International Quality & Productivity Centre Seminar

Achieving Better Practice
Corporate Governance in the Public Sector

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ACHIEVING BETTER PRACTICE CORPORATE GOVERNANCE IN THE PUBLIC SECTOR

1. Introduction

Corporate governance has emerged from obscurity into being a mainstream topic.¹

I am pleased to open this conference by discussing the essential characteristics that enable better practice corporate governance in the public sector. This topic is again receiving extensive national interest and, in my view, has become a centrepiece in the way we think about organisations and their conduct, operations and results.

In discussing better practice governance, I will emphasise that the fundamental elements of governance are well-known throughout the public sector in Australia. However, more importantly, I will stress that good governance requires a holistic, integrated approach to implementing these components. Moreover, I note and will elaborate later, that this is becoming an increasing difficult challenge as the public sector operating environment becomes increasing complex, for example because of ‘joined-up’ or connected government initiatives and developments in information technology and communication, and greater demands being made by stakeholders for both assurance and results. There are many lessons to be learnt, not least about the considerable diversity of organisations in the public sector and the wide-ranging scope to achieve similar outcomes or results in different ways.

I am sure that no-one at this conference would doubt the importance of good corporate governance. The recent collapses of Enron in the USA, and HIH and OneTel in Australia have stimulated considerable debate about the importance of effective corporate governance in the private sector. While the Australian public sector has not provided examples of spectacular governance failures, analysis undertaken for me by the Australian National Audit Office (ANAO) clearly shows that considerable scope still exists for Commonwealth entities to improve many aspects of their corporate governance. This also includes arriving at a more appropriate balance between ‘conformance and performance’, rather than simply reflecting a perceived ‘box-ticking’ approach to corporate governance based on the UK Cadbury Committee’s Code of Best Practice².

In the opinion of the Chairman, Australian Securities and Investments Commission (ASIC), we have been through a period of complacency when corporate governance became formalistic, even ritualistic.³
What is corporate governance?

While the term ‘corporate governance’ has no single accepted definition. It is generally understood to encompass how an organisation is managed, its corporate and other structures, its culture, its policies and strategies, and the ways in which it deals with its various stakeholders.

I would like to emphasise that governance has a very broad reach – going well beyond management. Managing involves administrative, supervisory and facilitating tasks associated with on-going organisational operations. Executives and managers administer and lead organisations through developing business strategies, and implementing and monitoring them on a day-to-day basis. Boards and other governance structures deal with overall organisation policy, direction and culture. They provide the ‘tone at the top’ which is essential for sound corporate governance. Whoever governs exercises ultimate authority within organisations and is finally held accountable for overall organisational performance by stakeholders. In essence, those who govern authorise what organisations do. Executives manage organisations by virtue of the authority delegated to them by those who govern.4

Thus, management is but one part of governance. The Netherlands Ministry of Finance observes that ‘government governance comprises management – control – supervision – accountability.’5 The main point I would like to make is that effective governance makes management accountable to its many stakeholders, through appropriate management structures, reporting requirements, control structures and the many other elements of corporate governance discussed later in this paper.

The legislative framework

Comprehensive legislative structures regulate the activities of the Australian Public Service, of Chief Executive Officers (CEOs) and their staff. They may also impose obligations on client groups. The legal framework for governance in the APS is derived from three main sources:

- the Financial Management and Accountability (FMA) Act 1997;
- the Commonwealth Authorities and Companies (CAC) Act 1997; and
- the Public Service Act 1999.

The FMA Act mainly applies to ‘core’ government departments responsible for policy development while the CAC Act applies to more commercial ‘non-core’ government activities, including government business enterprises.

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

Thus, legislatively, and in practice, the CEO is responsible for the administration of an agency. The buck stops with them, in most cases. And 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.

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

**The corporate governance continuum**

The literature on corporate governance insists that corporate governance frameworks must be tailored to each organisation as ‘one size does not fit all’. Differences in corporate governance relate to the complexity of entities in terms of the nature of their outputs and the type and range of stakeholders they are accountable to.

It should be stressed that fundamental differences arise in the governance of private and public sector entities. As I have stated previously elsewhere, the political environment, with its focus on checks and balances and value systems that emphasise legislatively based notions of ethics and codes of conduct, implies quite different emphases in corporate governance frameworks from those of a commercially-oriented private sector firm or corporation.

Fundamental differences also arise in governance between public sector bodies depending, for example, whether they are part of ‘core’ government or ‘non-core’ government. Thus a ‘corporate governance continuum’ has emerged which traverses a range of governance arrangements and structures. This continuum suggests that governance arrangements become progressively more complicated and inter-related, moving from private sector entities, through Government Business Enterprises (GBEs) and other CAC agencies, to ‘core’ public sector FMA agencies.

**Structure of paper**

Against this background, my presentation falls into three major sections. Section 2 outlines the main elements of governance in the public sector. Section 3 discusses how these elements can be implemented in practice to enable effective and better practice governance. It will examine governance principles, ethical behaviour, management structures, controls, risk management, performance measurement and the achievement of a reasonable balance between the often conflicting demands of conformance and performance. Section 4 discusses emerging issues in public sector governance, including joined-up or connected government, electronic government and the changing nature of audit.

Not surprisingly, I will speak from a public sector perspective but will often make suitable comparisons with, and observations about, private sector experiences.
2. **Elements of Corporate Governance**

First, I would like to outline very briefly the fundamental accountability framework for public sector entities and the role of the ANAO, before focussing on corporate governance of public sector entities.

*Figure 1: Public sector accountability process*

![Diagram of Public Sector Accountability Process](source: International Federation of Accountants (2000))

Figure 1 shows the separation of executive and legislative functions of government, whereby the Parliament (legislature) provides the authority for the acquisition and use of resources to fund the overall public sector plan while the elected government (executive) is responsible for specific resourcing, planning, directing and controlling of public sector operations. The legislature has the right and responsibility to hold the government accountable for its management of public sector activities. One of the main ways it discharges this responsibility is through auditing and reporting by the legislated auditor - the ANAO.

Thus, one element of governance in the public sector involves ‘public governance’ and includes the systems of accountability to Ministers and in turn, Parliament. This will often dictate the high-level management structures of a public sector entity. Core mission, vision and objectives for public agencies are also often set at this level.

It is fair to say that most agencies have put in place many of the elements of good corporate governance. These include corporate plans setting out corporate objectives and strategies; public sector and/or agency values; business planning; audit committees; control structures, including risk management; performance assessment; and performance monitoring (including evaluation and review).

Figure 2 presents this perception of corporate governance diagrammatically. It illustrates the inter-relationship between all the elements of governance and thus the need to integrate them effectively in order to achieve good governance. It also
indicates the difficulty of balancing all these elements at any point in time, and over time, to provide the appropriate mix of conformance and performance (discussed in Section 2).

**Figure 2: Elements of governance of public sector entities**

![Diagram of governance elements]

Source: ANAO

There are other ways to represent corporate governance in the public sector. Again, this reflects the complexity of the governance framework and the diversity of approaches taken by public sector entities.

Bryan Horrigan, Professor of Law at the University of Canberra, regards corporate governance in both the private and public sectors as having the following dimensions:

- **Mission Governance** - Business planning.
- **Ownership Governance** - Multiple owners and multiple agencies and constituencies.
- **Structural Governance** - Two-tiered boards.
- **Strategy Governance** - Corporate and business plans.
- **Performance Governance** - Including organisational, individual, processes, outcomes and measures.
- **Conformance Governance** - Including compliance, due diligence, financial and legal risk management.
Decision–Making Governance - Including internal and external relationship management and communication.
Accountability Governance - Owners and shareholders as well as stakeholders.
Value-Capital Enhancement - Including long term sustainability of corporate capital, as well as ‘triple bottom line’ emphasis on financial, environmental, and social capital.

Regardless of which framework is used, good corporate governance in both the public and private sectors requires:

- a clear identification, and articulation of, the definitions of responsibility;
- a real understanding of relationships between the organisation’s stakeholders and those entrusted to manage its resources and deliver its outcomes; and
- support from management, particularly from the top of an organisation.

Our audits show that more work is still required in the Australian Public Service (APS) to present the elements of public sector governance in a meaningful way so that people in the organisation can readily understand and accept both their purpose and the manner in which the various elements combine to achieve required organisational performance and discharge expected accountability obligations. Success in these respects can do much to integrate these elements effectively into a sound governance framework.

3. **Key Steps to Enable Effective Corporate Governance**

Through the findings of audits undertaken by the ANAO, and by examining the corporate governance literature, I have identified six main principles that public sector entities must adhere to in order to effectively apply the elements of corporate governance to achieve better practice governance (Figure 3). Three of these elements – leadership, integrity and commitment - relate to personal qualities of those in the organisation. The other three elements – accountability, integration and transparency – are mainly a product of strategies, systems, policies and processes in place.
Leadership

Effective public sector governance requires leadership from the governing Board and/or executive management of organisations. An effective framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation’s stakeholders and those who are entrusted to manage resources and deliver required outcomes. In the public sector, this necessitates lucid and unambiguous communication with the Minister and clearly stated government priorities.

The CEO's role in governance is fundamental. An indication of an agency's effectiveness is the way in which the organisation as a whole works together under the CEO's leadership. Executive management must also have a collective ability to provide leadership; to communicate a coherent set of governance principles throughout the agency; and to ensure the operation of the checks and balances which effective public sector governance demands. Public sector executives leading by example is perhaps the most effective way to encourage accountability and improve performance.

Commitment

Concern has been expressed that there has been more emphasis on the form rather than the substance of good corporate governance in both the public and private sectors in Australia. Effective corporate governance is more than just putting in place structures, such as committees and reporting mechanisms, to achieve desired results. Such structures are only a means for developing a more credible corporate governance framework and are not ends in themselves. That is, corporate governance is not just about process as many critics are now observing.
I want to stress that better practice public sector governance requires a strong commitment by all participants to effectively implement all elements of corporate governance. An effective framework is very much people oriented, involving better communication; a more systematic approach to corporate management; a greater emphasis on corporate values and ethical conduct; risk management; relationships with citizens and clients; and quality service delivery.

Integrity

Integrity is based on honesty and objectivity, as well as on high standards of propriety and probity in the stewardship of public funds and the management of an agency’s affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the agency. Integrity is reflected in the agency’s decision-making practices and procedures and in the quality and credibility of its performance reporting.

The statement below by Dr David Morgan, CEO of Westpac, emphasises the importance of integrity to corporate governance, citing its impact on accounting standards, ethical behaviour, risk management and auditor independence.

One really has to have a hard look at accounting standards that permit manipulation and permit a victory of form over substance, and as global accounting standards are converging even if they are only present in the US, it is something that we need to be concerned about and engaged in. The second is the whole issue of independence of auditors and the third is the whole issue of corporate ethics. Because, at the end of the day, you can’t legislate goodness, and important as accounting standards are, and as independent auditors are, corporate governance is really a state of mind and it is around the integrity of the company and its leadership, and I think Enron is going to provide appropriately a real refocus on this.\(^\text{10}\)

The Chairman of ASIC, in an address quoted earlier, in referring to action being taken by the Commission in relation to corporate officers and directors, stated that the latter who promote ethical conduct and good governance should take comfort that there is a day of reckoning for the less scrupulous.\(^\text{11}\)

Accountability

All APS agencies are required to be transparent, responsive and accountable for their actions. However, it has been observed that:

\textit{Responsibility is a slippery and ambiguous concept, and accountability is scarcely less so.}\(^\text{12}\)

The principles of corporate governance require those involved to identify and articulate their responsibilities and their relationships; consider who is responsible for what, to whom, and by when; acknowledge the relationship that exist between stakeholders and
those who are entrusted to manage resources; and deliver required outcomes. It provides a way forward to those, whether in the public or private sectors, who find themselves in somewhat different relationships than perhaps they have previously experienced.

Hence, a clear understanding and appreciation of the roles and responsibilities of the relevant participants in the governance framework, importantly, those of the responsible Minister(s), Board and CEO, are key components of sound accountability. The flip side is that the absence of these features weakens accountability and threatens the achievement of organisational objectives.

**Transparency**

Openness, or equivalent transparency, is about providing stakeholders with complete confidence regarding the decision-making processes and actions of public sector agencies in managing their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information, leads to effective and timely action, thus enhancing the processes of scrutiny. Such transparency is also essential to help ensure that public bodies are fully accountable and is therefore central to good governance overall.

According to the International Federation of Accountants:

> Openness is more than structures and processes. It is also an attitude and belief amongst key players, politicians, public servants and other stakeholders that information is to be shared and is not owned by any particular entity – it is a public resource, just like public money or assets.¹³

The Canadian Joint Committee on Corporate Governance argued that transparency (or disclosure) is a much better approach than attempting to regulate behaviour, if one is seeking to build a healthy governance culture. It states:

> Not only is disclosure preferable to regulation as a tool to change behaviour, it is also appropriate. With regard to corporate governance, we see two important benefits of disclosure. First, disclosure can provide examples of good practice that can assist boards that are looking for ways to become more effective. Second, a requirement to disclose against guidelines can modify behaviour by forcing boards to focus explicitly on their roles and responsibilities and how they are being discharged.¹⁴

Concern was expressed about the possibility of regulation being counter productive, for example, by discouraging competent and qualified people from becoming directors and resigning prematurely when there are problems being experienced. Unfortunately, greater demands for transparency are sometimes seen by directors as a threat with the ‘board’s instinct for secrecy’¹⁵ and being concerned only where disclosure is unavoidable. However, the reality is likely to be a requirement for continuous disclosure with greater use of the Internet, particularly on financial performance.
Integration

The real challenge is not simply to define the various elements of effective corporate governance but to ensure that they are holistically integrated into a coherent corporate approach by individual organisations and well understood and applied throughout those organisations. If implemented effectively, corporate governance should provide the integrated strategic management framework necessary to achieve the output and outcome performance standards required to fulfil organisational goals and objectives.

I will now discuss in more detail better practices in implementing some of the more important elements of corporate governance in the public sector.

Effectively implementing some important elements of corporate governance

Boards

Before discussing Board performance, I should repeat that the FMA Act confers legislative responsibility only on a CEO for the efficient, effective and ethical use of resources. Therefore, in the absence of legislation to the contrary, boards established by agency CEOs are only advisory, with the CEO retaining legislative responsibility for the administration of the agency. Many Budget-funded agencies have such Executive Boards, which nevertheless provide a cornerstone for building, or renewing, corporate governance of the agency. Further, some public sector entities (mainly government business enterprises) do have a governing board to which the CEO is accountable.

Despite legislative differences to the private sector, if public sector boards are to effectively support the CEO (or, if so charged, provide accountability in their own right) they must exhibit many of the attributes of effective private sector boards. This would be expected for those bodies covered by the CAC Act and more so for Public Sector Corporations also covered by Corporations Law. Nevertheless, there are differences even with the latter, as are well illustrated in the case of Telstra. A recent observation reflected a perceived conundrum:


In situations where commercial and political objectives conflict, there is the potential for the company to react more slowly than its competitors, or even to take a decision that is against its own commercial interests.16


According to the corporate governance literature, there are four main sets of board attributes; composition, characteristics, structure and process. Board composition refers to the size of the board and the mix of director demographics. It includes the concept of board independence. Board characteristics encompass the directors’ background, skills, training and experience. Board structure covers board organisation, board committees and the role of subsidiary boards. Board process refers to the arrangements for a board’s operations, including, for example, the frequency and duration of meetings, succession planning and the evaluation of directors’ performance.
I will discuss some of these attributes of Board performance, focussing on those that seem to be important in supporting public sector CEOs in the discharge of their responsibility to provide efficient, effective and ethical use of public resources.

**Composition of Boards**

The literature on board performance places great weight on selecting appropriate directors and, particularly in the private sector, the CEO. It also advocates choosing board members that are multi-skilled, experienced in a variety of business areas, prepared to update their knowledge, flexible, analytical, and prepared to monitor and assess their individual or collective capabilities.

In the private sector, it is common to have a mix of internal and external directors to complement the skills and perspectives of company executive members, and to provide greater independence from management. The approach of engaging external advisers is gaining acceptance in the Australian public sector, particularly in the larger agencies with more complex administrative responsibilities and/or significant prospective change agendas. In a recent interview, Dick Warburton commented that:

> ...in a converging world many of today’s business issues are increasingly relevant across a spectrum of industries. Senior executives are becoming ever more aware of the importance of sharing knowledge across industry to manage risks and maximise opportunities.\(^1\)^{7}

Ann-Maree Moodie\(^1\)\(^{8}\) makes the point that Board diversity enriches a board with alternative perspectives, disciplines, backgrounds and experiences but importantly the board must work together. She suggests a ‘Skills Audit’ that is mapped against the objectives of the board and strategic direction of the company.

**Performance of Boards**

Directors need to assess, and contribute to, the effectiveness of the board. One effective mechanism is the implementation of a ‘corporate governance health check’, that is, a formal annual board review with the introduction of formal performance measures. There are advantages in using an independent facilitator to assist with this process. According to Korn/Ferry International\(^1\)\(^{9}\), the five important criteria which Australian boards regard as essential for evaluating board performance, are:

- an understanding of the company’s mission and strategic plan;
- a comprehension of the organisation’s business;
- a willingness to challenge management when required;
- a willingness to appraise the chief executive; and
- the special expertise that board members have to add value to the company.
The Canadian Joint Committee on Corporate Governance broadly supported this view, stating that:

regular assessment of the board’s effectiveness, and the contribution of individual directors, is essential to improve governance practices. The governance system should include a process for the evaluation of the work of the board, its committees, and individual directors.\(^\text{20}\)

**Independence of Boards**

An Executive Board should ensure that the agency is conforming to legislation and Government policies and achieving agreed outcomes. A major issue in carrying out the Executive Board's conformance function is independence - whether board members who are likely to be also managers can sensibly be expected to report openly on what is effectively their own management performance - and be seen to be doing so by those to whom they are accountable.

The Canadian Joint Committee on Corporate Governance\(^\text{21}\) believes that this risk supports the need for external directors. It identified the following four conditions that can materially assist boards in developing a culture that provides opportunity for both directors and management to feel comfortable when management positions are challenged:

- strong board members who are independent of management, provided with appropriate orientation, and who bring an appropriately diverse set of experiences, competencies, skills and judgment to the board;
- strong leadership within the board from an outside director;
- a CEO who understands the role of the board and is openly supportive of building a healthy governance culture; and
- regular meetings of the outside directors without management to build relationships of confidence, and cohesion among themselves.

These characteristics are as important for public sector boards and management as they are for those in the private sector, which was the main subject of the Canadian Joint Committee review. The Joint Committee also noted\(^\text{22}\) that some boards are more advanced than others in developing a culture in which the board can act independently in carrying out its responsibilities. Where there are deficiencies in the four conditions noted above, or in any other conditions that compromise the independence of the board, then appropriate actions should be taken to remedy them. It is important to be pro-active rather than re-active in such situations.

**Succession planning and other board issues**

Succession planning for the board is required just as it is for the chief executive and senior management.\(^\text{23}\)
The trend towards shorter fixed terms has given some structure to succession planning. If a board does actively plan for its own succession, there are several benefits, as follows:

- matching the future configuration of the board with the strategic direction of the organisation;
- regularly refreshing the board’s membership;
- enhancing the depth of intellectual knowledge; and
- ensuring opportunities to target new members will be better organized.24

It is now being advocated that, to improve board performance, it is important that new board members should attend an induction program, while all board members undertake ongoing professional development. Continuing education and lifelong learning are as critical for directors as they are for anyone else in the organisation.

An Executive Board should be concerned about both performance and conformance issues. If boards are to add value, they must involve themselves actively and regularly in the functions of strategic planning and risk management. Thus, the Board should be primarily responsible for strategy formulation, strategic analysis, developing agency strategies and internal policy making. While the Board should not be involved in operational management, it should initiate links across program, functional or business units and actively seek out opportunities for adding corporate value to the agency. As well, it should set the tone for the corporate culture.

It is also now more generally accepted that the existence of a widely available Board charter would assist board independence. Such a charter would determine and include the duties and responsibilities of Executive Board members. The ANAO discussion paper ‘Corporate Governance in Commonwealth Authorities and Companies’25 suggests that such a charter may help to formalise relationships between the Board, the CEO, including management, and responsible Minister(s). Alternatively, written agreement or Memorandum of Understanding could be prepared outlining roles and responsibilities as is done, say, in New Zealand.

In summary, the board’s relationship to management is critical to healthy governance. It is a relationship that must continue to be maintained in a positive, complementary and supportive manner. What is required is a common (shared) appreciation by management and the board of their respective roles, a mutual respect for each party in carrying them out, continuing open dialogue and communication, and strong leadership within the board.

**Conformance and compliance in an integrated corporate governance framework**

Conformance and compliance control structures, incorporating sound risk management, are a particularly important element of an effective governance
framework because of their importance in promoting effective performance and ensuring accountability obligations are appropriately discharged.

In an ANAO publication entitled ‘Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control’, control is defined as:

... a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency’s objectives.\textsuperscript{27}

Box 1 outlines the main elements of a conformance and compliance framework.

**Box 1 Elements of a conformance and compliance framework**

<table>
<thead>
<tr>
<th>Some of the issues that the public sector must consider in a conformance and compliance framework include:</th>
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<tbody>
<tr>
<td>• upholding APS values and ethics;</td>
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<tr>
<td>• guidance on policies, procedures, processes, principles and tasks;</td>
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<tr>
<td>• ensuring and maintaining privacy;</td>
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<tr>
<td>• enforcing security and fraud controls;</td>
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<tr>
<td>• ensuring legislative compliance as required;</td>
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<td>• fiscal management;</td>
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<td>• contract management;</td>
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<tr>
<td>• risk management; and</td>
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<tr>
<td>• quality assurance.</td>
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The existence of strong control structures within a corporate governance framework provides assurance to clients and the Parliament that an agency is operating in the public interest and has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. In contrast, weak internal controls provide an environment where there exists an opportunity to commit fraud.\textsuperscript{28}

Accordingly, an effective corporate governance framework assists an organisation to identify and manage risks in a more systematic and effective manner. A corporate governance framework, incorporating sound values, cost structures and risk management processes can provide a solid foundation on which we can build a cost effective, transparent and accountable public sector. As one expert opinion puts it:

*Corporate governance is the organisation’s strategic response to risk.*\textsuperscript{29}

The devolution of authority and accountability to agency heads, from various public sector reforms over almost two decades, and particularly the recent changes to financial and industrial legislation, together with contracting out and requirements of contestability, have significantly increased the risk profile of agencies.
The notion of a control environment has to start from the top of an agency. To be effective it requires clear leadership and commitment. This imperative is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. The adoption of a sound and robust control environment at the top of an agency will strongly influence the design and operation of control processes and procedures to mitigate risks and achieve the agency’s objectives. The clear intent and message to staff should be that such processes and procedures should be designed to facilitate, rather than to inhibit, performance. This approach should be promoted as part of good management. In short, the control environment is a reflection of management’s attitude and commitment to ensuring well-controlled business operations that can demonstrate accountability for performance.

It is useful to point out here that audit committees provide a complementary vehicle for implementing relevant control systems incorporating sound risk management plans. I will discuss audit committees later in this paper.

Management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. The entity’s executive board, audit committee and internal audit are fundamental to this exercise. This information should be communicated through the organisation.

Mark Stock, a partner in KPMG (UK), recently observed that the following should be part of effective systems of internal control:

- ability to respond quickly to evolving risks;
- costs and benefits must be balanced;
- prompt reporting of weaknesses;
- lead and lag indicators leading to corrective action;
- reasonable but not absolute assurance; and
- embedded in an organisation and part of its culture.30

The key to developing an effective control framework lies in achieving the right balance so that the control environment is not unnecessarily restrictive nor encourages risk averse behaviour and indeed can promote sound risk management and the systematic approach that goes with it. That is, in this New Public Management environment, there is a need to balance control and autonomy – the performance/conformance debate that I have already alluded to and will discuss in more detail later.

The control structure provides a link between the agency’s strategic objectives and the functions and tasks undertaken to achieve those objectives. A sound governance model will include a robust control and reporting regime which is geared to the
achievement of the organisation’s objectives and which adds value by focusing control efforts on the ‘big picture’. Public sector organisations will need to concentrate on the potential of an effective control framework to enhance their operations in the context of the more contestable environment that is being created as part of government reform policy.

As well, with the increased emphasis on contestability and the greater convergence of the public and private sectors, there will be a need to focus more systematically on risk management practices in decision-making that will increasingly address issues of cost, quality and financial performance.

It must also be kept in mind that control is a process, a means to an end, and not an end in itself. It impacts on the whole organisation. The control environment is the responsibility of everyone in the agency and is effected by staff at all levels.

In summary, the language of a compliance program with its emphasis on – a culture of compliance, starting from the top, leadership, shared vision, ongoing commitment, effective mechanisms, continuous improvement, performance, transparency, and accountability, is also that of corporate governance. Indeed, as Professor Allan Fels has observed about the value of an effective compliance program:

It is good corporate governance, reduces litigation risks and, if there is litigation, will help reduce penalties.31

Risk management

I view risk management as an essential element of corporate governance, underlying many of the reforms that are currently taking place in the public sector. It is not a separate activity within management but an integral part of good management process, particularly as an adjunct to the control environment.

Box 2 The risk management process

Risk management establishes a process of identifying, analysing and mitigating risks which could prevent the agency from achieving its business objectives. It includes making links between risks/returns and resource priorities. Risk management includes putting control activities in place to manage risk throughout the organisation by developing fraud and risk management plans which cover activities as diverse as reviews of operating performance, information technology and management information systems, increased competition and contestability, contracting out and outsourcing, performance management and information, professional development, staff appraisal including client surveys, reconciliations of accounts, approvals and segregation of duties.

Principles of risk management

To be effective, the risk management process needs to be rigorous, structured and systematic.32 If organisations do not take a comprehensive approach to risk management then directors and managers may not adequately identify or analyse risks.
Compounding the problem, inappropriate treatment regimes may be designed which do not appropriately mitigate the actual risks confronting their organisations and programs.

Recent ANAO audits have highlighted the need for:

- a strategic direction in setting the risk management focus and practices;
- transparency in the process; and
- effective management information systems.

Management of risk in the public sector involves making decisions that accord with statutory requirements and are consistent with public service values and ethics. This means that more, rather than less, attention should be devoted to ensuring that the best decision is made. This will require placing emphasis on making the ‘right’ rather than ‘quick’ decisions. That said, with the increased convergence between the public and private sectors, there is a need to consider a private sector point of view where the focus on cost, quality and financial performance is an important aspect of competing effectively.

I cannot over-emphasise the need to integrate the agency’s approach to control with its overall risk management approach in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively.

**Responsibility for risk management**

Risk management is primarily the responsibility of the CEO and/or board but requires the active involvement of everyone in the organisation. Effective governance arrangements require directors to identify business risks, as well as potential opportunities, and ensure the establishment by management of appropriate processes and practices to manage all risks associated with the organisation’s operations.

In recent times there has been an increasing number of public sector agencies that have involved their Board and senior management in risk management at the organisational level and then required each program area or organisational unit, in turn, to prepare risk management plans. As indicated by Linda Nicolls, the Chair of Australia Post:

*The challenge then for senior executives is to prioritise issues, understand risks across the spectrum of business and find the right solutions quickly.*

The challenge then for senior executives is to prioritise issues, understand risks across the spectrum of business and find the right solutions quickly.
It is clearly not the responsibility of Board members to manage risk. They will oversee the processes and systems management has in place to do so, including reviewing key organisational risks and opportunities to ascertain what changes might be necessary to the strategic direction being adopted.

Integration of risk management within the broader corporate governance framework

With the wide range of business risks being confronted, including in relation to business continuity, I am not alone in suggesting we need a more holistic approach to the identification and management of risk in the business environment. James Deloach, a partner in Arthur Andersen, highlights the criticality of managing business risk. His premise is that an enterprise-wide approach to business risk management improves the linkage of risk and opportunity and positions the business risk management as a competitive advantage. He offers the view that current approaches are too firmly entrenched in command and control and thus rooted in the past. Such practices cannot adequately deal with an entity’s continually evolving risks and opportunities. He proposed the Enterprise-wide Risk Management (EWRM) model (Figure 4) which:

*Note that “value contributed” means the contribution of risk management to establishing sustainable competitive advantage, improving business performance and optimising costs.

Figure 4: The Enterprise-wide Risk Management Model

This theme has been picked up in the CPA Australia’s publication ‘Enterprise-wide Risk Management’. The CPA Enterprise-wide Risk Management approach applies risk management processes, structures and culture in a way that is:
• Truly holistic – considers risk right across the business (strategic, operational, compliance and financial), the hazard, uncertainty and opportunity elements of risk and the objectives and needs of all stakeholders;

• Synergistic – considers links with and interrelationships between risks and structures, strategies and processes;

• Integrated and aligned – with business planning, objectives, decision making and other elements of the organisation’s management framework; and

• Inclusive – involves the whole organisation, from the board, to senior management and employees.38

In essence, choices for managing risk at the operational or departmental level should be influenced by their potential impact on the organisation as a whole. Entities will look to manage the key drivers affecting the total ‘pool’ of risks, rather than addressing individual risks separately. The focus here is on the aggregation of risks and their comprehensive treatment.

This approach minimises the influence of the management ‘stove pipes’; leading to a more holistic, integrated, proactive and process-oriented approach being taken to manage all key risks and opportunities. In part, this reflects the fact that many risks are organisation-wide and often have at least a ripple effect. There is also the management imperative of ‘not re-inventing the wheel’.

**Importance of risk management**

Formal risk management may have been viewed as discretionary in the past but is now accepted as an essential element of sound corporate governance and management practice. The goal is to embed a culture of risk management in organisations so that consideration of risks and risk mitigation strategies becomes second nature to managers at all levels. I have been advised that an international guide to risk management terminology (ISO/IEC Guide 73) has been agreed and should be available in the second half of 2002. It is an important starting point for the development of a common language for those engaged in the management of risk.

The growing recognition and acceptance of risk management as a central element of good corporate governance (and as a legitimate management tool to assist in strategic and operational planning) has many potential benefits in the context of the changing public sector operating environment. Such an approach encourages a more outward looking examination of the role of the organisation, thereby increasing customer/client focus, including a greater emphasis on outcomes, as well as concentrating on resource priorities and performance assessment as part of management decision-making. The risk management framework is also a useful means for management to be assured of this approach, including being able to defend their decision-making publicly.

Other potential benefits from an effective risk management process include higher share prices (for publicly-listed companies) and lower insurance costs.
A recent joint study by the Economist Intelligence Unit and MMC Enterprise Risk has found that the majority of companies believe that implementing enterprise risk management has the potential to improve price/earning ratios and reduce the cost of capital. This highlights the real tangible effect that an integrated and well-considered approach to risk management can have on the “bottom line” for an entity.

Private and public sector organisations typically use many insurance products to mitigate various risks. However, as Robert Knapp, a previous National Manager of Comcover has observed, while insurance products of his organisation are designed to reduce the exposure of the public sector to insurable risks:

*The availability of this insurance does not remove the onus on agency management to properly manage risks.*

In fact, the majority of risks for both public and private sector entities are not insurable. However, organisations with robust risk management processes that are recognised by insurance companies can often save quite substantial amounts on premiums. For example, Comcover provides discounts of up to five per cent for organisations that participate in a benchmarking survey and can demonstrate either an advanced level of risk management development or sufficient improvement in their risk management systems (according to certain conditions).

Consistent with Federal Government policy, there has been a greater use of outsourcing to deliver a range of services with the consequent split between service delivery and policy-making. The associated increase in risk, particularly with contract management, is becoming more critical in agency operations. This issue has been treated at length in previous papers and a large amount of guidance has been issued on contracting, particularly for those processes leading up to contract signature. I do not intend to revisit the issue here but I commend the references to you.

The ANAO fosters the view that risk management is an essential element of corporate governance underlying many of the reforms that are currently taking place in the public sector. To restate my point, it is not a separate activity within management but an integral part of good management process, particularly as an adjunct to the control environment. More than ever, the public sector will require a formal, systematic approach to identifying, assessing, treating, managing and monitoring risk.

The intuitive, and often reactive, approach to managing risk that has characterised public sector management in the past will not be sufficient. We all know that reacting ‘after the horse has bolted’ is often quite costly and damaging to the credibility of agencies and Ministers. A more strategic approach is required to stay contestable in such an environment. This is a significant management challenge.

**Ethical framework**

As I discussed earlier, integrity is a key principal underpinning good corporate governance. To state this more clearly, good corporate governance is based on a clear
code of ethical behaviour and personal integrity exercised by the board, management and staff and communicated openly to stakeholders.

Ethical structures provide a basis for the CEO to have confidence that there is consistent ethical behaviour at all levels of the agency and that the agency and its employees:

- comply with public sector standards, codes of ethics and applicable codes of conduct;
- act with integrity in the performance of official duties and ensure due process in the use of official information, equipment and facilities;
- exercise consideration and sensitivity in their dealings with members of the public and employees; and
- identify and deal with any real or perceived conflict of interest.

This ethical framework flows from peak public service values, obligations and standards, which in turn are derived from legislation, policy and accepted public service conventions.

Such a culture is also essential for the establishment of sound risk management approaches and the confidence it can give to those stakeholders in the organisation and in what it does. According to O’Faircheallaigh, Wanna and Weller:

> Ethical behaviour is one of the principal means by which accountability is maintained in the public sector. Indeed, political and administrative accountability depend on the observance of ethical standards and ethical relations between individuals or between institutions.44

In Australia, the new public service values are a key element in the Government’s public sector reform program and, as I mentioned earlier, have been included in the new Public Service Act 1999. Regulations require agency heads to integrate these values into the culture of their agency. To take one example, the ANAO’s key values and behaviours relate to respect, integrity and excellence. These values are guided by the ANAO’s Code of Conduct that has been developed within the framework of the new Australian Public Service values, as well as the Australian Public Service Code of Conduct, together with the Codes of Ethics promulgated by the professional accounting bodies.

The increasing convergence of the public and private sectors places an even greater emphasis on public sector values.

**Monitoring and reporting - performance assessment**

In order to adequately assess performance there is a need to identify both the financial and non-financial drivers of an organisation’s business. Within the Australian
government sector, such assessment is underpinned by the introduction of the outcomes and outputs framework associated with the implementation of accrual budgeting. The outcomes and outputs framework is intended to assist management decision-making and performance by focusing attention on the Government’s goals and objectives (outcomes). The identification of appropriate performance indicators, together with reporting of actual results against these performance indicators, is a key plank within this new accountability framework and a central element of supervision.

The New Zealand Controller and Auditor General’s recent report on ‘Reporting Public Sector Performance’ lays down the challenge to CEOs, boards, managers and central agencies to embrace more comprehensive and effective performance reporting. In accordance with the framework outlined in Figure 5, my New Zealand counterpart sees performance in public sector terms as follows:

- Results – what an agency achieves, its actual outcomes, the impact of government activities on the community, and how the community is better or worse off as a result of these activities.
- Interactions with the public – process of the agency and the delivery of goods and services (outputs) to the public.
- Costs – inputs, the resources met by the taxpayer that are applied to the task. Costs also include any decline in the agency’s capability.

*Figure 5 – Elements of a Comprehensive Model of Performance Reporting*

The ANAO has examined public agency performance in many of its audits. For example, it conducted a cross-portfolio audit to assess performance information in the Portfolio Budget Statements (PBS) 2000-2001 and Annual Reports for 1999-2000. The Report concluded that, overall, performance information in the PBS should be
improved to enable agencies to establish and demonstrate the links between outcomes, outputs and performance indicators. It stated that:

_A common limitation in the performance information in all 10 audited agencies’ PBS and annual reports related to effectiveness indicators which did not actually measure outcome performance._

The Report also noted:

_it was important to track overall outcomes achieved across the layers of government and through the various partnerships with other agencies, including non-government bodies, as well as the particular contribution made by the specific Commonwealth agency to the outcome._

Overall, the Report also concluded that it would be difficult for Parliament and other stakeholders to assess agency performance with reasonable assurance.

I would also like to comment on key performance measures, which must be drivers of performance and aligned to agency objectives and vision statements. These indicators must also be reliable, accurate, relevant, regular, comprehensible and timely. I also advocate that public sector agencies use benchmarking where possible, as it helps to define which performance indicators are critical in measuring operational efficiency and often also provides clear evidence of what achievements are possible. In so doing it can aid in setting meaningful performance targets – an improvement on many that I have found to be vague or ambiguous or both.

Where targets have been set, it is essential to closely compare them with actual performance. Where agencies have not met valid targets and, moreover, as a matter of good governance, public sector agencies should undertake on-going evaluation and review of key projects and programs. We should be mindful of the so-called performance paradox where there is a weak correlation between performance indicators and actual performance.

**Integrating performance measures - the Balanced Scorecard**

The three main performance elements in the APS - inputs, processes and outputs/outcomes - need to be integrated and managed as a whole. Focussing on separate elements at the expense of others gives an unbalanced view of performance. For example, a focus just on outputs/outcomes may result in ineffectiveness (achieving the wrong things) or put capability at risk (achieving in the short term at the expense of the longer term). On the other hand, too much focus on capability and process can put program achievement at risk.

One broad measure of performance is the balanced scorecard which:

_...complements the financial measures with operational measures on customer satisfaction, internal processes, and the organisation’s..._
innovation and improvement activities - these operational measures are drivers of future financial performance.\textsuperscript{50}

The balanced scorecard approach, which has been adopted in a number of agencies,\textsuperscript{51} underlines the importance of the various linkages and their understanding and management, such as between strategy and operations, budgets and performance. It also requires that attention be given to measuring performance (Key Performance Indicators – KPIs) where practicable and to articulating a credible basis for assessing qualitative or so-called ‘soft’ indicators of success. A parallel is the distinction between price and the value for money concept, with the latter often embracing many non-price factors.

It is useful to bear in mind a recent observation as follows:

*The paradox of measurement holds for many public service functions. That is, the stronger the attempts to measure the inherently incommensurable, the more such quantification tends to become a substitute for judgement, experience, and commonsense in the governing process.*\textsuperscript{52}

**Nexus between conformance and performance**

**Current emphasis on conformance**

In view of my earlier comments on conformance, control structures and risks, we should examine the debate related to achieving a suitable balance in the nexus between conformance and performance. Does conformance entrench a risk-averse management culture and inhibit exploitation of emerging opportunities? Or, on the other hand, does a solid conformance control structure provide a tensile framework that strengthens and protects an entity from ‘corporate governance delinquency’, as rather colourfully described by Senator Murray?

This tension is observed by Richard Norman in the ‘Ying and Yang’ of Management\textsuperscript{53}, where he states:

*All organisations face a central problem of autonomy and control. ...Too much autonomy and too little control can undermine coordination and prevent the delivery of a consistent service and product. Too much control at the center can undermine motivation among those who are furthest from the source of power. The challenge is to balance the control necessary for a united strategy with sufficient autonomy to foster initiative and responsiveness*\textsuperscript{54}

I think most would agree that, in the past, the tendency in the public sector has been to focus primarily on ensuring conformance with legal and procedural (including budgetary and financial) requirements rather than striving for exceptional performance (see Figure 6). This has encouraged a risk-averse attitude among public servants. It has been observed that such an environment has largely focussed bureaucratic attention on process rather than on achieving the stated objectives of governments. It is also said
that there needs to be a cultural change in the public sector if public servants are to focus more on achieving required results and to be accountable for their performance including effective management, rather than avoidance, of risks.

**Figure 6: The performance conformance nexus**

![Diagram showing the performance conformance nexus](image)

Source: ANAO

Put another way, the implied view is that the APS could have been more effective in constructing robust control structures aimed at assuring achievement of defined outputs and outcomes, as well as being more responsive in providing efficient client-oriented services. Attention is now being given to addressing government programs and services directly to public sector clients, as citizens, and not the other way round.

In the private sector, with every aspect of corporate governance increasingly being put under a virtual microscope, we have seen more rigorous regulation, no doubt resulting in a tendency for boards to focus more on compliance to cover off the legal, regulatory and other risks that were most apparent. However, before the latest spate of corporate collapses, concerns were being expressed that companies were concentrating too much on that end of the spectrum and should have been focusing more on performance goals, that is, the drive for profits and other required corporate results.

For example, a prominent Chairman of three major Australian corporate boards has recently challenged boards’ ‘obsession’ with conformance rather than performance and their predisposition to be risk averse. In his words:

... there’s just been too much concentration in recent times on the conformance, the governance, the ticking of the boxes, who comes to meetings and I think it’s far from clear that that adds value, improves the performance of companies, delivers benefits for shareholders and

... having lots of due diligence and advisors around you when you’re making decisions doesn’t necessarily make the best decision.
Indeed, there has been an increasing emphasis on the strategic role of the board, in particular the need for the board to be aware of the major trends impacting on the organisation and its major risks and opportunities. Ian Dunlop, CEO of the Australian Institute of Company Directors (AICD) has observed that the compliance or conformance responsibilities that have dominated boards’ thinking remain critically important and must be performed to impeccable standards, but in essence they are ‘hygiene’ issues. The real added value for boards is at the strategy level. This requires boards to be forward looking, proactive, innovative, and not risk averse.57

The notion of corporate governance that emphasises both performance and conformance can sit easily in today’s public sector context. As I noted earlier, the challenge is to strike the appropriate balance that suits the circumstances of an individual organisation at particular periods.

Mr Sitesh Bhojani (Commissioner, Australian Competition and Consumer Commission) responded to the question as to what are the objectives of good corporate governance by saying that the following are still apposite:

- enhance corporate performance;
- simplify and reduce directors’ duties and liabilities;
- protect reputation of directors and the enterprise;
- minimise government interventions; and
- enhance public acceptance of the corporate sector.

The question would realistically appear to be one of achieving balance.58

As the public sector continues to move to a more private sector orientation, we are increasingly seeing a growing adoption, or adaptation, of private sector approaches, methods and techniques in public service delivery. Consequently, there is an issue of trade-offs between the nature and level of accountability and private sector cost efficiency, particularly in the delivery of public services and in the accountability regime itself. The increasing frequency of contracting out poses its own problem for achieving the balance between conformance and performance.

Contracting out inevitably involves some reduction in accountability... Accountability is also likely to be reduced through the reduced availability of citizen redress... At the same time, accountability may on occasion be increased through improved departmental and Ministerial control following from greater clarification of objectives and specification of standards. Providers may also become more responsive to public needs through the forces of market competition. Potential losses (and gains) in accountability need to be balanced against potential efficiency gains in each case.59
In summary, the challenge for any organisation is to get the right balance between performance and conformance at any point in time and over time.

4. Public sector challenges and issues that need to be resolved

I would now like to discuss some of the emerging challenges and topical issues in governing public sector entities. I will begin by highlighting some of the main themes that have been given prominence in recent audit reports.

Recent issues arising from audits of corporate governance

Audit reports over recent years have highlighted the value of corporate governance as a stimulus to performance and a constructive vehicle for self-assessment and review. In addition, there are some noteworthy areas and common themes where weaknesses may arise in public administration which agencies should take account of in their governance arrangements. All relate to core business of the APS, including:

- mission and operational alignment;
- contract management;
- management (including performance) reporting;
- costing of services; and
- internal control and good housekeeping.

Many of the audit reports undertaken by the ANAO address these key management fundamentals. These audits confirm that it is not only the vision or plan that is critical to success but also their implementation. This requires senior management involvement and/or oversight to deliver the required results. Severe reputational damage can be sustained by poor administration in the public sector. It is, therefore, incumbent on all agencies to have in place appropriate mechanisms to continually assess operational performance and conformance with statutes and agency procedures.

If you are responsible for an area of administration in government, I would encourage you to access our website (www.ano.gov.au) for reports which cover audits of similar areas to benefit from the experience of others. Our website allows you to search by theme, by agency, by title, by keywords, etc, to allow you to quickly get to the issues you are interested in. You may also register on our email list for copies of all our reports, or particular reports, as they are tabled.

The points I have made so far demonstrate the need to understand both the nature of modern public service as well as the changing public sector environment. Notions of partnership and networked government are becoming increasingly important elements
of that environment. Consequently, those elements rate separate treatment which I will now address. Other issues that I see as important and will discuss, include the impact of the electronic world, the increasing focus on social responsibility and audit operations and independence.

**Joined-up or connected government**

As I discussed at the outset of this paper, the APS is converging towards a more private sector orientation in order to improve efficiency, effectiveness and cost. This has lead to an increasing complexity of relationships to deliver services traditionally provided by the public sector, including:

- Commonwealth agencies undertaking activities with other Commonwealth agencies;
- cross government co-operation – such as Commonwealth agencies undertaking activities with State and/or Local government agencies; and
- public/private arrangements, including:
  - contestability and contracting out;
  - government as a minority (or majority) shareholder; and
  - other public/private sector partnership approaches such as alliances.

These various types of integrated approaches to public sector service delivery have been associated with concepts of ‘joined up government’ (UK), ‘horizontal government’ (Canada), and ‘integrated government’ (Australia). The UK Comptroller and Auditor General describes ‘joined-up government’ as

> the bringing together of a number of public, private and voluntary sector bodies to work across organisational boundaries towards a common goal.\(^{60}\)

The realisation of joined-up government services will require considerable cooperation across departments and across levels of government in order to deliver transparent, customer-focussed solutions. A good description comes from the policy of Modernising Government in the UK, as follows:

> Joining up is a mind-set and a culture. It is not a system or a structure. The concept of joining up recognises that no one has all the knowledge and resources, or controls all the levels to bring about sustainable solutions to complex issues\(^{61}\).

The new participatory governance is time consuming, resource intensive, difficult and, one could argue, selective with regards to who participates. But although difficult, the task is not impossible. Australia and Canada are reasonably placed for the challenges of horizontal accountability due to the long-standing complex patterns of cooperation
between levels of government created by federalism and experiences in employing alternative service delivery mechanisms, especially within the community sector.62

**Applying principles and elements of corporate governance to connected government**

Delivering services under the ‘joined-up’ arrangements raises the Corporate governance ‘bar’ considerably, particularly in terms of ‘joint’ performance and results to be achieved. In any such arrangements, a clear governance framework and accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants, are essential.

In particular, attention to the principles of corporate governance in this context requires those involved:

- to identify and articulate their responsibilities and their relationships;
- to consider who is responsible for what, to whom, and by when;
- to set unambiguous targets and performance measures;
- to ensure there are periodic independent evaluations;
- to cultivate new values, identify relevant pockets of knowledge, and link mentors to managers; and
- to acknowledge the relationship that exists between stakeholders and those who are entrusted to manage resources and deliver outputs and outcomes.

When considering how to improve accountability in joined-up governance, Peter Wilkins states that:

> A clearer articulation of causal relationships regarding the sharing of outcomes, accountability through shared outcomes, a two-way perspective based on relationships between partners and a recognition of accountability to the community through the multiple accountability relationships is often involved.63

While it easy to assert that performance measures must conform to better practice principles (such as alignment, clarity, relevance, timeliness, and appropriateness), this has proven difficult to achieve in practice. And as I stated earlier, the ANOA has noted considerable shortcoming in this area by APS agencies in their core business. Effective performance measurement and reporting will often be even more difficult in areas of connected government, partly because departments/agencies will have the same individual reporting obligations to Parliament but need to also ensure that their partners can live up to these reporting standards.64 The Canadian Auditor General recently observed that while departments had embraced results reporting, he raised concern about the extent to which it is actually utilized for the purposes of accountability,
monitoring, and planning by departments and central agencies involved in instances of connected government. These factors go to the heart of the issue – are there practical ways of delivering and assessing the dual roles and responsibilities? The reality is that, under partnership, network or other joined up arrangements, conventional corporate governance is placed under stress. Nevertheless, the identified elements for a sound accountability and regulatory framework necessary to support joint working are similar to those required for sound corporate governance of individual organisations.

Models of governance in connected government

Three main models can be employed to provide effective governance (not just management) of joined-up or connected government arrangements (see Box 3).

**Box 3 Models for governance of connected government arrangements**

1. **Lead Agency model.** The main agency applies its corporate governance framework to the partnership, with overall responsibility for the constituent parts.

2. **Committee model.** This occurs when a loose confederation of players come together and allocate corporate governance responsibility to discrete parts of the activity. In this way overall corporate governance equals the sum of the corporate governance from each party.

3. **Board model.** A Board is established to govern and manage the partnership. This is a separate entity with clear and comprehensive responsibility for all aspects of the partnership but only for the partnership.

Examples of joined-up government or extensive interaction with other agencies in the APS include:

- Centrelink – provides delivery services for Family and Community Services and fifteen other Commonwealth agencies plus all State Housing Authorities;

- Department of Employment and Workplace Relations – provides information and assistance to small business by acting as lead agency across the Commonwealth Government, State Governments and the private sector;

- AusIndustry (within Department of Industry, Science and Resources) – coordination agency responsible for delivering the Government’s Business Information Service Program which interacts with all three levels of government; and

- Health and Ageing – promotes, develops and funds health and aged care services through partnerships involving the Commonwealth Government and State Governments.
In Australia, many of these joined-up government arrangements favour the committee model. Centrelink is an example of this approach, whereby it typically enters into formal arrangements with other government entities (such as through Business Partnerships arrangements), sometimes on a purchaser/provider basis. The responsibilities of Centrelink and the other party are clearly spelt out in these arrangements and then subsumed into their own governance arrangements.

The Tony Blair model of governance in the United Kingdom is an amalgam of the above approaches, whereby performance contracts for heads of agencies separate and reward:

- performance and accountability of an agency as a whole; and
- agency contribution to joined-up government arrangements.

More specifically, a peer review report of the Cabinet Office role in Modernising Government offered the following comment on the corporate role of Permanent Secretaries:

Permanent Secretaries have an individual and a collective responsibility. An individual responsibility to serve their respective ministers, to oversee the performance and ongoing improvement of their department. They also have a collective responsibility to serve the government as a whole by supporting and moving forward the government agenda. They have a collective responsibility to modernise the Civil Service as an institution and to ensure that it is up to today’s challenges.  

As part of its approach to joined-up government, the UK Treasury has introduced pooled budgets, which are allocated towards broad policy objectives rather than departmentally controlled budgets. In establishing pooled budgets, there is a need for a clearly articulated accountability framework indicating how responsibilities and accountabilities will be shared. The ultimate accountability for the pooled budget lies with each partner.

Additional themes arising from ‘joined-up’ arrangements

Three additional themes arising from these ‘joined up’ arrangements include the following:

1. Demands for horizontal governance and collaboration will continue to multiply. Although governments have long had to manage horizontally, the premise is that many of the factors noted above will increase the amount of horizontal work that needs to be accomplished by public servants and their departments. Another way to put this is that, while executives have long been involved in horizontal management, ‘horizontality’ now affects the work of middle and front-line public servants.

2. Vertical structure, incentives, and accountabilities will persist. The expanding number of horizontal projects, or greater demand for horizontal competencies of
officials at all levels, does not mean the end of ‘vertical government’. Accountability and resource allocation is exercised in a top-down manner because of our system of Parliamentary government and because we need hierarchy to coordinate and organise vast amounts of expertise across a large country. Thus, improving horizontal management will not, and should not, supplant vertical systems, and therefore strategies must work within and supplement vertical systems to better address contemporary policy and service delivery challenges.68

3. There are particular difficulties where bodies within government do not have a statutory basis and/or are not formally recognised by existing accountability requirements.

**Broader responsibility - Triple Bottom Line reporting**

A broad view of the responsibility of business and government organisations is that it is accountable to a large body of stakeholders, rather than just shareholders (for corporates) or the parliament (for government entities). This broad view of organisational responsibility and accountability forms the basis for the concept of triple bottom line reporting, that incorporates economic, social and environmental performance considerations.

The definition of the ‘triple bottom line’ has recently been expanded to include not only economic, social and environmental concerns, but also governance issues. The phrase ‘quadruple bottom line’ has now entered the professional lexicon. The trend to quadruple bottom line reporting is currently moving fastest in the United States, particularly in the wake of major company collapses which have turned the spotlight on governance and social responsibility.69

**Social responsibilities underpinning the TBL concept**

More specifically, a corporate sense of social responsibility (equivalent to the TBL concept) dictates that business and government organisations are responsible to all stakeholders, employees, local community, customers, suppliers, business partners, government and the environment. In Australia, considerable media and community concern about the collapse of Ansett provided a good example of the importance of corporate responsibility to employees. The Lisbon European Council Summit recently defined a corporate sense of social responsibility to comprise best practice of lifelong learning, work organisation, equal opportunity, social inclusion and sustainable development.

Gekas70 and the European Commission,71 have provided a list of principles that underpin social and environmental responsibilities for organisations that try to harmonize business and societal pursuits. These cover trade practices, environmental policies, energy and waste policies, employee welfare and safety and community relations. A selection of these principles include:

- considering all transactions as an exercise in ethics;
• courageously ensuring that the business is ecologically sustainable, meeting the needs of the present without compromising the future;

• aiming for maximum commercial benefit but realising that the livelihood of employees and intermediaries is dependent on paying them a fair market price;

• supporting long-term, sustainable partnership-based relationship with the communities in which they operate;

• promoting respect for human rights on the part of suppliers; and

• contributing to communities through donations, social investment, partnerships with communities, etc.

Proponents of TBL consider that public and other stakeholders’ expectations in an increasingly globalised business and communications environment would provide the drivers for a shift away from the traditional input-output based model of accountability towards a focus on economic prosperity, environmental quality and social justice. There is a view that business benefits from a more socially responsible approach and that this can increase sales, promote employee confidence and trust, and encourage investment in the firm.

Progress in implementing TBL concept

The then Federal Minister for the Environment, Senator Hill, advocated the use of triple bottom line accounting as a means of softening the harsh economic realities of government policies in order to accommodate social and environmental costs to balance financial gains. In this way:

...Australians would not lose sight of social implications of our pursuit of economic growth.

In Australia, some private sector corporations, such as Rio Tinto, have lead the way in this kind of reporting. BP Australia is another example of a company that has long embraced TBL in recognition of its wider accountability requirements.

The public sector may be inherently better positioned for the application of TBL given the focus on outcomes as a primary measure of performance in the absence of any profit concept to assess results. Even publicly-owned commercial operations may be more amenable to TBL given the prevalence of community service obligations in their charters. I recognise that such reporting tends to be ‘after the event’, but point to the increasing tendency of agency Annual Reports to be more forward-looking and strategic, while identifying performance targets as well as reporting on results (outcomes/outputs) achieved. It was suggested recently that:

The real recognition will start when broader social issues are addressed in critical resource allocation decisions, for example fuel and utility pricing, education and research.
In my view, the Commonwealth public sector should take a leading role in TBL-type reporting as part of good corporate governance. John Ryan, Deputy CEO of the Department of Industry, Tourism and Resources, has suggested that governments should take only a light-handed regulatory approach. The public sector could make considerable progress in this area, based on existing ethical standards, not only adhering to observed better practice in this area but also contributing to its enhancement.

As an example, the introduction of public reporting on ecologically sustainable development is now a requirement in Commonwealth agency annual reports. The ANAO will be conducting an audit in this area next financial year. The continued high reputation of agencies is necessary for public confidence. This requirement is made more complex as stakeholder expectations change over time. Nevertheless, it is important that agencies see themselves as part of the broader social system in which they operate. Client focus and the adequacy of stakeholder consultation are very important within this context.

Key barriers to the adoption of TBL reporting include the lack of standard methodologies; the lack of appropriate skills, knowledge and/or experience; the difficulties of identifying social and environmental costs; and the valuation of liabilities. However, some organisations are moving to develop comprehensive guidance for reporting environmental and social information.

This is clearly still a ‘greenfield’ area for research and development. Both the major professional accounting bodies in Australia have been devoting increasing attention to TBL in their publications and conferences. To date, accounting for social and environmental performance is outside the traditional measurements under the general accounting principals (GAAP). A major difficulty that Alan Kohler has noted is that:

> The trouble is lumping three bottom lines together in this way, companies are mixing woolly, subjective and arguable ideas with objective and auditable financial requirements.

Moreover, because of the transborder and global issues inherent in TBL, the development of appropriate methodologies and indicators would benefit from international input as global consensus needs to evolve on the type of information that should be disclosed and the reporting format that should be used consistently by all. Major international initiatives underway include the Social Accountability 2000 standard and the Global Reporting Initiative. In Denmark, the Social Index is a self-assessment tool developed by the Ministry of Social Affairs for measuring the degree to which a company lives up to its social responsibility.

Verification of TBL information by independent third parties is also needed to avoid criticism that the reports are public relations schemes without substance. I note that a standard from the Institute of Social and Ethical Accountability in London (AA1000) incorporates an auditing standard through which organisations can provide assurance to stakeholders as to the quality of their social and ethical accounting, auditing and reporting.
Electronic government: records management and other e-systems

What is e-government?

Most definitions associate e-government with the use of the Internet as a vehicle to deliver government services to citizens and to interact with the business community. Australia’s Government Online program, administered by the National Office for the Information Economy, recognises that:

*Getting Government Online is a natural and important step in the development of government and community interaction... The Government must develop more and better services online – integrated services that break down the barriers of government structure and jurisdiction, and services that meet the real needs of individuals and business.78*

At its simplest, e-government could involve the electronic (Internet) delivery of a transaction traditionally accomplished by means of an exchange of paper-based correspondence or a physical visit to the office of a government department. Yet the above descriptions of e-government envisage providing electronic (Internet) access to sector-wide or integrated government services. E-government is an important component of the United Kingdom Governments initiatives to ‘join-up government’.

In promoting a joined-up approach to e-government, the UK government cites four guiding principles:

- building services around citizens’ choices;
- making government services more accessible;
- social inclusion; and
- using information better.

Many governments have set targets for electronic service delivery, and in particular for the delivery of government services online, for example, Australia, Singapore and Ireland was 2001; Japan and USA by 2003; Canada by 2004; and UK, Germany and China by 2005.79

More individuals in the community are gaining access to Internet technology and, as this number increases, the demand for government services, including information, over the Internet can be expected to increase dramatically.

The focus on the citizen as service recipient is common to many countries’ e-government strategy which rests on the premise that:
People should not need to understand how government is organised or to know which department or agency does what, or whether a function is exercised by central or local government.80

The role of portals in delivering joined-up government

As online services expand and governments move closer to the one-stop-shop model of providing information and conducting transactions online, user expectations will continue to increase, bringing pressure to bear for a fundamental change in the philosophy of government service delivery.

Online portals offer a single entry point for citizens to access integrated services and information for all of a government’s departments. The adoption of portals as vehicles for delivering integrated services demanded by citizens and the business community reflects such a transformation of the enterprise of government. Central to these changes are business process re-engineering and the use of human resources and technology to better support modernised service objectives.

The e-government landscape will continue to develop very rapidly in coming years. One of the main avenues for improvement is to fully exploit the portal model, including the development of intentions-based portals. This approach creates virtual agencies that cluster functions related to customer needs, regardless of the responsible agency or branch of government.81

The ‘E’ Impact on changing governance frameworks

Over the past decade in Australia, at the federal government level at least, public sector management has seen a shift from central agency control to a framework of devolved authority with enhanced responsibility and accountability demanded of public sector agencies and statutory bodies.

A number of tensions are brought into focus between such a devolved management environment and that required to implement a more joined-up delivery of government services to citizens and the business community. Virtually all of the results envisaged in e-government and joined-up government require the coordinated efforts of two or more agencies or levels of government. Yet the devolved environment, with more of a silo-based mentality, does not easily provide for a smooth transition to a more joined-up future.

The delivery of services via the Internet introduces new risks and exposures that can also result in a legal liability for government. Well-designed security and privacy policies can minimise such risks and liabilities, while informing agencies’ clients of important aspects of the services they can expect to receive. Nevertheless, such policies need to be kept under close scrutiny.

Transacting business in the electronic environment, whether acting as an individual agency or in partnership with the private sector or other government agencies, also
raises the issue of record keeping, and particularly the provision and maintenance of electronic records.

**The growth of electronic records**

In the public sector at the moment, we have a three-tiered hierarchy of records. Hardcopy documentation (traditional paper-file based records) is still at the top in many, if not most, agencies. That is followed by electronic or digitally-based information (using virtual office systems or *groupware*, electronic diaries or data and e-mail archives) and finally oral communications (which may or may not be supported by notes, diary entries, tape recordings or other evidentiary material). Nevertheless, there is an increasingly rapid move towards using electronic, rather than paper, records. The United Kingdom Public Records Office has listed a number of changes taking place in government with the use of information and communications technology focussing attention on records management responsibilities in the electronic business era.82

There is also an increasing tendency for policy and administrative decisions to be communicated and confirmed through e-mail. This is a function of our changing expectations about the speed of communications, a growing emphasis on timely management of the ‘political’ dimensions of policy, and the appropriation by the public sector of a ‘commercial paradigm’ in which ‘deals are done’. This is given added impetus by outsourcing and the involvement of private sector partners in various aspects of government’s operations.

The growth of electronic records becomes increasingly important in light of the Government’s plan to establish the public sector as a leading-edge user of IT, and its commitment to all appropriate services having been Internet-deliverable by end 2001. The use of IT-based records creates a number of issues, including such fundamental matters as those of appropriate definition of such records. Not least of the problems is the legal validity of electronic transactions that is receiving gradually increasing consideration. The other major consideration is to ‘authenticate’ the parties to transactions. This raises issues of electronic signatures and tying them to those responsible. The *Electronic Transactions Act 1999* provides some guidance on these matters. The Act is based on two principles – functional equivalence (also known as media neutrality) and technology neutrality.

The *Electronic Transactions Act 1999* (ETA) was introduced to provide a regulatory framework that recognised the importance of the information economy to the future economic and social prosperity of Australia in order to facilitate the use of electronic transactions and to enable business and the community to use electronic communications in their dealings with government.83

Among other things, the ETA ensures that requirements imposed under a law of the Commonwealth can be met in electronic form, for example, a requirement to give information in writing, to provide a signature, to produce a document, to record information, and to retain a document.
These days it is clear that all digital data - such as that which constitutes e-mail messages, database systems, websites and other information systems - created or received in the conduct of Commonwealth business, are Commonwealth records and need to be managed in accordance with the *Archives Act (Commonwealth) 1983*.

Several practical record-keeping issues associated with the developing IT environments have been identified by the ANAO. Some audits have found scope in particular agencies for increasing the use of technology to save time documenting activities and collecting results, and to reduce the error rate. Over the past three or so years, financial statement audits have consistently identified problems with excessive or unauthorised access to IT systems, inadequate review and approval of access to these systems, and inadequate approval and testing of changes to applications.

The ANAO recently tabled an Assurance and Control Assessment (ACA) audit of record keeping. The audit assessed record-keeping policies, systems, and processes in terms of good business practice, requirements under the Archives Act, relevant Government policies, and professional record-keeping principles.

Following the Australian Law Reform Commission’s 1998 report on the Archives Act\(^4\), the National Archives has been increasingly pro-active in the promulgation of guidance to Commonwealth bodies on record-keeping practices. Commonwealth record-keeping guidance culminated with the release in March 2000 of an extensive range of record-keeping standards, policies, tools and guidelines for the Commonwealth on the National Archives web-site under its *e-permanence* logo. The *e-permanence* guidelines form the basis for a coherent framework for Commonwealth record-keeping. Some of the guidelines are formal requirements, for example, where they are linked to Government record-keeping requirements for web-based activity under the *Government On-Line* strategy.

Records are an indispensable element of transparency, and thus of accountability, both within an organisation and externally. Records are consulted as proof of activity by senior managers, auditors, members of the public or by anyone inquiring into a decision, a process or the performance of an organisation or an individual. As we move towards and era of e-government, ensuring the creation and maintenance of appropriate electronic records will be equally important as ensuring appropriate security and privacy in electronic transactions between governments, citizens and the business community.

While the range of accountability issues associated with the introduction of e-government can be daunting, management’s focus has to be on its overall accountability for delivering identified organisational outputs and outcomes efficiently, effectively and ethically. With multiple agencies sharing responsibility for delivering e-government outcomes, new governance and accountability frameworks will be called for. The following observation points to likely consequences:

> One stop, non-stop e-government portals will revolutionise not just the way public services are delivered, but government itself as well.\(^5\)
Audit committees and audit independence

As I mentioned earlier, many recent corporate collapses (especially Enron and HIH) have stimulated debate about the role of audit committees and the independence of auditors.

Audit committees

An effective audit committee, as a crucial component of corporate governance, provides a complementary vehicle for implementing relevant control systems incorporating sound risk management plans. The internal auditing function of an organisation plays an important role in this respect by examining and reporting on control structures and risk exposures and on the agency’s risk management efforts to the agency governance team. An effective audit committee can also improve communication and coordination between management and internal as well as external audit, and strengthen internal control frameworks and structures to assist CEOs and boards meet their statutory and fiduciary duties.

An audit committee’s strength is its demonstrated independence and power to seek explanations and information, as well as its understanding of the various accountability relationships and their impact, particularly on financial performance. In particular, it can ensure that accepted audit recommendations are followed up and properly actioned, which greatly improves both internal and external audit effectiveness.

The CEO or the board of an organisation, as well as senior management, are responsible for devising and maintaining the control structure. In carrying out this responsibility, management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. This is obviously an area of significant interest to audit and one where it can work positively with the audit committee to achieve greater organisation effectiveness.

In my view, the questions about possible conflicts of interest, audit 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.

As with Boards of Management, it is important that audit committees select appropriately qualified members and rotate them on a regular, on-going basis. According to Hunt & Carey86, essentials of an audit committee member include common sense, wide experience, good judgement, a general understanding of the role of an audit committee, healthy scepticism, an ability and willingness to ask difficult questions that challenge management’s actions and not to put up with unintelligible “techno speak”.

There is a growing level of opinion that audit committee directors, chairs and the auditors themselves should only be allowed to serve for a specified period of time. While this may require extensive learning for new appointees, it would allay concerns
about these audit representatives getting too close to management over a period of years and threatening their objectivity. Recent discussion involving Ernst & Young provided a view that:

*rotation of audit partners every seven years was seen as more appropriate than legislated rotation of audit firms.*

It is interesting to note that the Auditor General of Canada audited the audit committees of 14 Crown Corporations (similar to Australian GBEs) in 2000 and found that half were ineffective or only marginally effective. Only one followed most of the best practices and was performing effectively.

Mainly observing Canadian Corporations, the Canadian Joint Committee on Corporate Governance found that the relationship between audit committees and external auditors could be improved in most companies. They stated that fundamental to such improvement is a mutual recognition that the external auditors are accountable to shareholders, and to the board and audit committee as their representatives. The external auditors are not accountable to management. Both audit committees and auditors need to work hard to improve this relationship, and management needs to understand and support their efforts. The audit committee should be prepared to work in partnership, in the fullest sense of that concept, with both internal and external audit. As an illustration, the committee should put in place a robust system of follow-up on audit recommendations to ensure their full and timely implementation. In turn, the performance of both internal and external audit should be regularly reviewed by the committee.

I agree with the Canadian Joint Committee that audit committees should adopt a formal written mandate that is approved by the board and that sets out the scope of the committee’s responsibilities. This mandate should be disclosed to key stakeholders, and a regular assessment of the effectiveness of the committee against the mandate should be conducted and reported to the board. The audit committee mandate should set out explicitly the role and responsibility of the audit committee with respect to:

- its relationship with and expectation of the external auditors;
- its relationship with and expectation of the internal auditor function;
- its oversight of internal control;
- disclosure of financial and related information; and
- any other matters that the audit committee feels are important to its mandate or that the board chooses to delegate to it.

**Audit independence**

I will touch briefly on the important aspect of audit independence. This issue was already under scrutiny in Australia prior to the controversies surrounding the recent
corporate collapses. This scrutiny included the Ramsay Report, the main output of a Federal Government inquiry into the state of audit independence in Australia. The findings and recommendations from this report are currently being examined by the JCPAA at its inquiry into this topic. The JCPAA is examining whether government should intervene to regulate the auditing profession.

The issue of auditor independence is likely to be considered in greater detail as the royal commission into the collapse of HIH continues. In this case, two members of the audit committee were ex-members of the accounting firm that, at the same time, undertook the external audit. As Henry Bosch said on Radio National recently:

_I think that’s far too cosy. Just having the machinery is not enough. You’ve got to use the machinery properly. An audit committee has a responsibility to ensure the independence of the auditors, and to have ex-partners sitting on the audit committee...seems to me to be a very unusual practice and not one to be recommended in practice._

A critical component of the ethical conduct of auditors is that they remain sufficiently independent in fact and in perception, to provide an unbiased and hence creditable audit opinion. In order for the audit report to carry any weight, the auditor must have the freedom to perform the audit, report findings and express an opinion free from external influence. I reiterate that external auditors are not accountable to management. Moreover, audit committees need to be fully supportive of audit independence and be prepared to work constructively and openly with them. This involves, inter alia, full, frank and timely discussion of all material issues and ensuring the full cooperation of management.

**Factors affecting audit independence**

The Securities and Exchange Commission (SEC) in the USA has recognised the need to modernise the rules for determining whether an auditor is independent. Similarly, Blake Dawson Waldron, in its Corporate Governance Update noted that:

_lack of independence is a slippery concept, and legal independence does not always equate with real independence._

In February last year, the SEC released a final ruling on the requirements for auditor independence. Taking on board this guidance, Blake Dawson Waldron noted a number of relationships that mean an auditor is not independent, including:

- an organisation employs a current auditor or employee of an auditor;
- an organisation employs certain (immediate) relatives of the auditor;
- an organisation employs a former auditor or employee of the auditor;
- a retired audit partner joins the board of the organisation;
- audit firm employs a former employee of the organisation it audits;
• an employee of an organisation received remuneration form its audit firm;
• audit firm invests in an organisation it audits; or
• where there are loans between an organisation and the audit firm.

I was interested to note that PricewaterhouseCoopers has recently formed an independent board to oversee the firm’s audit standards, quality and independence, in a major new development for the accounting profession.

Regulating audit independence in Australia

In Australia, auditor independence is regulated by two primary sources; the legislative requirements of the Corporations Law and the Statement of Auditing Practice (AUP) 32 “Audit Independence”.

The Corporations law prohibits the appointment of an auditor with financial interests in the entity exceeding $5,000. There are additional Corporation Law requirements relating to the appointment and removal of auditors that further reduce the possibility of undue management pressure on auditors.

Statement of Auditing Practice AUP 32 “Independence”, although not codified as an auditing standard, provides guidance to auditors when considering their independence. The Statement requires auditors to comply with the ethical requirements of CPA Australia and the Australian Institute of Chartered Accountants. These professional requirements specify that a ‘reasonable person’ must be able to conclude that the independence of auditors is not substantially impeded. In order to satisfy this condition, auditors are proscribed from being employees of audited entities, having material beneficial interest in clients, accepting non-arms length loans from clients and acting as liquidator or administrator for a client when a continuing professional relationship exists. Nor should they hold directorships in the client entity. Quoting the ASIC Chairman again, he opined that:

> at the very centre of this minefield, is the paradox that auditors are expected to reconcile a commercial service provider/client relationship with a watchdog/whistleblowing responsibility.⁹¹

After considering many relationships with the client that would result in an auditor not being independent, Professor Ramsay⁹² made a number of recommendations. Interestingly, he recommended that the regulation of non-audit services provided by audit firms to their clients be dealt with in professional ethical rules, suitably updated to reflect proposals being made by the International Federation of Accountants (IFAC). Perhaps more controversially, he also recommended the establishment of an Auditor Independence Supervisory Board to be funded by the professional Accounting bodies. The other recommendations that I want to refer to here are those relating to amendments to the Corporations Act indicating a general statement of principle requiring an auditor to be independent and for the auditor to make an annual declaration, addressed to the board of directors, that the auditor has maintained its
independence in accordance with the Corporations Law and the rules of the professional Accounting bodies.

Importance of audit independence

Most would agree that the public’s perception of auditor independence is critical. In the words of the Chief Accountant of the United States SEC, ‘enduring public confidence begins with the auditor.’ In these respects, I should mention that the mandate of Auditors-General is usually legislated by Parliament with funding normally provided by means of parliamentary appropriations. In my case, I am an independent Officer of the Parliament. My independence is continually reinforced by the JCPAA.

5. Concluding remarks

While the Australian public sector has provided many examples of better practice governance, analysis undertaken by the ANAO and other bodies suggest there is still considerable scope for continued improvement.

Virtually all public sector entities have, at least in some form, the required elements of corporate governance in place. However, achieving better practice requires application of the principles of corporate governance – integrity, openness, accountability, integration, leadership and commitment. In addition, these principles and ensuing actions must be effectively communicated throughout all levels of the organisation and to all stakeholders to ensure they are well understood and accepted by all concerned. What is needed is ownership and commitment. They cannot be presumed. Consequently, there needs to be a heavy emphasis on people, and their knowledge and skills, in ensuring robust corporate governance frameworks.

Such arrangements have to be dynamic and flexible to meet the needs of all participants, including those of the general public. They require a holistic approach as the concepts and systems are interrelated. Weak links can severely constrain effective functioning. This is especially important for audit functions and monitoring board or other governing performance. Thus, corporate governance must embrace both the strategic and operational imperatives identified by management and Boards. Moreover it must provide an appropriate balance between conformance and performance, constantly adapting to varying operating conditions and other organisational imperatives over time.

The changing public sector environment will provide new challenges to corporate governance. I have discussed the potential impacts of more connected government and the impact of electronic technology. Discussions of these inter-related developments indicate that the pressures for good corporate governance will only increase, in line with the growth in ‘fuzzy’ accountability.

Of particular relevance for the topic of this paper are some key corporate governance lessons provided by Greenwood and Johnstone in their recent article. These are:
• Non-executive directors must ask difficult questions – they need to probe, follow up when insufficient information is provided by management and seek independent advice where necessary (eg regarding the performance of the CEO, external auditor’s reports, and legal advice).

• Beware the dominant director – particularly where that individual may be an executive director.

• Having an audit committee is not enough – it must be robust, independent and it must understand its role and report regularly and fully to the board.

• Board papers must be effectively presented – and management accounts in particular must be organised in such a way as to be readily accessible to directors.

• Ensure that there are effective risk management systems in place and get regular reports on legal, financial, operational and OH&S risks – these cannot just be ‘rubber stamped’.

• Listen to your internal and external auditors and consider the need to change external auditors on a regular basis to avoid ‘capture’.

In the public sector, Bob Sendt, my NSW counterpart, provides the following principles of effective governance for public sector boards.

• Legislation should clearly distinguish between advisory and governing boards.

• The respective roles, responsibilities and accountabilities of Government and its Ministers and boards should be clearly defined.

• Legislation should provide boards with the powers to match their governance responsibilities.

• There should be a consistency of approach for government boards in terms of the function of the board and the role of the government regardless of the nature, size, assets or income of the organisation being governed.

• Roles of Ministers and boards should be clear and separate. 95

In summary, there is a large authoritative body of knowledge about what makes good corporate governance. Many accounting and legal consulting firms are active in promoting and helping to implement such knowledge, particularly in the training of managers and board members. The challenge, as I see it, is to select those approaches that best meet the individual organisation’s needs and apply them rigorously. While there are no easy solutions to raising corporate governance standards in Australia, work undertaken by the ANAO in the federal public sector with APS agencies has clearly highlighted the contribution that good corporate governance can make to an organisation’s performance and to the confidence of all stakeholders.
While there are no easy solutions to raising corporate governance standards, I suggest that, if organisations adopt the frameworks, practices and attitudes I have discussed today, they would go a long way towards ensuring better practice corporate governance in the Australian public sector.
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