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Governance and Auditing in a Changing Environment in the Public Sector

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GOVERNANCE AND AUDITING IN A CHANGING ENVIRONMENT IN THE PUBLIC SECTOR

1. INTRODUCTION

Thank you for the invitation to speak at your inaugural luncheon discussion forum. The Chartered Secretaries’ Australia commitment to advancing corporate governance strikes a particular resonance with me given that the ANAO is equally committed to fostering better practice in Public Sector Governance - a term we, at the ANAO, have coined to focus on the governance arrangements for federal public sector organisations, namely:

‘Public sector governance has a very broad coverage, including how an organisation is managed, its corporate and other structures, its culture, its policies and strategies and the way it deals with its various stakeholders. The concept encompasses the manner in which public sector organisations acquit their responsibilities of stewardship by being open, accountable and prudent in decision-making, in providing policy advice, and in managing and delivering.’

Recent corporate collapses, both here and overseas, have led to the governance and audit landscape being reconfigured for both the public and the private sectors. The ANAO is adjusting its own approach at the same time as it is responding to federal agencies’ needs for greater guidance in an increasingly complex environment. The ANAO’s approach is built on the four principles of good governance in public sector agencies, namely: transparency; integrity; accountability; and stewardship. We adhere to these principles as we aim to get the right mix of audit products to provide adequate assurance and improve administration, which also assists us to guide agencies in dealing with their own challenges.

In the last two years, scrutiny of the accounting and auditing profession worldwide has been intense. In Australia, we have seen the latest chapter of the Government’s Corporate Law Economic Reform Program, (CLERP 9), promoting transparency, accountability and shareholder rights focusing on strengthening the financial reporting framework. This has implications for the accounting and auditing profession in both the public and private sectors. The Australian Stock Exchange (ASX) has taken an active interest in refining governance arrangements for Australian companies and recently published appropriate Guidelines. Standards Australia has released a new standard - AS 8000-2003 on good governance principles. 4 We have also seen the Joint Committee of Public Accounts and Audit (JCPAA) release its review of independent auditing by registered company auditors. 5 Importantly, these activities have implications for the public as well as the private sector.

While the ANAO is integral to the changing public sector governance environment, it also stands apart from it, due to the Office’s unique independent position within the Commonwealth. The ANAO shares the accounting profession’s concern over issues such as independence, the role of audit committees and boards, and the harmonisation of accounting and auditing standards internationally, but importantly, it also faces
unique challenges due to the particular dynamics influencing public sector administration.

Against this background, my contribution to your discussion forum today is a snapshot view of the audit role in developing sound corporate and organisational governance in a changing environment - with a particular emphasis on the public sector. Time does not permit me to address every detail and nuance of corporate governance, instead I propose to focus on some of the aspects of the changing governance and auditing landscape and then outline how the ANAO is supporting the Australian public sector in the changing governance environment. Finally, I will make some concluding comments.

II. THE CHANGING GOVERNANCE AND AUDITING LANDSCAPE

The tectonic plates of the corporate governance world are on the move following the raft of major corporate failures in recent times exposing significant shortcomings in corporate governance arrangements. In response to this worldwide concern about corporate governance, there has been a concerted push for reform through more comprehensive corporate disclosure requirements. While primarily focusing on the private sector, the implications of the changes also impact on the public and ‘not for profit’ sectors.

I will now briefly touch on the major recent initiatives aimed at improving governance in Australia. For this paper I have selected the following contributions to the governance reformation in Australia – CLERP 9, the ASX Guidelines and the Uhrig review dealing with governance arrangements for statutory authorities. The other areas of related interest are auditor independence and the harmonisation of Australian and international accounting and auditing standards.

(a) Corporate Law Economic Reform Program (CLERP 9 Arrangements)

In September 2002, the Treasurer and the Parliamentary Secretary to the Treasurer released the CLERP 9 policy paper - Corporate Disclosure – Strengthening the financial reporting framework – proposing a range of measures designed to enhance audit regulation and the general corporate disclosure framework. This paper included the Government’s response to the Ramsay report on the Independence of Australian Company Auditors. Since the release of the CLERP 9 policy paper, the Government has consulted widely with stakeholders with over 60 submissions being received.

The draft Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Bill 2003 and the accompanying commentary on the draft provisions was released by the Treasurer on 8 October with responses now received by Treasury (due by 10 November 2003). The draft Bill broadly captures the policy proposals contained in the September 2002 CLERP 9 policy paper subject to changes that reflect the outcome of the consultation process. The Treasurer made the point that: the development of the draft Bill benefited from comments made on the policy paper; incorporates recommendations contained in the Ramsay report - Independence of Australian Company Auditors - which was released in October 2001; and takes account of the relevant recommendations of the report of the Joint Committee of Public Accounts and Audit's Report 391 (Review of Independent Auditing by Registered
Company Auditors released on 18 September 2002. The Bill also implements relevant recommendations of the HIH Royal Commission. In introducing the draft Bill the Treasurer said its ‘provisions will enhance auditor independence, achieve better disclosure outcomes and improve enforcement arrangements for corporate misbehaviour, while fostering innovation and wealth creation’.12 The Bill establishes a framework which includes the following features13:

- **Measures designed to improve the reliability and credibility of financial statements through enhanced auditor independence:**
  - Expanding the role of the Financial Reporting Council (FRC) to include the oversight of the audit standard setting process and monitoring and advising on auditor independence.
  - Requiring auditors to meet a general standard of independence and make an annual declaration that they have maintained their independence.
  - Requiring disclosure in relation to all non-audit services.
  - Introducing and/or enhancing restrictions on certain employment and financial relationships.
  - Rotating of auditors will be required after five years (and up to seven years where ASIC relief has been granted).
  - Requiring auditors to attend company Annual General Meetings.
  - Giving the Australian Securities and Investments Commission (ASIC) a power to impose conditions on Auditors' registration.

- **Improved enforcement arrangements:**
  - Enhancing the Companies Auditors and Liquidators Disciplinary Board by appointing a deputy chair and facilitating concurrent hearings. In addition, the majority of members will be non accountants.
  - Establishing a financial reporting panel to resolve disputes between ASIC and companies regarding the application of accounting standards.
  - Making the auditing standards legislative instruments in the same way as Australian Accounting Standards Board (AASB) accounting standards.
  - Protecting employees and others who report suspected breaches of the law to ASIC.
  - Strengthening the obligations for auditors to report suspected breaches of the law to ASIC.

- **Measures to better allocate and manage risk:**
  - Introducing a regime of proportionate liability to ensure that liability rests with all defendants in proportion to their contribution to the plaintiff's loss. The proportionate liability reforms are of general application and are not confined to auditors.
  - Enabling auditors to incorporate that will protect auditors who are not responsible for loss caused by another auditor in the audit firm.
Better disclosure to shareholders and improved shareholder activism:

- Improving the presentation of disclosure documents and the operation of the secondary sale provisions.
- Enhancing the disclosure requirements applying to director and executive remuneration thus allowing shareholders to be better equipped to hold directors accountable for their decisions regarding remuneration.
- Giving shareholders greater ability to ask auditors questions regarding the conduct of the audit and the content of the audit report.
- Improving mechanisms for shareholders to participate and vote in general meetings.

Better enforcement mechanisms for continuous disclosure:

- Increasing the maximum civil penalty for a contravention of the continuous disclosure (and other financial services civil penalty) provisions by a body corporate.
- Persons involved in a contravention of the continuous disclosure regime by a body corporate will be subject to civil penalties.
- Giving ASIC the power to issue infringement notices specifying payment of a financial penalty in relation to contraventions of the continuous disclosure regime.

Policy changes reflected in the Bill

As part of the consultative process referred to earlier, a number of changes have been made to the reforms proposed in the 2002 policy paper (referred to as CLERP 9 in the text). The more significant of these changes are described below.

Legal backing for auditing standards

CLERP 9 proposed that core auditing standards have the force of law on the same basis as AASB accounting standards. However, given the views of stakeholders and ASIC that it is not possible to identify a selection of auditing standards that are applicable to all Corporations Act audits, all standards will have legal backing.

Auditor rotation

CLERP 9 proposed that auditors of listed companies be rotated after five years. The Bill retains a five year rotation requirement, however, in light of concerns surrounding the impact of this requirement on smaller audit firms and those operating in rural and regional areas, ASIC will be given a power to provide relief by allowing up to a seven year rotation in appropriate circumstances.
CEO/CFO signoff

The Bill requires CEO/CFOs to certify to the board of directors that the financial statements are in accordance with the Act and accounting standards, and that they present a true and fair view. While CLERP 9 did not make any policy recommendations on this issue, there has been substantial public debate on the desirability of such a requirement. The Joint Committee of Public Accounts and Audit and a number of submissions received on CLERP 9 supported the introduction of this measure.

Financial Reporting Panel

The Bill establishes a Financial Reporting Panel to resolve disputes between ASIC and companies concerning the company's accounting treatments in its financial report.

Managing conflicts of interest

CLERP 9 proposed that ASIC provide guidance via a policy statement on the level and manner of disclosure of conflicts of interest required under the general duty to provide financial services 'efficiently, honestly and fairly'. The Bill instead introduces an additional licensing obligation to supplement the general duty to provide financial services 'efficiently, honestly and fairly'. This will provide a stronger legislative basis for ASIC to develop guidance and take enforcement action.

Infringement notices

CLERP 9 proposed that ASIC have the power to issue infringement notices specifying payment of a fixed financial penalty (up to $100,000) in relation to contraventions of the continuous disclosure regime. An infringement notice will specify payment of a financial penalty based on a company's market capitalisation and disclosure of information if considered necessary by ASIC, and will indicate that compliance with the notice will be published.

Disqualification of directors

The Bill allows ASIC to apply to a Court for an extension of up to 15 years on the current five year automatic disqualification period contained in section 206B of the Corporations Act 2001 (Corporations Act). Further, in response to recommendations of the Cole Royal Commission, the maximum period of disqualification by a Court of directors for insolvency and non-payment of debts is increased from 10 to 20 years.

Retail/wholesale and sophisticated investor test

CLERP 9 proposed to more closely align the exemptions from the disclosure regimes that apply to sophisticated investors and wholesale clients under Chapters 6D and 7 of the Corporations Act. While there was in-principle support, there was no consensus over how this proposal could be practically achieved and this proposal is not being progressed at this stage.
Executive remuneration

The Bill introduces a number of measures designed to promote transparency and accountability in relation to the remuneration of directors and company management. In particular, the Bill requires disclosure to be in a clearly identified section of the annual directors' report; expands the range of disclosures required; applies the disclosure requirements to senior managers employed within a corporate group; allows shareholders the opportunity to discuss the remuneration section of the annual directors' report and vote on a non-binding resolution; and provides shareholders with greater say in relation to the termination benefits of directors.

HIH recommendations

The HIH Royal Commission released its report on 15 April and made a number of recommendations relevant to financial reporting and corporate governance. The Bill implements the following recommendations 16:

- The general standard of independence proposed in CLERP 9 was refined to provide that an auditor is not independent if the auditor might be impaired in the auditor's exercise of objective and impartial judgment on all matters arising out of the auditor's engagement (or a reasonable person with full knowledge of all relevant facts and circumstances might apprehend that the auditor might be impaired).

- Directors must provide a statement in the annual report that identifies all non-audit services provided by the audit firm and the fees applicable to each item of work and explain why those non-audit services do not compromise audit independence.

- A mandatory cooling off period of four years applies to a former partner who was directly involved in the audit of a client before the partner can become a director of the client or take a senior management position with the client. This restriction will be extended to include key senior audit personnel. In addition, a two-year cooling off period will apply to former partners of the audit firm who were not directly involved in the audit of a client.

- A prohibition is introduced on any more than one former partner of an audit firm, at any time, being a director of or taking a senior management position with an audited body.

- Companies will be required to prepare an operating and financial review to provide an overview of the past, present and expected future direction of the company.

The draft Bill has received in-principle support from the two major accounting bodies 17 and the Australian Institute of Company Directors 18. However, there were reservations expressed. These centred on shareholders having a direct say on executive salary packages (boards should unambiguously maintain responsibility for setting executive remuneration), auditing standards having the force of law, practical limitations on compulsory audit partner rotation to avoid penalising smaller firms, spot penalties, and the limiting of whistleblower protection to employees who report suspected incidents to ASIC. While clarity in direction is generally appreciated, concerns have been voiced...
about ‘rushing into overly prescriptive legislation’ and the use of a system of ‘black letter’ law as an approach to achieving good corporate governance\textsuperscript{19}.

Notwithstanding the scope of the latest CLERP 9 reforms, it is very much still work in progress. As the former Parliamentary Secretary concluded in his address to the ASIC Summer School in March 2003:

‘.. CLERP 9 won’t be the end of corporate law reform in Australia. I have already started work with Treasury officers and other stakeholders in developing a further number of chapters in the CLERP program. There is still a lot of work to be done to ensure that we keep improving Australia’s corporate regulatory environment with a view to making this a world-renowned place to do business with, a well informed market place with high levels of participation and a place that is very welcoming to international capital’.\textsuperscript{20}

(b) ASX Corporate Governance Guidelines

A second element of the Australian governance reform agenda has been the establishment of the ASX Corporate Governance Council to develop a practical guide on best practice in corporate governance. The Principles of Good Governance and Best Practice Recommendations, released in March 2003\textsuperscript{21}, ask all listed companies to formulate and abide by detailed schedules of best practice covering board structure, financial reporting, remuneration, audit committees and ethics. As one commentator observed:

‘...the Australian Stock Exchange Corporate Governance Council released its report “Principles of good corporate governance and best practice recommendations”. In doing so it signalled the beginning of a new era in corporate governance which will be characterised by attempts to define best practice and a challenge to corporations to meet the standards or explain why not.’\textsuperscript{22}

The ASX Corporate Governance Council Guidelines recognise that there is no one rigidly defined governance model by setting out key themes which underlie good corporate governance generally. These themes flow into the following ten key principles which, in turn, are underpinned by twenty-eight specific best practice recommendations. The ten principles are summarised below, namely that a company should:

1. \textit{lay solid foundations for management and oversight} – recognise and publish the respective roles and responsibilities of the board and management;

2. \textit{structure the board to add value} – have a board with an effective composition, size and commitment to adequately discharge its responsibilities and duties;

3. \textit{promote ethical and responsible decision making} – actively promote ethical and responsible decision making;
4. **safeguard integrity in financial reporting** – have a structure to independently verify and safeguard the integrity of the company’s financial reporting;

5. **make timely balance sheet disclosures** – promote timely and balanced disclosure of all material matters concerning the company;

6. **respect the rights of shareholders** – and facilitate the effective exercise of those rights;

7. **recognise and manage risk** – establish a sound system of risk oversight and management of internal control;

8. **encourage enhanced performance** – fairly review and actively encourage enhanced board and management effectiveness;

9. **remunerate fairly and responsibly** – ensure that the level of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined; and

10. **recognise the legitimate interests of stakeholders** – recognise legal and other obligations to all legitimate stakeholders.23

While these guidelines are focused at the private sector and seen as a comprehensive response to ‘*revelations about lamentable corporate behaviour at the tail end of the boom*’24, I have included them in this paper because they provide broad pointers for the public sector, for example the themes of management, ethical decision-making, managing risk, and enhanced performance are particularly apposite.

The response to the ASX rules has been overwhelmingly positive. However, there has also been some disquiet regarding the lack of consultation, being too prescriptive – *one size fits all*, increasing the cost of governance, lacking teeth, and requiring independent directors and Chairpersons. Senator Campbell summed it up well:

> ‘This guide has been criticised by one side that it is too prescriptive and by others that it lacks teeth. What is important is that, in particular, for smaller companies it will give them a chance to go through a corporate governance review which is not bad for a company. The corporate governance guidelines are not supposed to have teeth. It is meant to be a process that encourages companies to review their corporate governance procedures and then report to the marketplace’. 25

**(c) The Uhrig Review**

The third area of importance to the governance landscape is the review that was led by Mr John Uhrig AC into the corporate governance of statutory authorities and office holders, with particular attention being paid to those that impact on the business community. As Senator Minchin observed, following the announcement of the review by the Prime Minister 26:
‘Good corporate governance is crucial to the performance of both the private and public sector entities. We have seen in recent times the effect poor corporate governance has had on organizations in the private sector. Statutory authorities and office holders can have a major impact on business, especially in the areas of tax and regulation. The community is entitled to expect that statutory authorities and office holders will operate with the highest levels of good governance’.  

The focus of the Uhrig review was on a select group of agencies with critical business relationships, including the Australian Taxation Office, the Australian Competition and Consumer Competition, the Australian Prudential Regulation Authority, the Reserve Bank of Australia, the Australian Securities and Investments Commission, the Health Insurance Commission and Centrelink, addressing the following issues:

- existing governance frameworks;
- existing Government stewardship;
- good governance; and
- governance going forward.

In addition to analysing existing governance arrangements, it was also anticipated that the review would also address the selection process for board members and office holders, the mix of experience and skills required by boards, their development requirements, and their relationship to government. An expected outcome of the review is the development of a broad template of governance principles.

The government has received John Uhrig’s report but I understand that it is yet to finally consider its findings, principles and recommendations. In acknowledging the receipt of the Uhrig Report the Prime Minister said he expected the Government’s response to include a timetable for the implementation of the second stage to the review, which would involve assessing the performance of statutory authorities and office holders against the principles established by Uhrig. Reforms will be undertaken on a whole-of-government basis.

(d) Auditor independence

A particular issue that was exposed in the various reviews of corporate governance has been that of audit independence, which is at the heart of an effective governance framework. The debate over audit independence is not new, although it has attained an increased profile in the wake of the recent corporate difficulties and collapses in Australia and internationally. Audit bodies, and the accounting profession worldwide, have been actively engaged in clarifying and reinforcing independence for many years. However, recent events have put the debate onto a different plane with higher-level expectations being generated, particularly in relation to compliance.

While the ANAO takes a professional interest in this ongoing debate, it is also set apart from it by virtue of its statutory and functional independence. Nevertheless, there is also an operational imperative with the ANAO outsourcing a proportion of its audit work to private sector accounting firms. As well, with the increasing use of such firms
by the public sector for internal audit, we are often dependent on their work in coming to an audit opinion on organisations’ control environments and financial statements.

The independence of the Commonwealth Auditor-General is a key feature of our democratic system of government. Three elements are crucial to reinforcing the independence of the Office: the powerful Auditor-General Act 1997; direct financial appropriation as part of the Budget process; and the ability of the Auditor-General to develop and set professional standards for his/her Office. In practice, the latter are largely those set by the Australian Auditing and Assurance Standards Board (AASB).

Senator Murray, who has taken a particular interest in a number of these issues, outlined what he considered to be the four fundamental pre-conditions for more generic auditor independence as follows:

- the appointment process must be objective, on merit, and not influenced by improper considerations;
- security of tenure has to be guaranteed for a known and viable period;
- ending the appointment must be subject to known and proper criteria, not capricious or improper considerations; and
- remuneration has to be sufficient to ensure that the task can be properly fulfilled, sufficient to prevent improper inducements being attractive, and sufficient to cover reasonable risk arising from the task.30

The Statement of Auditing Standards (AUS 1) requires an auditor not only to be independent, but also to appear to be independent. For the purpose of this Statement:

(a) actual independence is the achievement of actual freedom from bias, personal interest, prior commitment to an interest, or susceptibility to undue influence or pressure; and

(b) perceived independence is the belief of financial report users that actual independence has been achieved.31

While AUS1 provides guidance to auditors when considering independence, Professional Statement F1, entitled ‘Professional Independence’32 addresses the principles of independence. Compliance with the new Professional Statement F1 has been required since 1 January 2003. The ANAO supported the Ramsay Report33 recommendation that the auditor should make an annual declaration, addressed to the board of directors, that the auditor has maintained his/her independence in accordance with the Corporations Act 2001 and the rules of the professional accounting bodies. I was personally pleased to see this incorporated into the Draft CLERP 9 Bill. I should note that, pursuant to that Act, the Auditor-General is a registered company auditor.

The issues relating to independence are difficult, particularly in the light of the relatively recent report on HIH 34 (which include reinforcing the independence of auditors). However, the Government’s legislative proposals set out in the Draft CLERP 9 Bill go a long way to improve the credibility of auditor independence and include a number of the HIH Report recommendations referred to earlier. The proposed Bill establishes a general requirement for auditor independence in the Corporations Act.
The CLERP 9 policy paper proposed a general statement of principle requiring the independence of auditors which was based on the relevant recommendation in the Ramsay report. The general requirement for auditor independence contained in the draft Bill is based on the CLERP 9 proposal together with a number of important refinements recommended by the HIH Royal Commission. The draft Bill (proposed S 324 CA) prohibits an individual auditor, an audit firm or an audit company from engaging in audit activity in relation to an audited body at a particular time if:

- a conflict of interest situation exists in relation to the audited body at that time;
- the individual auditor, the audit firm or the audit company are aware that the conflict of interest situation exists; and
- the individual auditor, the audit firm or the audit company does not take all reasonable steps to ensure that the conflict of interest situation ceases to exist, as soon as possible after the relevant person becomes aware that the conflict of interest situation exists.  

The draft Bill (proposed S 324 CB) defines a conflict of interest situation exists in relation to an audited body at a particular time, if circumstances exist at that time that:

- impair, or might impair, the ability of the auditor, or a professional member of the audit team, to exercise objective and impartial judgment in relation to the conduct of an audit of the audited body; or
- would give a person, with full knowledge of the facts and circumstances, reasonable grounds for concern that the ability of the auditor, or a professional member of the audit team, to exercise objective and impartial judgment in relation to the conduct of an audit of the audited body is, or might be impaired.

A very useful table setting out the requirements for independence is included in Chris Brown’s (Senior Associate, Minter Ellison Lawyers) article in the latest Journal of CSA. As Chris observes, proposal S 307 C requires auditors to make a declaration that they have complied with the auditor independence requirements in the Act and with any applicable code of professional conduct. The declaration is absolute (that is, it is not opinion-based and there is no due diligence defence).

As the United States Panel on Audit Effectiveness noted in its review of the current audit model:

> Independence is fundamental to the reliability of auditors’ reports. Those reports would not be credible, and investors and creditors would have little confidence in them, if audits were not independent in both fact and appearance. To be credible, an auditor’s opinion must be based on an objective and disinterested assessment of whether the financial statements are presented fairly in conformity with generally accepted accounting principles.

In my view, the questions about possible conflicts of interest, audit partner rotation and selection of auditors are central to the roles and responsibilities of audit committees as
part of the corporate governance framework. One challenge is, therefore, how to strengthen those roles to enhance their effectiveness and credibility in the eyes of both internal and external stakeholders. However, I note that an ASIC survey of auditor independence found that ‘it was not normal for the level of non-audit services to be given consideration by the board or the audit committee’. In fact, usually the Chief Financial Officer was the primary person responsible for engaging the external auditor in these roles.

The Big Four accounting/auditing firms have taken a range of actions to enhance the perception and the reality of the independence of their auditing roles from their other consulting/advising activities, most dramatically in creating separate and distinct bodies and/or introducing independent oversight. The latter can be illustrated by two different approaches taken by PriceWaterhouse Coopers (PWC) and KPMG Australia. PWC has created an Audit Standards Oversight Board to assess its systems relating to the monitoring of control, independence and professional education in respect of financial statements audits of publicly listed companies. KPMG Australia’s Ethics and Conflicts Committee has initiated independent reviews of its processes and policies in respect of independence, conflict resolution and quality controls. These are illustrative of the seriousness with which the Profession is addressing the ‘independence’ issue.

The recent series of high profile Australian corporate collapses has certainly brought attention to the issue of the particular roles and responsibilities of both private and public sector auditors in the Australian context. Citizens are more aware of governance issues than ever before. The public expects that auditors will alert shareholders or other stakeholders to the fundamental soundness (or otherwise) of business entities. It should also be noted, however, that the mere fact that auditors are independent will not save companies from collapse or agencies from the impacts of poor management. As noted in a recent legal update on corporate governance:

‘It is clear that the most rigorous and independent audit will not save a company with poor management and business practices from insolvency’.

This view has also been endorsed by the Chairman of the Australian Securities and Investments Commission (ASIC) who noted that, when it comes to a company’s compliance and accounting standard, ‘the final buck stops with the board’ rather than with company auditors. Auditors do, however, have a very important role to play in terms of providing advice that draws on their broad range of experiences, which may range across the public and private sectors. Any concern and/or suggestions should be conveyed in the audit management letter and/or discussed directly with the board of directors, who actually appoint the auditors in the private sector. One issue is whether, how, and to what extent, should the contents of such a letter be conveyed to other stakeholders.

However, I cannot overstate the fact that the ANAO operates in an advisory capacity, rather than participating directly in decision-making by public sector managers. While I urge my officers to ‘stand in the managers’ shoes’ in order to understand the complexities of the particular business environments under review, it is for the managers themselves to decide whether or not they will act on ANAO or other advice
with reference to their particular risks and opportunities. This is one essential difference between management consultancies and the public sector audit approach. Our 'observer status' as public sector auditors reduces the risk of conflict of interest issues arising in the course of our work. Nevertheless, that does not absolve us from any responsibility to the Parliament for our views and actions.

The ANAO, in its submission to the JCPAA Review (Report No 391), indicated that there is a range of steps that could be taken to strengthen the independence of auditors and provide greater public confidence in their performance and the role that they have in adding credibility to financial reports prepared by companies, including:

- underlining the independence of auditors in statute;
- enhancing the role of audit committees in corporate governance;
- improving the disclosure of ‘other services’ provided by auditors;
- encouraging the profession to tighten current guidelines on ‘other services’ work that auditors are able to undertake;
- encouraging the rotation of auditors after a suitable time period, for example, seven years; and
- encouraging the wider involvement within the profession of users and preparers of financial statements and reports, particularly in the setting of auditing standards and guidelines.

Clearly, the thrust of these suggestions have been taken up by Government. However, I would like to emphasise the point regarding the importance of an effective audit committee to, not only to good governance arrangements generally, but also in the private sector, to strengthening auditor independence. In order to maintain independence, most authoritative commentators recommend that, in the private sector, either the audit committee comprises only independent directors, or includes at least a majority of independent directors. The fundamental position is that an audit committee should be in a position to discuss matters with auditors freely and frankly without the constraint of having senior management on the committee. As Chris McRostie, the chief executive of the Institute of Internal Auditors, has commented:
the very least, I would suggest that the Board Chair or agency CEO should not chair the committee. The ANAO has such an independent chair for its own audit committee.

(e) International Harmonisation of Accounting and Auditing Standards

The last issue I want to discuss in this changing landscape is the reform of the accounting and auditing environment relating to the harmonisation (or adoption) of international accounting standards. Company boards and audit committees should be well aware of the decision announced by the Financial Reporting Council (FRC) in July 2002 to work towards implementing the International Financial Reporting Standards (IFRS) in Australia for the financial years commencing on or after 1 January 2005. The FRC is established under the Australian Securities and Investments Commission Act 2001 and is the peak body responsible for the broad oversight of Australia’s accounting standard setting process for the private, public and not-for-profit sectors.

The FRC supports the Australian Accounting Standards Board (AASB) and the AASB’s work towards harmonising its standards with those of the International Accounting Standards Board (IASB). The FRC has required the AASB to refer to the adoption of international standards. Following the statement by the FRC, the AASB announced its convergence (now adoption) strategy, which includes the decision to continue to issue one series of sector-neutral Standards applicable to both for-profit and not-for-profit entities, including the public sector. No one pretends that the transition will be easy. Some critics have raised issues about the costs involved, as well as the resulting quality of accounting information and its contribution to good corporate governance. The two major accounting bodies in their submission on the CLERP 9 draft bill suggested that the proposed Financial Reporting Panel (FRP) should be under the auspices of the FRC and its powers include ‘a mechanism for offering assistance where there are accounting standards interpretation issues before financial statements are finalised (a HIH recommendation).

From a private sector viewpoint, a single set of high quality accounting standards, which are accepted across major international capital markets, would greatly facilitate cross-border comparisons by investors; reduce the cost of capital; and assist Australian companies wishing to raise capital or list overseas. From a public sector perspective, it would aid transparency and accountability. In particular, over time, such standards would facilitate an improved comparison between the operations of the public sector and private enterprise for those functions and services that could be provided by either group, whether in partnership or separately. A single set of high quality auditing standards would also enhance the reputation and credibility of the auditing profession and help restore public confidence in it. This has also been of major concern to the International Federation of Accountants (IFAC) which commissioned a recently released report entitled ‘Rebuilding Public Confidence in Financial Reporting’.

There is no room for complacency for more than 20,000 reporting entities in Australia in meeting the timetable for the adoption of international accounting standards (now referred to as the International Financial Reporting Standards (IFRSs)) by 1 January 2005. For accounting purposes, this effectively means that organisations will have had to make the shift to the new framework by 1 July 2004 (1 January 2004 for those reporting on a calendar year basis). Indeed, the former Chairman of the Australian Accounting Standards Board expressed the view that boards and audit committees
should have a standing agenda item dealing with the transition, especially given the proposed requirement for comparative figures for the first reporting period.\textsuperscript{54} I note that ASIC’s Chief Accountant was recently reported as indicating there will be no relief for Australian companies in these timing requirements.\textsuperscript{55} A recent survey of public and private Australian organisations showed that less than half of the respondents had identified the main changes that will affect their organisations.\textsuperscript{56} However, there may be some relief if there is a dispensation from the requirement for comparatives at the outset.\textsuperscript{57}

This is also a major issue for the public sector. It will be a significant challenge for agencies to meet these tight timeframes, and will depend in large part on the extent to which agency audit committees have come to terms with the implications of the revised standards for corporate governance and reporting. At the Federal Government level, the onus is particularly on the Department of Finance and Administration, in conjunction with the ANAO, to provide suitable guidance material, as well as organise timely awareness-raising web-based and face-to-face information sessions, such as implementation workshops (the workshops were held in the last week in November and the first week in December with an update in April/May 2004).

While the accounting profession as whole will be busy with this work, the public sector has the added task of considering the harmonisation (or convergence) of Government Financial Statistics (GFS), used in the Federal Budget, with Australian Generally Accepted Accounting Principles (GAAP). These initiatives indicate the gradual acceptance of the notion of ‘one set’ of standards or at least one standards setting body. The aim of this work is the development of an Australian accounting standard for a single set of government financial reports to reduce existing levels of confusion, and to aid comparability and transparency. The recommendation from the Budget Estimates and Framework Review for the harmonisation of GFS was taken up by the FRC in December 2002, when it announced the broad strategic direction for public sector accounting standard setting. The FRC announced:

‘The Board should pursue as an urgent priority the harmonisation of Government GFS and GAAP reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements’.\textsuperscript{58}

The Financial Reporting Council has set the broad strategic direction for the Australian Accounting Standards Board in relation to this project. The Board issued a timetable in June 2003 for the project with an Exposure Draft planned for May 2004. This will not affect the 2003-04 financial statements. Moreover, the Board has also recently set up a GAAP/GFS Convergence Project Advisory Panel which has been asked to provide comments on a recently available Consultation Paper by 31 January 2004. The AASB will consider the Panel’s comments in making its final decisions for inclusion in the Exposure Draft. Some convergence issues were recently outlined at the CPA Australia National Public Sector Convention.\textsuperscript{59}

Turning briefly to the area of auditing standards, under the CLERP 9 proposals the Government is seeking to expand the responsibilities of the FRC to oversee auditor
independence requirements in Australia, including auditing standard setting arrangements. The latter will be achieved by reconstituting the existing Australian Auditing and Assurance Standards Board (AuASB) with a government appointed Chairman under the auspices of the FRC. Auditing standards will have the force of law on the same basis as accounting standards. The Professional bodies have some difficulties with these latter proposals, noting that auditing standards already have the force of law through the Companies Auditors Liquidators Disciplinary Board (CALBD) under the Corporations law. As well, ‘Australianising’ auditing standards having specific Corporations Act backing would undermine the aim of harmonisation with International Auditing Standards.

III. ANAO SUPPORTING THE PUBLIC SECTOR

Auditing the Public Sector

The ANAO provides independent assurance on the financial statements and financial administration of Commonwealth public sector entities to the Parliament, the Executive, Boards, Chief Executive Officers (CEOs) and the public. While, to many, this is the essence of public sector auditing, we also aim to improve public sector administration and accountability by adding value through an effective program of performance audits and related products, including Better Practice Guides (BPGs).

The communication of our outputs and their outcomes through representation at a range of Parliamentary Committees, agency audit committees and Boards of government authorities and companies, is also a growing element of our value adding activities. Additionally, the ANAO seeks opportunities to contribute to the development of the accountability framework, including better practices and standards (as well as harmonisation) in public sector accounting and auditing. Involvement and communication are important drivers, supported by an intensive, and extensive, audit work program.

The ANAO is committed to providing an integrated auditing framework with the objective of delivering high quality audit products that maintain and improve the high standards and professionalism of our audits and related services. These are the means to contribute to better governance.

Like all public sector agencies negotiating the challenges of the changing governance environment, the ANAO has strengthened its own business practices to respond to new demands and directions - the ANAO has responded both at the strategic and tactical levels. On the strategic level, we have given specific attention to relationship management that demonstrates integrity and transparency, as well as to well-targeted products and services that provide assurance and value for money. At the tactical level, we have focussed on ensuring that our work continuously improves as we demonstrate accountability to Parliament, in terms of our legislative responsibilities, and for our overall results to all our stakeholders. Some insights into our audit approach and philosophy are provided below, followed by some comments on our latest guidance on public sector governance.
The Audit Work Program

As part of its commitment to transparency, we make the ANAO’s annual audit work program available on our website – www.anao.gov.au. While there is little discretion about the approximately 300 financial statement audits conducted each year, the audit topics for the more than 60 performance and other audit products conducted each year are generally selected on two grounds:

- the capacity of an audit to add the greatest value in terms of improved accountability, economy, efficiency and administrative effectiveness; and
- the desire to ensure appropriate coverage of entity operations within available audit resources over a reasonable period of time.

As public sector bodies do not operate in isolation from the wider community, a quite wide range of issues can impact on the sector as a whole as well on individual agencies. The ANAO recognises this and, accordingly, continually monitors the broader environment so that important issues can be identified and taken into account in the development of its annual audit work program. As well, with our direct involvement with entities in audit activity, and through regular liaison with entity management, including through audit committee activities, the ANAO is able to identify, and take into account, specific entity issues.

The themes, including the challenges that confront the public sector, continually change, reflecting a range of developments in the broader economic and social environment. However, corporate governance, at least in recent years, has become an enduring audit theme. Annual themes are identified as a basis for selecting topics to ensure that the audit program is targeted appropriately to add value to (improve the performance of) public administration. An important part of this planning process is the early engagement of relevant stakeholders, including agency heads, and the Parliament, through the JCPAA, to ensure that the work program is optimally targeted.

Role of audit in improving corporate governance

At a time of increasingly high expectations of corporate governance in both the public and private sectors, managers need access to information on better practice leadership, management, control structures and performance measures to reach the common and ambitious proxy target of ‘world’s best practice’. Public sector audit has an important role to play in supporting such practices and therefore contributing to a world class public service. However, there is the added obligation to ensure that audit opinions, recommendations and other related information are fully explained to all stakeholders, particularly to an audit committee and the general public. These groups are entitled to quality explanations of management and audit approaches, judgements and decisions that are clear and transparent.

The main roles for the ANAO in the governance framework are to provide assurance about conformance and performance and advice on change and its impacts across the public sector. This advice draws on a broad range of audit experiences, which may range across both the public and private sectors. The statutory independence of the Auditor-General, as well as access to expertise across all Commonwealth departments and agencies, gives public audit a unique position within the accountability framework.
In this regard, the ability of my office to investigate and report, freely and fearlessly, is crucial.

The ANAO provides this assurance and advice through the following suite of audit products.

**Assurance auditing**

Financial statement audits express an opinion on whether financial statements of Commonwealth Government entities have been prepared in accordance with the Government’s reporting framework and give a true and fair view (in accordance with applicable Accounting Standards and other mandatory professional reporting requirements) of the financial position of each entity as at year end, and the results of the entities’ operations and the entities’ cash flows.

In addition to the audit opinion on the financial statement, the ANAO provides each client with a report that deals with the results of the financial statement audit process – a report is also provided to the responsible Minister. The ANAO also now provides two cross-entity assurance reports each year to Parliament. The first details the results of an assessment of the control structure of major entities while the second provides a summary commentary on the results of all financial statement audits undertaken in the 12-month audit cycle ending in October of each year.

**Performance auditing**

The aim of a performance audit is to ‘examine and report to the Parliament on the economy, efficiency and effectiveness of the operations of the administration of the Commonwealth and to recommend ways in which these may be improved’. And are best described as an independent, objective and systematic examination of the operations of a body for the purposes of forming an opinion on whether:

- the operations have been managed in an economical, efficient and effective manner;
- internal procedures for promoting and monitoring economy, efficiency and effectiveness are adequate; and
- improvements might be made to management practices (including procedures for promoting and monitoring performance).

Performance audits are conducted in all ministerial portfolios with the main concentration being directed to portfolios with significant Government outlays or revenues. The performance audit reports are tabled in the Parliament (63 in the 2002-03 financial year) and all recent performance audit reports are also placed on the ANAO’s homepage at http://www.anao.gov.au, and summarised in the ANAO’s series of six-monthly activity reports.

Performance audits often involve assessments of governance, probity and the quality of management in individual agencies. While the auditor’s professional opinion in these cases is derived from compliance with rigorous standards and therefore provides a high level of assurance, it does not provide complete assurance as to the entities’ operations.
This ‘expectation gap’ is a complex issue that challenges the profession as much as it challenges our stakeholders. In considering whether performance audits should be legislatively enforced in the private sector, KPMG recently noted that there would first need to be reform to the liability requirements under which auditors in Australia operate (ie. either joint and several liability or unlimited liability).

Audit product continuum

In practice, the audit environment is more complicated than simply requiring performance and assurance audits. The ANAO attempts to provide an audit product continuum as a strategic approach to better governance. We fill the gaps between high-level performance audits and traditional financial statement audits with Better Practice Guides, financial reporting for agencies and statutory authorities, and Business Support Process Audit reports covering a range of issues challenging the APS. Our reports are treated as authoritative. Our annual audit of the Consolidated Financial Statements and our assessment of agency control structures, for example, provide a unique overview as to the ongoing financial performance of over 200 Commonwealth entities.

For the ANAO, a key issue is getting the balance right between control and innovation. The aim is to get the ‘right mix’ of products and services to enhance governance. In setting its agenda for the future, the ANAO relies on intelligence garnered through the review and analysis of Commonwealth entities as well as ongoing feedback and guidance from the Parliament and other audit clients as to the areas they see as adding most value to public administration.

In addition, I would also like to reiterate the point that, under the Auditor-General Act 1997, I am required to set auditing standards with which individuals performing Auditor-General functions must comply. This gives the ANAO the flexibility to set its own agenda and to develop appropriate auditing tools for the contemporary environment. In setting the standards, I acknowledge the commonality of professional requirements between private and public sector auditors and, as such, the ANAO auditing standards are formulated with regard to the auditing standards issued by the Auditing and Assurance Standards Board of the Australian Accounting Research Foundation. Consistency with international standards, including the International Organization of Supreme Audit Institutions (INTOSAI) Auditing Standards, and those of the International Auditing and Assurance Standards Board of the International Federation of Accountants is also a consideration.

Cross portfolio audits

Recent years have seen an increase in the number of ‘across the board’ issues and cross-portfolio audits undertaken that compare experiences in a range of agencies and entities. For example, the ANAO has recently undertaken cross portfolio analysis of, among other things, compliance with the 2001 Senate Order on commercial-in-confidence considerations in relation to listing of departmental and agency contracts valued at $100,000 or more on the internet. Other recent cross-portfolio audits include absence management in the APS, the management of Commonwealth guarantees, warranties, indemnities and letters of comfort; energy efficiency in Commonwealth agencies’ operations; and the payment of accounts
and Goods and Services Tax administration by small Commonwealth organisations.73

Our ability to compare operations across the public sector, and sometimes with the private sector, as well as our statutory independence, are significant strengths and add value to a wide range of stakeholders. This approach is becoming more important with the greater use of a ‘whole of Government’ approach to public administration. The notion is to tailor public services to the individual recipient in a ‘seamless’ manner. Major issues of governance arise, as I will discuss later.

In terms of benchmarking services across agencies, our products currently comprise functional reviews of the major corporate support areas. The overall results of these reviews are published generically and tabled in the Parliament. At the audit client level, a customised report is provided to all entities participating in the benchmarking study. Our most recent benchmarking studies have covered the following areas: people management in public sector agencies74 the internal audit function75; the finance function76; and managing people for business outcomes77. Finally, as well as benchmarking and analysing public sector performance, we compare our own performance to that of our peers in Australia and internationally.

**ANAO Guidance on Public Sector Governance**

A key element in the role of audit in improving corporate governance is providing advice on better practice. I will spend some time discussing, in more detail than my earlier references, the ANAO’s recently released Better Practice Guide titled - ‘Public Sector Governance – Volumes 1 & 2’78. However, before I do this, I thought it might be useful to put the public sector governance challenge in context by briefly outlining the complexity of this sector as a backdrop to my comments on the guide.

**Complexity of Corporate Governance in the Public Sector**

The main governance structures in the Commonwealth public sector can be illustrated by the following Figure drawn from the Better Practice Guide.79
The Commonwealth public sector has an extensive legal, regulative and policy framework (that government organisations must comply with and conform to) that regulate the activities of the Australian Public Service, Chief Executive Officers (CEOs) and their staff. The legal framework for governance in the APS is largely derived from:

- **the Financial Management and Accountability (FMA) Act 1997** which mainly applies to entities that are financially and legally part of the Commonwealth and do not own their own assets. These are typically ‘core’ government departments responsible for policy development but also include statutory authorities (some 17 Departments of State, five Parliamentary Departments and 58 prescribed agencies);

- **the Commonwealth Authorities and Companies (CAC) Act 1997** which applies to those Commonwealth entities which have been established as separate legal entities and can hold moneys in their own right (some 84 Commonwealth authorities and 28 companies). Some of these entities are predominately Budget-funded; others operate on a commercial basis.

- **the Public Service Act 1999** which sets out values and the APS Code of Conduct for Commonwealth employees.

The *FMA Act* requires CEOs to promote the efficient, effective and ethical use of Commonwealth resources for which they are responsible. It replaced voluminous and detailed rules and prescriptions with principles-based legislation. The main purpose of the Act is to provide a framework for the proper management of public money and public property. Thus, legislatively, and in practice, the CEO is responsible for the administration of an agency - the ‘buck’ stops with them, in most cases. It would be fair to say that, with the greater devolution of authority to agencies in recent years, the responsibilities on public sector CEOs have probably never been greater.

For CAC bodies, we have seen the duties of directors and officers of these bodies more closely align with those of company directors following the recent changes to the public...
and private sector legislative framework. This has facilitated the flow of experienced directors between the two sectors and is enhancing the quality of Australian Boards.81

The formal framework for corporate governance goes beyond these three Acts to include the broader constitutional powers affecting public sector powers, appropriations and responsibilities as well as supporting legislation such as Administration Arrangement Orders, the Remuneration Tribunal Act 1973, any enabling legislation of an organisation and other legislation outlined in Figure 2 following.

Figure 2: Legal elements affecting governance in the Commonwealth

![Diagram of legal elements affecting governance in the Commonwealth]

Source: Department of Finance and Administration (2002)82

The above represents a formidable body of law. As I said earlier, in addition to this legislation, Commonwealth government entities are subject to a variety of regulations and policies which also impact on their governance, such as the outcomes and outputs reporting regime, the growing emphasis on risk management and insurable risk, and the need for effective coordination of Whole-of-Government and inter-agency issues, including across levels of government and across sectors of the economy.

While a similarly complex diagram could be developed for many in the private sector, there are marked differences between the governance of private and public sector entities. In the public sector, quite complex relationships can exist between those with primary accountability responsibilities, especially the Parliament, Ministers, the CEO and boards. Consequently, there can be far greater management complexity in terms of stewardship, accountability and legislative requirements than is the norm in the private sector. In addition, the public sector typically has more explicit and stringent value systems that emphasise legislatively based notions of ethics and codes of conduct. For example, as observed by Professor Richard Mulgan of the Australian National University:

‘...private sector companies operating under private law are not normally held to the same common law standards of rationality and fairness that the public law imposes on government agencies under the principles of administrative law’.83
Hence, corporate governance is often relatively more straightforward in the private sector as the roles and responsibilities are more clearly defined and generally involve a narrower range of active stakeholders and less complex objectives and strategies.

This is less so for Government Business Enterprises (GBEs) and other CAC agencies that are subject to the Corporations Act, the CAC Act (and, for Commonwealth GBEs, Governance Arrangements for Commonwealth Government Business Enterprises) even with the added complexity of Ministerial responsibilities and oversight. In contrast, publicly-listed private companies are subject to the Corporations Act and tend to have much more clearly defined and unambiguous Board accountabilities and responsibilities. CAC type agencies are also often required to meet broader government policy objectives, such as delivering ‘value-based’ services, or prescribed services, to selected clients, in addition to meeting financial objectives. While convergence between the two sectors is lessening such differences, it nevertheless highlights the variations in modern governance demands across organisations both within and across sectors of the economy.

The governance of agencies subject to the FMA Act, however, often differs significantly from that of private sector corporations. The FMA Act prescribes that CEOs of FMA agencies are ultimately accountable for the performance of the agency, generally making them effectively the CEO and Chairman of the Board, in the many cases where Advisory Boards are in place. In these cases, the Boards support the CEO rather than the CEO being held accountable by the Board. Instead, the CEO is responsible directly to the Minister, who is the shareholder or citizen representative, or ‘trustee’ in the view of some governance commentators.

As most Commonwealth agencies now have procedures in place to help them comply with the legislative requirements depicted in Figure 2, the next major task is to draw these procedures together so that the day to day operations of organisations supports robust governance, which in turn supports good performance. The ANAO has adapted a model developed by the Queensland Department of Transport to show the elements of good governance and how they relate to each other as shown in Figure 3 below.
While each element is important and useful in itself, the relationships that are established between them are crucial to the successful performance of an organisation. Hence the aim is not only to have the necessary elements in place, but also to create positively reinforcing links between all of those elements. While the latter are usually well understood and have been put in place in many Federal, State and Local Government bodies, the on-going problem has been to secure full integration with a strategic framework that is guided, and even driven, by ‘tone at the top’ and a culture that is fully supportive of the approach.

**The Better Practice Guide**

This document was produced to assist public sector organisations to meet the current pressures, and expectations, of their governance framework, processes and practices. In my introduction to the Guide, I make the point that it is not prescriptive and has no legislative status. Governance arrangements must be tailored to individual agency circumstances, based on a risk management approach that considers potential benefits and costs associated with activities that contribute to meeting specified objectives. It is not a one size fits all situation, as many have noted - effective governance arrangements are those that are tailored to match individual agency circumstances, the guide attempts to provide an appropriate range of options. I should mention that the guide is generally available both in hard copy, and from the ANAO website.

The guide is aimed at all levels in an organisation. While it provides guidance specifically to those working at the top, it also seeks to assist people working at all levels of an organisation to more fully understand the principles of better public sector governance and to know more about how to apply them. The Guide therefore attempts to cover the full range of public sector-specific governance issues as well as providing...
more detailed guidance on specific aspects of governance that are of particular concern to public sector organisations.

A theme running through the Guide is the basic principle that actions are more important than words. The ANAO is trying to make the point that corporate governance is largely the exercise of common sense. Its application depends on circumstances and context, and a range of other intangibles: such as judgements about and interpretation of what is appropriate for individual organisations. The basic message is that the intent and spirit of the law are just as important as the letter of the law. Accordingly, when it comes to public sector governance, better practice requires that governance structures be supported by the application of core governance principles which reflect, importantly, public sector values and codes of conduct.

The guide is in two parts. The first deals with overall frameworks, processes and practices, while the second is in module format, and discusses governance options for specific issues in more detail. The plan is to have a guide that is a living document, with ongoing relevance to the national debate. In future, the guidance modules in Volume 2 can be updated as governance arrangements continue to evolve and other aspects of governance gain prominence. Overall, the goal is to retain the fundamental emphasis on practice designed to assist agencies to actually make a difference to what they do.

To ensure that the Guide focused on current issues of concern to the public sector, the Office conducted interviews with senior Commonwealth Public Sector agency heads and board members. Their responses to questions about what they considered were the important and emerging governance issues, and which issues they required guidance on, strongly influenced the contents and nature of the guide. We also consulted widely in drafting and finalising the Guide.

This new Better Practice Guide is different to the previous two we produced, which had more specific purposes. The first guide, published in 1997, dealt with the application of corporate governance in public sector agencies, and in particular made the case for the establishment of executive boards for agencies. It predated the Financial Management and Accountability Act 1997 and the Commonwealth Authorities and Companies Act 1997. The ANAO issued the second guide as a discussion paper in 1999, which was designed to assist members of the boards and senior managers of CAC Act bodies to evaluate their governance frameworks and make them more effective. With the publication of the third, and current guide, the scope has widened again, as I have already mentioned.

As a series, these publications demonstrate the ongoing interest in and contribution to debate on good governance by the ANAO. I particularly want to draw your attention to the framework, processes and practices of good corporate governance outlined in Part 3 of Volume 1 of the guide. A key element is risk management which is also covered there. I also refer you to my recent paper – ‘Strategic Insights into Enterprise Risk Management’ – for a fuller treatment of the issue. To reinforce the issue, Don Argus believes that governance is about the management of risk including operational, financial, environmental, social, legal and sovereign. ‘Boards need to understand the risk/reward equation. There is no simple answer and it is wrong to generalise because industries and entities have different risk appetites’. In that context, the Argus
definition of corporate governance includes the need to ensure that entities control and report on material business risk. He believes ‘a great audit committee won’t make a company great but a great company will have a strong audit committee’. 87

**Cross Agency Governance Issues**

This is an important aspect of public administration as governments seek to address increasingly complex and wide-ranging policy and operational issues in ‘joined-up government’ or more collaborative type arrangements. Better practice in this area of public administration is still developing and, to some extent, so is the better practice in corporate governance. However, the specifics of the governance arrangements need to match the scale, nature and complexity of the task or activity. A key determinant is the extent to which the activity falls primarily within the province of one agency or falls more or less across two or more agencies.

In ‘lead agency’ arrangements, it may be the case that the lead organisation has primary policy responsibility (that is, rather than only an operational or service delivery role), effectively becoming an actual or de facto purchaser of services from one or more other agencies to facilitate implementation. Such arrangements are particularly common in the social welfare area. Partnership or joint venture forms may also involve parties that are predominantly concerned with policy matters joining forces with one or more other agencies that have an operational focus in delivering or overseeing the delivery of programs, increasingly through the use of computing and communication technology.

Where more formal mechanisms are contemplated (for example, service level agreements, contracts, joint boards or committees) it is important that the associated documentation clearly articulates:

- the objectives of the arrangement, including desired outcomes, and timeframes;
- the roles and responsibilities of the parties, including their capacity to contribute, and positions on governing boards or committees;
- the details of the activity, including specifications of services or projects to be undertaken;
- resources to be applied by the parties and related budgetary issues;
- the approach to identifying and sharing the risks and opportunities involved;
- agreed modes of review and evaluation; and
- agreed dispute resolution arrangements.

Guidance Paper No. 7 provides the elements of better practice as well as setting out the forms of cross-agency governance. The arrangements are likely to be more complicated with the involvement of various levels of government and/or the private sector where there is a real ‘partnership’ involvement.

**Overview of audit activities**

In summary, our strategic approach allows us to target areas of most interest and value to the Parliament, the Government and the Australian Public Service (APS). We
remain responsive to the needs of a changing public sector and endeavour to ensure that better practice and lessons learned in individual agencies both in Australia and overseas are disseminated across the APS. For many years, we also responded to the implementation of New Public Management (NPM) with a series of products focussing on the challenges and opportunities inherent in the NPM approach. Audits in recent years have covered, among other things, outsourcing, asset sales, contract management and networked service delivery. However, among other factors, a loss of corporate knowledge has required a greater focus on the control environment, including systems, record-keeping and adherence to legislative requirements.

It is my aim to ensure that ANAO audits continue to encourage improvements in the APS. As technology changes, as services change, and new ways of delivering services are introduced, including a much greater focus on risk management, so our auditing methodologies and practices will need to adapt for example, to provide continuous reporting. What will not change is our commitment to improving public sector performance and accountability. As with the private sector, these requirements will extend to the notion of corporate sustainability under so-called triple bottom line (TBL) reporting. The ANAO has had its first experience of independent verification of a TBL Report by the Department of Family and Community Services recently. The then Minister noted that TBL reporting is recognised by the Australian Government ‘as a useful way for organisations to demonstrate their contribution to Australia’s wellbeing and prosperity.

IV. CONCLUDING REMARKS

As the governance and accountability environment becomes more complex, the ANAO performs a crucial function in providing assurance on performance across the public sector as well as providing practical guidance, such as our latest Better Practice Guide – Public Sector Governance, which is proving to be a useful contributor. This is important as agencies increasingly find new methods to deal with common issues, and form alliances and partnerships, including with the private sector, to deliver government services. Consideration of the corporate governance procedures underpinning these new more complex administrative arrangements, and promotion of better practice examples, is a key feature of many ANAO audit reports.

To deal successfully with the challenges, we have to learn from each other. This requires a continuing open dialogue, and sharing of experiences from both the private and the public sector, in Australia and overseas. As the auditor for the Commonwealth, the ANAO will continue to play our part in contributing to broader debates over accounting and governance. In addition, we will continue to assist agencies in dealing with the challenges facing them. This is important so that Parliament can obtain maximum value from agencies’ financial statements, as well as be assured as to the effectiveness of agencies’ governance and accountability arrangements.

The public service in general, and the ANAO in particular, is characterised by an emphasis on operational transparency, integrity, accountability and proper stewardship of public resources. This provides an excellent platform on which to build the new directions in accounting and auditing, and should, in turn, provide the level of assurance required by stakeholders, Parliament and the public. Harmonisation of
national accounting and auditing standards with international standards and/or the adoption of the latter standards reflects the realities of global pressures and the greater convergence of various sectors of the economy. The pressure is very much on improved performance and achieving required results. However, this still should not be at the expense of due process, or the public interest, or at the expense of high-level values, ethics and professional codes of conduct. ‘At the core of good governance is a sound culture that allows the principles of good governance to thrive’.  

Corporate governance is set to remain among the “hottest” issues for some time to come as evidenced by recent headlines such as, ‘Governance: there’s no escape’. Drawing on Don Argus’ observation that ‘any new standards or guidelines [and I include the ANAO’s new Corporate Governance BPG] should not simply become a question of ticking the box’. Achieving an appropriate balance between conformance and performance is at the heart of sound governance. This very much depends on the governing body and the ‘tone at the top’. While results are of importance, it is often how we achieve those results, and our credibility (and trust) with our stakeholders, that will ultimately determine our success whether we are in the public or private sectors.

The success of governance and auditing in a changing environment is mainly related to achieving a ‘culture’ of openness (transparency), honesty and integrity. These in turn depend on the values and ethics of our people which we can support through our structures, processes and outcomes we want to achieve. That is our set of common challenges in all sectors of the economy.
NOTES AND REFERENCES

13. The following overview of the framework of the CLERP (Audit Reform and Corporate Disclosure) Bill 2003 is based on the introduction to the Bill found at www.treasury.gov.au/documents/700/PDF/01
14. For a full treatment of the changes between the original CLERP 9 Paper and the draft Bill see the Ernst & Young October 2003 Paper ‘Implementing CLERP 9’ at www.ey.com/au/corporategovernance
15. The following overview is based on the introduction to the Bill found at www.treasury.gov.au/documents/700/PDF/01
18. Australian Institute of Company Directors, media release 8 October 2003, Proposals for strengthening corporate disclosure welcomed: Directors and media release 9 November 2003, Directors willing to ensure legislative intentions are met: CLERP 9, found at www.companydirectors.com.au
20 Campbell, Senator, The Hon Ian. 2003, Address to the ASIC Summer School, Sydney, March, p. 4
23 Arbouw, John, 2003, ‘Corporate Governance Time Bomb’ Company Director, Vol 19 No 3, April
36 Ibid.
37 Brown, Chris 2003. CLERP 9 Bill: no real surprises, but plenty of food for thought. Keeping Good Companies, Journal of Chartered Secretaries Australia Ltd. VOL 55 No. 11 December p.675 (Figure 1).
38 Ibid, p 676.
44 Quoted in Auditors could be whistleblowers, ASIC chairman proposes, Committee Bulletin Vol. 13 no. 3, February 2002, 16-28, p. 3.


48 AASB Action Alert Number 52 – August 2002.

49 Haswell, Stephen and McKinnon, Jill 2003, *IASB Standards for Australia by 2005: Catapult or Trojan Horse?* Australian Accounting Review Vol 13 No 1, March. pp.8-16


51 CPA Australia 2003. *Accounting bodies lodge major submission on CLERP 9 draft bill.* 10 November, found at www.cpaaustralia.com/01_information_centre/16_media_releases/2003/1_125/11/03.


62 In 2002-03, the ANAO published 63 audit reports and 5 Better Practice Guides. (performance audits products), and 8 information services products (including BPGs and benchmarking material. This is in addition to the issue of 290 financial statement audit opinions.


65 The Auditor-General Bill 1996.
It should be observed that risk management can minimise the uncertainty surrounding innovation, by requiring the assessment of a range of options in terms of the likely opportunities for improved service delivery and program outcomes, and what needs to be done to manage the risks associated with each option. See, for example, Northern Ireland Audit Office 2002 Investing in Partnership: Government Grants to Voluntary and Community Bodies, Belfast, 16 May.


90 Ibid. Minister’s Statement p.i.

91 Ernst & Young 2003, Corporate Governance Update – Special Edition, November, p. 2

92 Durie, John (Chanticleer) 2003, ‘Governance there’s no escape’, The Australian Financial Review, 24 July, p. 64