charges or hours for separate matters;
- the invoice amount is in line with prior estimates;
- hourly charge rates are as agreed;
- there has been no 'over-servicing' involving duplication of work, unapproved or excessive research;
- partners and senior staff have not charged for low-level research;
- recorded length of telephone calls is correct;
- there are no charges for 'relationship building', since this cost would normally be factored into the overhead and charge-out rate;
- charges for the firm's internal briefing, 'own initiative' work and incidental expenses are reasonable and were to be expected from prior discussion with the agency; and
- GST has not been added to the quoted amount, since standard contracts should specify 'GST inclusive' pricing.

Managing the contract and defining the basis for charging

From the outset, an agency and its law firm should have a shared understanding of the nature, extent and basis of charging for legal services and disbursements and reflect that in the legal services contract. This is part of having an effectively working relationship, based on trust, mutual respect and propriety, which is essential for both agency and firm.

The following case study represents billing practices with an extreme focus on a firm's profitability and is not to suggest that such practices have been observed by the ANAO (or any other agency) in the culture of law firms providing services to Australian Government agencies. Nevertheless, it has been included in this Guide to highlight potential risks of failing to ensure a shared understanding between the agency and providers on parameters for charging. The case study examines practices that occurred in the US, and which became known in the US legal community as 'Skaddenomics'.

³⁹ Government policy requires that agencies adopt maximum payment terms 'not exceeding 30 days' from the date of receipt of the correct products or services and a correctly rendered invoice when contracting with small businesses. Department of Finance and Administration, *Procurement Guidance: 30 Day Payment Policy for Small Business* (available at <http://www.finance.gov.au/ctc/model_payment_clauses_for_cont.html>).

Case study - Skaddenomics

A US legal journal reported in 1991 that, when a public utility client of a top-tier law firm scrutinised and queried the firm's charges for legal services, which amounted to US\$1.6m, the firm eventually agreed to reduce them by \$1.1m.⁴⁰ The reductions were mainly in respect of costs.

The firm had agreed to charge reduced hourly rates for partners, associates and paralegals and to bill the client for costs such as filing fees, copying expenses, long distance telephone or other overhead expenses properly incurred. In practice the firm's billing for costs of travel, refreshments, etc included undisclosed percentage markups on the costs.

They included the cost of breakfast and coffee for the firm's lawyers, along with a charge for the use of the firm's conference room while lawyers discussed client business over breakfast there. The firm also charged for expenses, such as meals while working 'overtime' and for word processing, which the client had not expected to be billed for.

It could be argued that the cost of meals while working through lunchtime or at night on 'overtime' should be absorbed by the firm or the lawyer, since it was a matter for them, not the client, to decide whether the client's work would be done in normal work hours. However, there was no mutual understanding that this would be appropriate only in limited circumstances (for example, if a client initiated urgent work with a deadline that left the firm with no option but to work through the night).

This case highlights billing issues and lessons for clients. The negotiated contract permitted the firm to charge for 'other overhead' costs but in practice was open-ended enough to provide for a range of mark-ups, add-ons and charges not envisaged by the client. This provided no incentive for the firm to seek best value-for-money options when incurring the costs, as the percentage mark-up meant more income for the firm every time a more expensive overhead cost was applied to the client's matter. The critical issue in this case was that the law firm and the client had different expectations and interpretations of the meaning of some provisions of the contract for services.

Better practice arrangements would clarify the nature and scope of allowable costs up front. For example, the contract could specify the class of travel for which the client will reimburse the firm for travel attributable to the client's matter, and dollar limits that will apply to directly-attributable accommodation costs, unless actual reasonable costs are agreed. Some agencies' legal services contracts provide law firms with specified limits equivalent to those available under workplace agreements for agency staff. These should be carefully managed as it is not necessarily appropriate to treat external contractors as being equivalent to internal staff. Appropriate contract management should also minimise the risks of inappropriate billing.

Contract arrangements typically now include in the normal hourly or daily rate all otherwise billable internal costs such as for telephone calls, faxes, emailing, photocopying (except for large amounts), typing services, use of premises for ordinary business meetings, and staff meals and expenses (except where travelling).

Emails can have advantages

An agency's phone contact with its law firm should be brief and to the point, since 'time is money' to a law firm. In many cases quick legal questions and follow-up can be dealt with by emailing the external lawyer responsible for actioning a request, subject to any security issues concerning emails.⁴¹ Unlike phone calls, emails are recorded and tend to be succinct. Email contact also avoids billing for time in missed phone calls at lunchtime and other inconvenient times. Faxes have similar advantages.

Oral requests or instructions to firms should be confirmed in writing or by email, as appropriate, to avoid any misunderstandings that may become apparent later.

⁴⁰ *The American Lawyer*, September 1991 'Skaddenomics: the ludicrous world of law firm billing'.

⁴¹ As part of risk management, an agency should consider whether it can implement secure email links with external legal services providers that meet Commonwealth security guidelines. AGIMO advised the ANAO, in June 2006, that the issue of whether to extend FedLink to State and Territory governments and trusted business partners has been raised in a current review of Fedlink and that a proposed model would facilitate this extension beyond Australian Government agencies. In the meantime, suppliers have various other 'virtual private network' (VPN) products, including some that are compatible with eventual merging into FedLink.

Completion of legal work may be delayed if the agency's responsible officer or the firm's lawyer is on leave or otherwise absent from the office for a lengthy period of time without a suitable alternative contact. To help avoid this, the agency officer and the firm's lawyer should, at the outset, identify alternative contacts in the agency and the firm. Email 'out of office' messages and phone answering machine messages are useful in this respect.

10.3 Constructive feedback

Dialogue is invaluable

Dialogue is invaluable for both the *informed purchaser*, who buys external services on behalf of the agency, and the external provider. External providers tend to welcome **meaningful constructive feedback** from agencies about the legal services they provide for the agency. External providers not only tend to be responsive to it, but may also regard such dialogue as a good opportunity to learn more about the agency's business and current legal concerns. Constructive feedback is more effective if provided at the time issues arise. Delayed feedback is less effective because the provider cannot readily remedy the problem.

Overlying the stream of communication about issues as they arise should be periodic discussions on the overall relationship at mutually suitable intervals (e.g. every three to six months). The discussions allow two-way feedback between purchaser and provider on their relationship and the main issues and services in the preceding period. They are also an opportunity to discuss emerging trends (including in quality or costs of services) or any changes in levels of service or areas of expertise likely to be required by the agency in the coming months.

Recording feedback

Keeping written records of all feedback provided to external providers helps to inform assessment about whether feedback is having any effect on external provider behaviour. Repeated discussion of the same problems at successive meetings possibly indicates that the agency may need to reconsider its approach to the relationship management focus or strategy or consider engaging a new provider.

The agency should write to external providers about any significant changes that will affect the way the relationship is managed. Communicating significant changes in writing reduces the risk of misunderstanding between purchaser and provider and ensures that all relevant providers receive the same information.

10.4 Quality control and rating legal services

Quality control

Feedback from internal clients on whether legal services met their needs provides an important quality measure. As with internal legal service providers, structured processes to collect regular feedback from internal clients will strengthen any dialogue with the external provider.

The external provider's own quality control processes will not guarantee that services meet the agency's requirements. The *informed purchaser* should be sufficiently expert to recognise instances where legal advice provided:

- may not readily be understood in the agency;
- does not adequately address the question or key points;
- does not take the agency's business or circumstances adequately into account;
- appears to be significantly under or over-researched; or

- is not provided in good time or in the right format.

As discussed below, these issues should be raised with the external provider at the time the advice is produced, to give the provider an opportunity to remedy the problem.

Rating legal services

Like any task, legal work can be assessed on its three principal aspects: time, cost and quality. For feedback to legal services providers, agencies commonly have their in-house client rate legal advice received, for example on a scale of 1 to 5, with comments as appropriate, on the following questions:

- Was the lawyer pro-active in providing the services?
- Did the lawyer keep the client informed of progress?
- Was the lawyer readily contactable?
- Was the advice provided on time?
- Was it good advice: ie good quality, correct, useful and practical?
- Did the service meet expectations?
- Did the lawyer confirm that there was no conflict of interest?
- Did the service give value for money (having regard to what it would have cost had the advice been provided in-house, and taking account of in-house expertise)?
- Was the outcome cost within agreed budget?
- Would you use this lawyer/firm again?

Similar ratings could be applied to a law firm that litigates on behalf of the agency. However, the firm's success rate in winning an agency's cases in court may not be an appropriate measure of performance if the cases were difficult.

In response to their rating by in-house clients, external service providers may wish to comment on the clients' performance; specifically whether clients' instructions were useful, correct and adequate and whether clients provided documents and replies to queries in good time.

Alternatively some agencies may consider that, where there is a well managed partnership between an in-house *informed purchaser* and an external firm, a risk based approach to formal rating of legal service could be adopted. That is, a sample consisting of significant and selected minor matters could be used for rating, rather than seeking to rate every service.

11. 'Educating' clients

Better practice principles

- Provide a 'gatekeeping' role by educating clients on when and how to seek legal advice.
- Define responsibilities of both the client and provider.
- Educate clients through guidance notes, ongoing informal communications and legal services newsletters.
- Quickly acknowledge, coordinate and rank requests.
- Include the *informed purchaser* in senior management meetings.
- Re-assess agency needs periodically through corporate planning and reporting.
- Share relevant information with providers (both internal and external).

11.1 Role of the internal legal unit

An agency's internal legal unit should combine a strong service culture with a clear understanding of the way its legal services contribute to the agency's work. A well managed internal legal area can enhance the quality and continuity of legal services available to the agency.

As noted earlier, regular and informed communication between key stakeholders about potential legal problems and issues is part of risk management. In their day-to-day work, however, line area staff may be uncertain about when to seek legal services or what to ask. Accordingly, an agency will achieve more consistency in the use of legal services and minimise its exposure to risk if it establishes and continually updates guidelines on when and how staff should seek legal services and educates its staff on the process of seeking legal advice. Strategic decisions discussed earlier should inform the development of detailed guidance to be given to staff on these points.

Gatekeeping role

The *informed purchaser* and the internal legal unit can potentially play a valuable 'gatekeeping' role for the agency through ongoing 'education' of internal clients about whether or not to seek legal services. In particular, where an agency's legal services resources are centrally controlled (i.e. line areas do not have their own budgets for legal expenditure), line area staff may regard legal services and advice as a "free good" and seek too much of them too often, unless access controls are agreed.

Guidance for staff

Agencies are most likely to achieve more efficient and effective results from legal services arrangements if staff are given agreed and mutually understood guidance on when and how to access services. Guidance should also delineate the respective responsibilities of agency staff, the *informed purchaser* and internal and external legal service providers. It should be clear about who bears the cost of legal services when they are used.

Guidance protocols should cover the following points:

- who is the main point of contact for internal clients;
- how to contact them;
- when to seek services;
- the issues to consider before seeking services;

- what background material the client needs to provide;
- what service standards the client can expect (including response times);
- what feedback the client may be asked to provide; and
- any other agency-specific issues, such as whether requests for legal services need to be approved by senior line area staff; whether requests should be in writing (eg email); and whether client and lawyer need to discuss the issue.

In larger agencies a 'legal opinions help desk' that agency staff can contact by phone or email could assist staff with their legal queries and facilitate a consistent approach. A readily available leaflet for staff setting out basic guidance on what to do, and what not to do, when seeking legal advice can be useful for staff unfamiliar with the procedure.

Example of guidance on seeking legal services	
What to do when seeking legal services	
Seek services early and be ready to seek services progressively as issues emerge.	
Set out the policy and operational issues and the implications of the issues. A timeline of events can be useful.	
Put the question into context because that can prompt different legal possibilities that the client may have been unaware of.	
Refer to any previous advice on the issue, and provide a copy if available.	
Specify the required time frame and allow a reasonable period for the service.	
Seek guidance on the sensitivity of the issue before referring the question to an external adviser.	
What not to do when seeking legal services	
Avoid putting the same question to more than one legal adviser in the hope of a 'favourable' opinion. The skill is in choosing a lawyer or firm with the relevant expertise who will give value for money.	
Don't try to draft contracts, legislation or other legal documents. Explain to the lawyer what you want, not how to do it.	
Don't ask a closed question. Rather than ask 'is this allowable under section x of Y Act?', to which the answer might be no, ask instead 'is this allowable under the X Act or other Commonwealth legislation?', because the answer might be yes.	

Helping the client adds value for the agency

As discussed above, the *informed purchaser* and internal legal staff can play an ongoing educative role. In this role they can assist continuity, maximise value for money, reduce risk exposure and help avoid misunderstandings and potentially expensive mistakes. In many cases an initial discussion between the internal client and the internal legal area also helps establish whether an issue is a policy matter more appropriately handled by the line area or whether the issue does require legal resources. Internal legal staff are usually best placed to establish whether the issue (or a similar issue) has arisen before, and this can save the agency from seeking repeat services.

Internal clients value readily available assistance to help them clarify the issue that needs to be addressed or the question that needs answering. The internal legal area should be able quickly to acknowledge, coordinate and rank requests for assistance from line areas. Accordingly, the size and functions of any internal legal

services area should be carefully considered so that, for reasons of structure, capability or operating style, it does not create a bottleneck that restricts the ability of the agency as a whole to access legal services, including external services.

The *informed purchaser* needs sufficient authority and control of resources to give clients the service they require and, at the same time, should be able to demonstrate to agency management that these resources have achieved value for money.

Proactive outreach

Education of legal service users will always be desirable when legal services purchasing arrangements are changed. Training on the agency's legal services purchasing arrangements may be included in induction or other relevant training courses. Depending on the needs of the agency, specialist internal or external providers may also deliver training on specific aspects of legal services or legal risk.

Larger agencies may find that a regular 'legal issues' newsletter is an effective method of keeping staff informed of legal matters affecting the agency or the environment it operates in.

The internal legal unit should itself be governed by well-understood protocols that guide lawyers and support staff in their work. Standard procedures help promote quality legal services and reduce risk. Any written guidance should be regularly reviewed to ensure currency. This is particularly so for agencies with high staff turnover.

11.2 Communicating in the agency

Formal links in the agency

The *informed purchaser* is the crucial link between the agency's executives and its legal service providers. If the *informed purchaser* is to identify and protect the agency's interests, their inclusion in senior management forums is highly desirable. Participation in senior management forums, such as meetings of executive management or audit committees, allows the *informed purchaser* to learn at first hand of any potential or actual issues arising in line areas that may have an impact on demand for legal services or advice.

Agency corporate planning and reporting processes also give the *informed purchaser* an opportunity to re-assess the overall picture of the agency's legal services needs. For instance, in many agencies, annual budgeting rounds allow the *informed purchaser*, line areas and senior managers to take a longer-term view of issues affecting the agency's legal service requirements, any trends in legal service requirements flowing from likely changes to workload drivers and any resource implications. Coordinated risk management processes may also provide opportunities for longer-term assessment of legal service needs and risks.

Informal networks

The *informed purchaser* should manage relationships with key internal clients and stakeholders who are not included in senior management forums. Informal networks in agencies are valuable in communicating daily issues but are unlikely to provide the *informed purchaser* with knowledge sufficient to be fully across relevant agency developments.

As noted above, the *informed purchaser* has a responsibility to the agency to share relevant information with legal services providers, both internal and external. Regular messages to and meetings with staff on significant advices or events, such as major litigation outcomes, can fulfil this requirement for internal staff. Similarly, regular briefings, reports or other feedback can help external providers better understand agency needs and meet them with better value services.

11.3 Cost effective solutions for evolving needs

To gain the best value legal services for the agency, the *informed purchaser* should have good knowledge of its business, legal service needs and priorities and also understand the law, legal practice and the operation of the legal services market.

The *informed purchaser* should also be able to recognise emerging patterns in the agency's legal services requirements and *anticipate* the need to make some adjustment in purchasing arrangements to accommodate them. This includes an ability to recognise when a surge in the agency's need for legal services overall, or in a particular area, will continue and require an appropriate cost-effective response.

12. Information and knowledge

Better practice principles

Adopt a management system to respond consistently to requests for legal services to required standards and to enable any matter to be picked up and taken forward by any legal unit staff member.

Gain any benefits from legal knowledge base and gain maximum value from services provided previously.

Ensure the system is used according to agreed protocols and is flexible enough to accommodate changing needs.

An agency needs immediate information from its legal database for daily workflow management. It can also derive longer-term value from the knowledge stored in the legal database. This requires a focused approach to gain that information and knowledge.

12.1 Workflow and matter management

Agencies use a wide range of matter⁴² management systems for daily workflow. Effective systems for workflow allocation rely on constant oral communication between legal managers and staff. Other effective systems rely more on custom-designed electronic applications, with communication through more generic office tools such as email.

Whatever matter management system is used, it should enable the agency to respond consistently to requests for legal advice and services to required standards; and to manage them in a way that enables any matter to be picked up and taken forward by a suitably-qualified staff member. The history and status of any matter should never be difficult to access or understand.

Over time, agencies change the way they purchase legal services. Agency responsibilities and business also change. Matter management systems should be able to accommodate these changes. Ideally, the agency should retain the internal competence to adjust the system itself or, failing that, the agency should be readily able to access the necessary expertise externally.

Matter management systems

An agency's matter management system should be able to:

- record requests for advice or services and the internal or external service provider to whom the work was assigned;
- record activity relating to the progress of the matter (including research, background documents, phone calls, emails or other correspondence with internal clients and external providers, and the final advice or outcome of the matter);
- update and track matter status and history;
- link matters with like matters;
- be searchable; and
- gather and report relevant data to stakeholders (including cost data).

In designing or purchasing such a system, agencies could also consider the need to:

- provide quality assurance and record feedback from clients on service quality;

⁴² In this context 'matter' means an individual case or legal task.

- track costs and billing history for each matter; and
- measure adherence to agreed service standards by legal service providers.

A matter management system should include document management. If documents are managed in a separate system, it should be readily accessible from the matter management system.

The matter management system should be capable of being readily amended to accommodate changing agency needs.

System security

Much of the information in documents produced and obtained by the legal unit is confidential and sensitive. The agency should decide who in the agency is to have access to matter management systems and the information they contain. Even within the legal unit, access may need to be restricted to staff with a clear need for access to particular areas of the system.

Restrictions on access should aim to protect systems and information from accidental damage or loss, fraud and unnecessary access. Documents should be stored in 'read only' format. Confidential documents should be stored in a way that is readily searchable by authorised staff.

The agency should decide whether external legal service providers are to have access to particular information in the system and what access restrictions are to be placed on advices from those providers.

AGIMO better practice

The Australian Government Information Management Office (AGIMO) makes available a better practice program to help ensure that government continues to be an effective and exemplary user of information and computer technology (ICT). AGIMO's better practice checklists aim to help agencies enhance their understanding of a range of issues associated with technology enabled government. See also AGIMO checklists concerning knowledge management and intranets.⁴³

Matter management is concerned with immediate work flow. Associated with this is knowledge capture and management, which seek to derive longer term value from matter management.

12.2 Knowledge capture and management

Knowledge from agencies' matter management

An agency with limited resources should seek continually to gain maximum benefit from expenditure on legal services. Lawyers are 'knowledge workers' who rely on a systematic storage of legal knowledge and access to it. Poorly organised, disconnected or duplicate knowledge management systems (including separated or unreferenced databases in the legal unit or in line areas) put at risk an agency's ability to benefit from its knowledge base.

Matter management and associated knowledge management systems should facilitate day-to-day purchase and performance of legal services and assist the agency to gain maximum value from services and advice already paid for.

An agency that relies on an external provider's knowledge management processes should assess the risks that this arrangement poses to the agency's ability to capture and use the knowledge that it has paid for. Identifying and mitigating these risks become crucial for some agencies.

Overall, a well-maintained knowledge management system will enable agencies to capture knowledge as it is produced (either internally or externally), and archive it consistently. This should then reduce the costs to

⁴⁴ AGIMO *Better Practice in Online Service Delivery*, Better Practice Checklist, 13 Knowledge Management and 14 Designing and Managing an Intranet, May 2004 (available at <http://www.agimo.gov.au/practice/delivery>).

the agency when it loses internal staff or changes external providers.

Agencies that have their knowledge management system for legal services as part of the IT platform for the agency as a whole should limit system access to relevant staff in the legal unit and should distinguish legal advices from the rest of the agency's electronic files and documents.

OLSC and knowledge management

Legal knowledge management is one of the issues that the Office of Legal Services Coordination (OLSC) considers when an agency seeks the Attorney-General's approval to use an in-house lawyer in litigation. OLSC has asked that an agency include, among other information, in the data supporting its request:

Information about the nature of knowledge management arrangements in place in the agency (eg, how the agency stores and accesses past opinions and its 'corporate memory'). This, too, goes to the agency's ability to provide consistency of service and to attain high standards in the conduct of court litigation. Knowledge management also includes generally collating, recording and accessing the specialist expertise that in-house lawyers may have, how they acquire it, how they share it and how they maintain it for future in-house lawyers. A knowledge management system should ideally address litigation knowledge, jurisdictional knowledge and understanding of relevant legislation.⁴⁴

12.3 Systems to capture legal knowledge

Integrated or reference systems

Some agencies have integrated their matter management and knowledge management systems to good effect. Other agencies have matter management systems fully referenced to knowledge management systems, also with good effect. In either case a knowledge management system should also be:

- used according to agreed protocols;
- searchable by topic, service provider, client, dates that the service or advice was requested and required, relevant legislation;
- kept up to date; and
- subject to regular quality assurance processes.

The system should record advices received from internal and external providers and be able to record (back capture) advices that pre-date the system. It should also be amended to accommodate changing agency needs.

When submitting in-house legal advice, the lawyer should confirm that the agency's legal advice database was checked for relevant precedents before preparing the advice. This will help prevent unnecessary duplication of work and contradictory advice.

⁴⁴ Office of Legal Services Coordination, Guidance Note No.3 of 2005, *Use of in-house lawyers for court litigation*, paragraph 3.

Knowledge management in law firms

Law firms have recognised the importance of knowledge management. A law firm's knowledge manager has stated that:

*Law is a knowledge intensive industry. Fundamentally, the business that lawyers are in is the sale of their knowledge. Law firms are now being challenged by the need to better manage their collective knowledge as an asset of their business.*⁴⁵

A survey found that firms' attitudes and practices vary:

Lawyers in some law firms are strongly encouraged to share with others what they have learned from their recent assignments, and teamwork in such firms seems fully recognized and rewarded. Lawyers in other firms have senior staff who are too busy to reflect on their experiences and share them, and teamwork in such firms seems not recognized and rewarded.

*Making this picture even more interesting is the use of information technology. Law firms with current projects for information technology to support knowledge management that focus on end-user tools for lawyers seem to have individual reward attitudes. Law firms with projects that focus on storing information for sharing seem to have teamwork reward attitudes.*⁴⁶

Agree on consistent usage

A risk for agencies is that staff may use knowledge management systems inconsistently. Individuals may have different understandings of what agreed protocols mean in practice. If different usages are not identified and addressed, the knowledge management system as a whole could be degraded. Knowledge management systems should remain tightly structured so that the integrity of knowledge storage (e.g. in personal folders) is not affected by individual preferences or misunderstandings about how the system should be used.

Some agencies generate numerous legal advices. Since not all advices have significant or precedent value, agreed criteria can identify the most significant advices. As well as archiving significant advices, agencies may consider sharing and discussing significant advices among internal providers and, where appropriate, external providers.

Electronic systems and folders

A knowledge management system need not be fully electronic to be effective. For many agencies, the authoritative and complete history of a matter is a physical, paper-based file. In this situation an effective system to track the location of the physical matter files becomes a crucial link between the matter management and knowledge management systems.

As well as physical paper-based records, electronic folders are often used to store advices. Such folders should:

- be accessible to all relevant staff (i.e. advices should not be placed on accessible common 'drives' or stored in email and other personal folders);
- help minimise duplication of storage;
- be integrated with, or fully referenced to, the matter management system;
- be used according to agreed protocols;
- be searchable, like the knowledge management system;
- record advices from both internal and external providers;

⁴⁵ Stuart Kay *Benchmarking Knowledge Management in US and UK Law Firms*, 2002, available at <<http://www.gtlaw.com.au/>>. See also Stuart Kay *Cost, Value and ROI for Knowledge Management in Law Firms*, 2003, available at <<http://www.llrx.com/features/kmcost.htm>>.

⁴⁶ V. Khandelwal and P. Gottschalk *A Knowledge Management Survey of Australian Law Firms*, CIT/5/2003, School of Computing & Information Technology, University of Western Sydney, available at <<http://www.cit.uws.edu.au/research/reports/>>.

- record relevant advices that pre-date the folder system; and
- be kept up to date.

Quality control in data input

Useful system output requires care in data input. Efforts should be made at the data input stage to avoid a system that produces numerous irrelevant document references in response to a search for a particular word or phrase. This can be done by considering each new document in the legal unit to identify key words and phrases for input to the knowledge system.

Care should be taken in preparing the title of each document. The title should include key words and indicate the nature of the document's contents, since the title is likely to be the primary means by which the document is later classified and stored. Each document, whether draft or final, should be dated.

A knowledge management system is of little value if data is input wrongly. For example, 'FOI' (freedom of information) inadvertently input as 'FIO' will render the data inaccessible in later searches for FOI data. Care and attention at the data input stage can save much time later by avoiding the need for laborious searches for valuable information.

Quality control (checking that data is correct at the time of input) is better than quality assurance (checking that input is correct afterwards), especially if the latter is only of a sample. A legal unit's productivity can be enhanced by a good knowledge management system. Such a system starts with good data input, and for larger agencies this may mean having data input by a *dedicated resource* (or independently verified after input) instead of being maintained by busy lawyers in a hurry to move on to their next task. In such cases, the person responsible for managing the system should also perform training, editorial, maintenance and updating functions.

13. Reviewing service arrangements

Better practice principles

Regularly review the agency's legal service sourcing arrangements (in consultation with stakeholders and clients).

Be clear why arrangements are being reviewed, as this will affect the objective and scope of the review.

13.1 What prompts a review

Agencies' legal service needs change over time, as does the market from which agencies purchase legal services. Accordingly, agencies will benefit from periodic or occasional reviews of their legal services arrangements to ensure that arrangements continue to give value for money to the agency.

Agencies should be clear about their reason for reviewing their legal services purchasing arrangements, as this will affect the objective and scope of the review. Reviews can be comprehensive or targeted, depending on what the agency wants to learn from the process. For example, if there has been a major concern, a review could address its causes. Alternatively, should the agency distinguish problem areas from those performing well (and then investigate the problem areas); or does the whole staffing or purchasing system need to be reassessed?

It will also be timely to review arrangements before a contract with an external service provider, or a panel arrangement with such providers, expires. Note that 'evergreen' contracts (contracts that have no expiry date or that include a 'perpetual option') are not consistent with the policy framework in the *Commonwealth Procurement Guidelines*. This is because there is usually no way of demonstrating and ensuring value for money without an approach to the market within a reasonable period.

Other factors that may prompt a review are:

- the agency's inability to demonstrate that current arrangements are cost-effective;
- the agency's inability to demonstrate that current arrangements adhere to government policy;
- the agency experiences a significant failure of legal risk management; or
- the agency experiences a significant failure of legal services acquisition.

Reviews might also be conducted because of significant changes to:

- the agency's structure or business;
- the agency's operating environment;
- the agency's purchasing policies;
- the agency's risk profile;
- the level of demand for legal services;
- areas of required legal expertise; and
- the market for legal services.

13.2 Points to consider

The process and coverage of the review will depend on the reasons for the review, the individual circumstances of the agency and what it wants to get out of the review. An agency may find it useful to re-consider some of the following points as part of its review process:

- the nature of the agency's work;
- what are the key drivers of its legal workload;
- the agency's operating environment;
- the agency's ability to attract and retain its own lawyers;
- the agency's risk profile and risk mitigation strategies;
- agency structure;
- required quality of legal services;
- current quality of legal services providers;
- ability of providers to meet required deadlines;
- required levels and areas of technical legal expertise;
- the agency's compliance with government policy; and
- comparative full costs of providers.

The review should be undertaken by experienced staff or relevant consultants, with no conflicts of interest. It should be underpinned by accurate performance data and not be skewed towards a pre-determined outcome. It should use performance measures established at the start of the purchasing arrangements under review.

Client surveying

To assist a review of its legal services, an agency may wish to survey internal clients of legal services to establish perceptions of service quality. The NSW Attorney-General's Department's Legal Management Services, in its document *Guidelines for Reviewing Agency Legal Services*, has suggested a range of questions for such a survey.⁴⁷

13.3 Measuring value

Whatever its scope, the review should be explicit about how value is being measured. Potentially relevant factors include:

- easy access to general advice and other services;
- accessing strategic, high-level advice or services;
- timeliness of advice;
- whether to retain in-house legal capability and expertise;
- the role of legal services in managing risk and conflict of interest; and
- the full cost of legal services.

⁴⁷ Attorney-General's Department of NSW, Legal Management Services, *Guidelines for Reviewing Agency Legal Services*, section 4 Client Surveying (available through Lawlink at <<http://www.lawlink.nsw.gov.au/>>).

The review will benefit from consultations with relevant stakeholders and internal clients. It should consider whether any other aspects of the agency's structure or operations are likely to be affected by changes to legal services arrangements. Senior managers and other stakeholders (as well as the *informed purchaser*) should be consulted about the results of the review, particularly if any changes to the arrangements are recommended, and if there are any funding implications for new arrangements.

Summary of better practices

The table below summarises indicators of the main better practice principles from each chapter of this guide.

Issues	Indicators of better practice principles
1. Legal Services Directions	Ensure the agency and its legal services providers are aware of their responsibilities under the <i>Legal Services Directions 2005</i> and have due regard for OLSC guidance. Adopt appropriate compliance monitoring.
2. Defining legal service needs	Identify nature, scope and volume of legal service needs. Prepare business case from identified needs to gain agency management agreement on its legal services arrangements.
3. Funding and sourcing legal services	As part of preparing a business case for legal service needs, consider assessing agency's underlying demand for legal services by means such as internal charging, and assess advantages of various legal service insourcing and outsourcing options.
4. The <i>informed purchaser</i>	Appoint an <i>informed purchaser</i> , an individual (or group), with good knowledge of agency 'business' and the law and legal practice, who is to: coordinate all legal service arrangements; link strategic decisions to their daily implementation; and ensure value-for-money legal services.
5. Costing and reporting legal services	Management decisions on sourcing of legal services are based on full costing of internal services. Legal services purchasing, including expenditure, is recorded and monitored. Expenditure data is publicly available.
6. Managing uncertainty and risk	Identify, assess and manage the agency's legal risks to program delivery and its legal services risks (risks to its ongoing ability to obtain legal services).
7. Using in-house legal services	Use in-house lawyers to best advantage. Adopt comprehensive staff management policies (e.g. training and succession planning). Measure quality of legal services against agreed standards (e.g. through regular feedback). Implement quality assurance methods (e.g. second counselling and knowledge sharing).
8. Purchasing external legal services	Match tender requirements to agency's identified legal service needs. Purchase legal services by means of value-for-money arrangements made on the basis of a sound understanding of agency needs and legal services market. Consider establishing provider panels and packaging legal service needs.

9. Negotiating a fee	<p>Consider the full range of fee options appropriate to the nature, scope and volume of services required, including volume rebates and learning discounts.</p> <p>Ensure a clear understanding between client and provider on the nature and scope of work and agree on the basis for charging.</p>
10. Managing relationships	<p>Adopt relationship management methods that include sufficient reporting and monitoring.</p> <p>Ensure there are clearly understood service delivery standards and immediately query any unsatisfactory services.</p> <p>Implement agreed protocols for interaction between providers and clients.</p> <p>Implement performance measures (including regular feedback).</p> <p>Discuss regularly the overall relationship with external providers.</p>
11. 'Educating' clients	<p>Provide a 'gatekeeping' role by educating clients on when and how to seek legal advice.</p> <p>Define responsibilities of both the client and provider.</p> <p>Educate clients through guidance notes, ongoing informal communications and legal services newsletters.</p> <p>Quickly acknowledge, coordinate and rank requests.</p> <p>Include the <i>informed purchaser</i> in senior management meetings.</p> <p>Re-assess agency needs periodically through corporate planning and reporting.</p> <p>Share relevant information with providers (both internal and external).</p>
12. Information and knowledge	<p>Adopt a management system to respond consistently to requests for legal services to required standards and to enable any matter to be picked up and taken forward by any legal unit staff member.</p> <p>Gain any benefits from legal knowledge base and gain maximum value from services provided previously.</p> <p>Ensure system is used according to agreed protocols and is flexible enough to accommodate changing needs.</p>
13. Reviewing service arrangements	<p>Review regularly the agency's legal service sourcing arrangements (in consultation with stakeholders and clients).</p> <p>Be clear why arrangements are being reviewed, as this will affect the objective and scope of the review.</p>

Abbreviations

AGIMO	Australian Government Information Management Office
ANAO	Australian National Audit Office
APS	Australian Public Service
CSS	Commonwealth Superannuation Scheme
CTC	Competitive Tendering and Contracting
FMA	<i>Financial Management and Accountability Act 1997</i>
GST	Goods and Services Tax
IT	Information Technology
NSW	New South Wales
OLSC	Office of Legal Services Coordination
PSS	Public Sector Superannuation Scheme
UK	United Kingdom

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