

Address to ANZSOG Students at ANU

**ANAO's Role in Encouraging
Better Public Service
Governance**

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ANAO'S ROLE IN ENCOURAGING BETTER PUBLIC SECTOR GOVERNANCE

1. Introduction

I appreciate the opportunity to speak at this session of the Managing Government Finances course on the role of the Australian National Audit Office (ANAO) and some contemporary issues in corporate governance, especially as it affects the public sector.¹

The need for appropriate corporate governance continues to be a major issue for leaders of many kinds, in respect of countries, corporations, not-for-profit entities and the public sector. The corporate governance reform agenda is proceeding strongly in Australia, in particular with the recent passage of the CLERP 9 legislation², as well as the Australian Government's recent response to the Uhrig review of the corporate governance of Commonwealth statutory authorities and office holders.³

At the ANAO, we are very conscious that virtually everyone in Australia has an interest in how well the public sector performs, in how well it achieves value for money outputs, and in how accountable it is to the public and the taxpayer in particular. There is a high expectation of the public sector, quite rightly in my view, that it will have exemplary governance and administrative practices.

Encouraging improvement in key areas of Australian Government governance and administrative practices is an underlying role of the ANAO. In this presentation, I will:

- explain the ANAO's role, authority and major activities;
- explain how the office encourages improvements in public sector governance; and
- discuss some topical issues in public sector governance.

2. Profiling the ANAO

Role of the ANAO

The office of the Auditor-General of the Commonwealth of Australia dates back to the beginning of Federation, being created by the Commonwealth Parliament in 1901. However, our experience in performance auditing, which covers the whole spectrum of governance issues, could be said to span less than one-quarter of that period. The Auditor-General, through the ANAO, provides an independent review of the performance and accountability of the Commonwealth public sector in its use of public resources. Through the delivery of an integrated range of high quality audit products that are timely, cost effective and consistent with public sector values and ethics, the ANAO aims to meet the needs and expectations of the Parliament, the Executive and audit clients and to add value to public sector performance and accountability. As with other public sector organisations, the ANAO expects to be judged both by its results and the manner in which it achieves those results.

The ANAO provides independent assurance to the Parliament, the Executive, Boards, Chief Executive Officers (CEOs) and the general public on the financial statements

and financial administration of Commonwealth public sector entities. For many, this is our ‘core’ business. However, the ANAO also aims to improve public sector administration and accountability by adding value through an effective program of performance audits, including business support process audits and related products, especially Better Practice Guides (BPGs). A growing element of the ANAO’s value adding activities is the communication of the ANAO’s activities and their outcomes through representation at meetings of a range of Parliamentary committees, agency audit committees and of Boards of government authorities and companies. The ANAO also seeks opportunities to contribute to the development of the accountability framework, including better practice and standards in public sector accounting and auditing, and through activities conducted with professional and other audit bodies in Australia and overseas.

Legislation

The *Auditor-General Act 1997* is a robust piece of legislation founded on the important notion of audit independence. The Act has received international acclaim. It establishes the Auditor-General as an ‘independent officer of the Parliament’—a title that symbolises the Auditor-General’s independence and unique relationship with the Parliament. Consequently, while the ANAO is part of a changing auditing landscape, currently challenging both public and private sector auditors, it is also set apart from it due to its statutory independence. This is one of the ANAO’s major strengths that enhances its reputation, credibility and effectiveness.

The Act outlines the mandate and powers of the Auditor-General and the functions of the ANAO, as the external auditor of Commonwealth public sector entities. Specifically, Part 4 of the Act governs the activities undertaken by the ANAO. These activities are described in some detail later in this paper. However, it is important to note that, even where the Act provides extensive powers for information-gathering (Part 5), the Parliament has expressed concern about the lack of audit access to, and reporting on, confidential information, particularly that classified as ‘commercial-in-confidence’ in contracts with the private sector. In addition, there has also been a question about access to the premises of private sector contractors. This concern resulted in some enhancement of the *Procurement Guidelines* put out by the Minister for Finance and Administration⁴, but no changes to the relevant Act.

I should also mention that Part 5 of the Act also imposes penalties for making false statements, etc and for disclosing information obtained in the course of performing an Auditor-General function when not actually performing that function. As well, there are ‘public interest’ tests in relation to the inclusion of ‘sensitive information’ in public reports with involvement of the Attorney-General in issuing a certificate stating that disclosure of information would be contrary to the public interest for reasons set out in sub-section 37(2) of the *Auditor-General Act 1997*.

Mandate

The Auditor-General has a broad mandate, currently enshrined in the *Auditor-General Act 1997*, to audit the financial statements of all Australian Government entities and, subject to some qualifications, for example in relation to Government Business Enterprises, to undertake performance audits of those same entities. A particular challenge in public sector auditing is the increasing tension over the role of national audit offices and the boundaries between government policy and its implementation. The Commonwealth Auditor-General’s performance audit mandate stops short of

review of Government policy decisions (see later). The scope of a performance audit may, however, incorporate the audit of information leading to policy decisions, an assessment of whether policy objectives have been met, and an assessment of the results of policy implementation both within the administering agency and, externally, any impact on other involved bodies.

Contribution to the Parliament

The Parliament is the ANAO's primary client. The ANAO's interaction with both individual parliamentarians and parliamentary committees provides the opportunity to ensure that financial and performance audit products and services are tailored to the Parliament's needs. The ANAO's relationship with the Parliament is crucial to its ability to maintain the quality and relevance of the ANAO's audit products. It is the Parliament that makes the ultimate decision on the ANAO's resources. This is important for signalling the independence of the Auditor-General by removing the issue of fee dependence between auditor and auditee in the Australian public sector.⁵ This is clearly a different relationship to that experienced in the private sector. Nevertheless, all ANAO products are fully costed as an important part of its accountability to the Parliament. As well, we provide assistance to individual Parliamentarians and Parliamentary Committees on request. Staff exchanges have also resulted in mutual benefit.

Independence

Corresponding with public sector changes, the role of the Auditor-General and the place of auditing in democratic government have also changed. While the accountability imperative remains constant, the role of the ANAO has evolved to take account of, and respond positively to, the ongoing public sector reform agenda. In today's environment, the ANAO's role includes providing independent assurance on the overall performance, as well as on the accountability, of the public sector in delivering the Government's programs and services and effectively implementing a wide range of public sector reforms. The importance of the independence of the Auditor-General in this respect cannot be overstated. As the public and private sectors converge; as the business environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have all the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them. Section 8 of the *Auditor-General Act 1997* confirms this.

The independence of the Commonwealth Auditor-General is a key feature of our democratic system of government. Three elements are crucial to reinforcing the independence of the Office: the powerful *Auditor-General Act 1997*; direct financial appropriation as part of the Budget process; and the ability of the Auditor-General to develop and set professional auditing standards for his/her Office. In practice, the latter are largely those set by the Australian Auditing and Assurance Standards Board (AASB), which are now being converged with the International Auditing and Assurance Standards. The ANAO takes an active role in commenting on the development of, and changes to, these standards.

The way in which the ANAO performs its functions further reinforces its independent status. The ANAO operates in an advisory capacity, rather than participating directly in decision-making by public sector managers. While ANAO officers are encouraged to 'stand in the managers' shoes' in order to understand the complexities of the particular business environments under review, it is for the managers themselves to

decide whether or not they will act on ANAO or other advice with reference to their particular risks and opportunities. We are not management consultants and seek to ensure we do not compromise our independence in any advice provided. The ANAO's 'observer status' as public sector auditors, rather than as participants, or apparent decision-makers, reduces the risk of conflict of interest issues arising in the course of its work. However, that does not absolve the ANAO from any responsibility to the Parliament for its views and actions.

A particular issue exposed in various reviews of corporate governance has been that of professional audit independence, which is at the heart of an effective governance framework. The debate over professional audit independence is not new, although it has attained an increased profile in the wake of the recent corporate difficulties and collapses in Australia and internationally. Audit bodies, and the accounting profession worldwide, have been actively engaged in clarifying and reinforcing independence for many years. This is illustrated by the international study undertaken on behalf of the International Federation of Accountants (IFAC) last year aimed at restoring credibility and confidence in the profession.⁶

While the ANAO takes a professional interest in this ongoing debate, it is also largely set apart from it by virtue of its statutory and functional independence. Nevertheless, there is an operational imperative involved, with the ANAO outsourcing a proportion of its audit work to private sector accounting firms. As well, with the increasing use of such firms by the public sector for internal audit, the ANAO is often dependent on their work in coming to an audit opinion on organisations' control environments and financial statements. In the latter respect, the ANAO has to be satisfied as to the quality of the work done under the requirements of the auditing and assurance standards.

The principles of audit independence in Australia are detailed in the Professional Statement F1, entitled *Professional Independence*⁷, released by CPA Australia and The Institute of Chartered Accountants in Australia (ICAA) in 2002. Compliance with the Professional Statement F1 by CPA and ICAA members has been mandatory since 31 December 2003. Under F1, independence is defined as:

- a) *Independence of mind*—the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and
- b) *Independence in appearance*—the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a *firm's*, or a member of the *firm's*, integrity, objectivity or professional scepticism had been compromised.

Comments on a revised version of F1, recognising the prescriptive independence tests recently legislated in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9), were due by 6 September last. CLERP 9 legislation incorporates the following measures designed to enhance auditor independence:

- the role of the Financial Reporting Council (FRC) will be expanded to cover oversight of the audit standard setting process and monitoring and advising on auditor independence;
- auditors will be required to meet a general standard of independence and make an annual declaration that they have maintained their independence;
- disclosure will be required of certain matters in relation to all non-audit services;
- restrictions on certain employment and financial relationships will be introduced and/or enhanced;
- auditors will be required to rotate after five years (and up to seven years where Australian Securities and Investments Commission (ASIC) relief has been granted);
- auditors will be required to attend company Annual General Meetings (AGMs); and
- ASIC will be given a power to impose conditions on auditors' registration.

Client focus

It is vital that the ANAO continues to be an active participant in the public sector's development of the changing Australian Public Service (APS) environment. While, in the past, the ANAO's prime focus may have been on ensuring compliance with legislation, including parliamentary appropriations, this has now been subsumed as part of a broader approach to assist agencies in improving public sector administration. To be successful, this approach requires considerable cooperation between the ANAO and the agencies and other bodies with which it deals. This means that our relationship management strategies are given particular prominence, with links being constantly formed and strengthened, particularly with our major clients. The ANAO does this through a range of activities including assistance to parliamentary and agency audit committees, liaison with State/Territory and international counterparts through forums such as the International Organisation of Supreme Audit Institutions (INTOSAI) and the Australasian Council of Auditors-General (ACAG), and ongoing interaction with the accounting profession, particularly through the major accounting bodies.

Such is the strategic importance of meeting clients' needs, it comprises the first of the ANAO's four key results areas on its balanced scorecard. The objective is to satisfy the needs and expectations of the Parliament, the Executive Government and of our audit clients in relation to performance assurance and accountability. The ANAO aims to do this by enhancing our dialogue and relationship with all members of Parliament and Parliamentary committees—particularly the Joint Committee of Public Accounts and Audit (JCPAA)—so that they are well informed about the ANAO's activities (a short explanation of the role of the JCPAA is provided later). As well, this should better place us to provide that Committee with timely and constructive assistance, including secondment of ANAO staff to assist parliamentary committees in reviewing matters relevant to our audit reports. The ANAO also strives to build on its product and professional relationships with the Executive Government and each of its audit clients so that it can continue to meet their audit related needs and contribute to public sector reform in our particular areas of knowledge and expertise.

It is important that the ANAO works cooperatively with agencies to gain genuine acceptance and implementation of its recommendations. We need to do so if the

ANAO is to be effective, add value, and maintain its credibility as an agent of change. The ANAO's preferred approach is to encourage agencies to take necessary remedial action and improvements by acknowledging and reinforcing any action taken by them in the course of our audits. ANAO officers endeavour to meet formally and informally with agency senior management throughout the year. In particular, the ANAO promotes their interest and involvement at the start of each audit and in planning processes to facilitate progress and completion of the audit as well as commitment to its findings and recommendations. Finally, the ANAO aims to meet its clients' needs by periodically reviewing the relevance and mix of its products and services, striving for innovative approaches, and continually improving the quality and effectiveness of its products and services. The above initiatives are aimed at securing the engagement and commitment of all stakeholders to the ANAO's work and its report findings and recommendations.

In addition to the contact referred to above, the ANAO also builds regular and ongoing liaison with its stakeholders into its annual planning process. The most important aspect of this liaison, in terms of setting strategy for the Office over successive financial years, is the development of the ANAO's annual audit work program (AWP). Information on the selection basis and process of the AWP is included in its Introduction.⁸ However, I would like to stress here the extensive discussion that takes place with agencies and the Parliament, notably with the JCPAA, which has the responsibility to bring together audit suggestions from the Parliament and makes recommendations to the Auditor-General in the context of the annual AWP. In this respect, I should observe that Section 8 of the *Auditor-General Act 1997* states that the Auditor-General is not subject to direction from anyone in relation to:

- (a) whether or not a particular audit is to be conducted; or
- (b) the way in which a particular audit is to be conducted; or
- (c) the priority to be given to any particular matter.

A particularly important facet of the ANAO's ongoing work with stakeholders is the relationships that have developed with the audit committees of individual agencies. Financial legislation introduced in January 1998 required all Australian Government bodies to establish an audit committee. The ANAO sees its relationship with audit committees as one of partnership. Senior ANAO staff routinely observe and participate in meetings of these committees. Through this mechanism the ANAO seeks to: develop its linkages with overall agency review processes; co-ordinate the ANAO's AWP with the range of ongoing internal agency review activities; and strengthen the effectiveness and credibility of audit committees in the eyes of both internal and external stakeholders.

Finally, senior executives at the ANAO have targets for Parliamentary liaison built into their individual performance agreements. The ANAO's ultimate aim is to be accessible to the Parliament and the APS to enhance the reach and significance of its work and to maintain its relevance and credibility through the acceptance, and implementation, of its audit findings and recommendations. Our particular emphases are on remedial action as necessary, better practice, and achievement of required results, while fully reflecting public service values and ethics in APS administration.

ANAO Accountability

Annual Report

The ANAO's annual report is the most public and comprehensive mechanism for demonstrating our accountability to the Parliament. The ANAO aims to include an analysis of achievements to date, as well as perceived challenges for the future. In this way, the ANAO provides the Parliament with a comprehensive overview of its performance over the preceding financial year and an indication of areas of priority and commitment for the future.

The annual report includes an assessment of the Office's achievements against its annual balanced scorecard. The scorecard incorporates the ANAO performance indicators set out in its Portfolio Budget Statements. The ANAO is subject to Senate Committee review of its estimates as are other agencies. The annual scorecard is explained in further detail later in this paper in relation to our performance.

Each year, the ANAO's annual report also includes results of quality assurance processes including peer reviews and benchmarking activities. It also includes commentary on the key strategic issues targeted by the ANAO for the next 12 months. This commentary, together with the publication of the results of the ANAO's audits every six months in the activity reports, allows the ANAO to contribute to contemporary debate on a broad range of issues facing the APS. Importantly, the commentary also provides a focus for ongoing discussion with the Parliament (notably the JCPAA), in setting appropriate strategies for the future.

Client surveys

Another important performance management and assessment mechanism is a survey of agencies and entities conducted separately from the Office. After each performance audit is tabled, feedback on the audit process is sought independently from the senior manager responsible for the audited program by means of a questionnaire and interview. An independent consultant performs this evaluation. The results of the most recent survey were positive, with key indices at their highest levels since the survey was commenced in 1997–98. Agency managers continued to support the ANAO's efforts to move to a more 'value adding' approach. They also referred to the value of ANAO reports and recommendations in providing assurance and in obtaining leverage to facilitate particular organisational strategies and activities. This survey is one of the most direct and credible ways that the ANAO has to test that its ongoing commitment to relationship management is achieving required results.

In addition, as well as the regular contact that the ANAO has with the JCPAA and other Parliamentary committees, the ANAO conducts face-to-face surveys of parliamentarians. These surveys are conducted periodically to help ensure that the ANAO is 'hitting the mark' in terms of its product mix. They also provide greater assurance that the ANAO will continue to be able to respond to the challenges of the future, and that it has a shared understanding of appropriate standards of accountability to lead and guide agencies into the future.

Other external scrutiny

In addition to the afore-mentioned review, and quality assurance procedures discussed later in this paper, the ANAO is subject to several layers of other external scrutiny,

including those applying to all other APS agencies and entities. The most important of these are:

- the JCPAA, in reviewing all the ANAO's reports to the Parliament as well as its annual budget; and
- the Independent Auditor of the ANAO, who carries out both the audit of the ANAO's financial statements and selected performance audits.

The JCPAA is a statutory committee with members from both houses of the Parliament and has particular responsibilities for the ANAO. The JCPAA carries out its own inquiries and reports; considers and reviews the operations, reports and performance of the ANAO; reports to the Parliament about the Auditor-General's functions and powers; is involved in the selection of the Auditor-General and of the ANAO's independent external auditor; and makes recommendations to the Parliament on the annual budget for the Office. The Committee reviews all ANAO reports with the senior audit staff involved and examines a selection at quarterly public hearings. The JCPAA may also conduct more broadly based inquiries into matters arising from an audit. The independent external Auditor conducts both financial statement and performance audits of the ANAO. Copies of the latter are included on our web site.

ANAO's Integrated Audit Approach

The ANAO's range of products aims to provide assurance that the risks facing the APS, and the management of its finances and programs, are being adequately addressed through an integrated audit approach. The ongoing challenge for the ANAO is to strike the right balance of audit activity across the public service to fulfil the ANAO's statutory obligations, while meeting the particular needs of the Parliament and individual agencies. The key to this outcome is understanding the Parliament's priorities and the business/functional imperatives of agencies that are creating a need for audit examination.

The ANAO is committed to delivering high quality audit products. The integrated audit approach applied by the ANAO is designed to address any expectation gaps in ANAO coverage. First, at the broader level across the public sector, the ANAO needs to ensure that its product mix and coverage are tailored to the environment in which it operates and to the accountability needs of the Parliament. As the APS environment changes, so do the associated accountability arrangements. The ANAO's audit product mix also needs to reflect Parliamentary concerns about compliance issues where there are perceived gaps appearing, as well as inadequacies being reflected in public administration.

The Parliament wants general assurance that the public service is working well. Further, the Parliament wants to know how public administration can be improved. The ANAO seeks to provide such assurance on the state of the APS and to contribute to improvements in the APS through the provision of a range of quality audit products. Those products are based on a thorough audit planning process, designed to address emerging issues in the APS, and to provide sufficient coverage of activities.

The second layer of the integrated audit approach occurs at the agency level where the ANAO aims to ensure that its audit services assist public sector entities to improve their performance and accountability, as well as to better manage their functions and/or business.

The ANAO is committed to an integrated auditing framework that draws on the strengths of both the assurance and performance audit sides of its business. The approach capitalises on intelligence gathered in each field and allows the ANAO to target areas for audit activity that add most value to overall public administration.

Range of audit products

The Auditor-General's mandate extends to 257⁹ public sector bodies, including Australian Government agencies, authorities, companies and their subsidiaries. These audit clients include Budget-dependent agencies involved in the delivery of core public services, and commercially oriented entities such as Government Business Entities (GBEs). The *Auditor-General Act 1997* provides the authority to undertake financial audits, performance audits, and to provide other information support services, including the development of BPGs. Performance audits of wholly-owned GBEs may only be undertaken at the request of the responsible Minister, the Finance Minister or the JCPAA. The Finance Minister is to consult with the responsible Minister before making such a request. However, the Auditor-General can ask any of these three parties to make such a request (Section 17 of the *Auditor-General Act 1997*).

The ANAO aims to provide well-targeted products and services that provide both assurance and value for money. The ANAO also attempts to provide an audit product continuum as a strategic approach to better governance. The ANAO fills the gaps between high-level performance audits and traditional financial statement audits with BPGs and Business Support Process audits covering a range of issues challenging the APS. The range of products currently produced by the ANAO includes the following major activities, that need to be put in the context of our overall audit effort. All our products are placed on our web site, indicated on the title page of this Paper.

Performance audits

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

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

The Explanatory Memorandum to the Auditor-General Bill made it clear that “The Auditor-General’s ‘performance audit’ functions do not extend to examining, or reporting on, the appropriateness of Government policy.”¹⁰

Performance audits are conducted in all ministerial portfolios with the main concentration being directed to portfolios with significant Government outlays or revenues. Performance audit reports, including Business Support Process audit

reports, are tabled in the Parliament (61 in 2002-03, and 57 in 2003-04). All recent performance audit reports are placed on the ANAO's homepage at <http://www.anao.gov.au>, and are also summarised in the ANAO's series of six-monthly activity reports.¹¹ They are also listed progressively in each performance audit completed.

The JCPAA reviews all our reports, as noted earlier, and makes a selection of up to five each quarter for public hearings and report. This is an important element of accountability and is indicative of our performance, particularly in the implementation of our recommendations. In my view, this is a key performance measure for the ANAO. We do have follow-up audits to review the extent to which our recommendations are being implemented, or have been implemented. Our representation on entities' audit committees also provides an opportunity to review this outcome as well. Ministers also provide regular reports to the Minister for Finance and Administration on this issue. However, the JCPAA public hearing process is probably the most effective action, particularly where the Committee itself institutes a follow-up process, including its own separate inquiry and report on occasions.

Performance audits often involve assessments of governance, probity and the quality of management in individual agencies. While the auditor's professional opinion in these cases is derived from compliance with rigorous standards, and therefore provides a high level of assurance, the audit does not provide complete assurance as to the entities' operations. This 'expectation gap' is a complex issue that challenges the profession as much as it challenges our immediate range of stakeholders. Different perceptions and requirements inevitably arise which need to be addressed. However, all entity comments are included in our reports which aids the Parliament's, and the general public's, understanding of the issues.

Business Support Process audits

General performance audits include what we call Business Support Process (BSP) audits. Assurance is provided to a greater extent through the conduct of BSP audits that examine business processes which support the delivery of outputs by public sector agencies. The focus of BSP audit reports is essentially the efficiency and effectiveness of the accountability, control, and compliance mechanisms and systems operating within public sector agencies. The audits are generally conducted in a number of agencies, with findings reported in generic terms to the Parliament and on an individual basis to client agencies. Output from these may also include BPGs. BSP audits replaced what we described as financial control and administration audits, and assurance and assessment control audits, previously undertaken by the ANAO.

Cross-agency audits

The ANAO has sought to maximise its efforts and the value added to public sector administration through an increased focus on cross-agency audits. These audits are designed to provide an analysis of performance across the public sector. They are conducted on agencies where there are shared objectives, shared service delivery or, simply, a sharing of common issues. These audits are important as agencies increasingly find new methods to deal with shared issues, and form alliances and partnerships, including with the private sector, to deliver government services. This approach is also becoming more important with the greater use of a 'whole-of-government' approach to public administration.

Cross-agency audits are conducted where aspects of performance management or control arrangements across the APS are to be reviewed by the ANAO as a performance audit. Issues can be identified for cross-agency coverage in the course of a financial statement audit, where that issue is identified as likely to apply to a number of agencies across the APS. The ANAO considers that the ability to leverage off experience and knowledge gained from these multi-agency audits provides a significant return for the audit effort involved. Topics covered, or planned to be covered, via cross-agency audits in the current Audit Work Program include annual performance reports, intellectual property, special accounts, performance management, fraud, workforce planning, outsourcing of legal services, and Internet service delivery.

Assurance audits

Financial statement audits express an opinion on whether financial statements of Australian Government entities have been prepared in accordance with the Government's reporting framework and give a true and fair view (in accordance with applicable Accounting Standards and other mandatory professional reporting requirements) of the financial position of each entity as at year end, and the results of the entities' operations and the entities' cash flows. In 2002–03, the ANAO conducted assurance audits of 257 entities. We will audit 254 entities for 2003-04.

In addition to the audit opinion on the financial statement, the ANAO provides each client with a report that deals with the results of the financial statement audit process. A report is also provided to the responsible Minister. The ANAO also provides two cross-entity assurance reports each year to Parliament. The first details the results of an assessment of the control structure of major entities¹², while the second provides a summary commentary on the results of all financial statement audits undertaken in the 12-month audit cycle ending in October of each year.¹³

Information Technology (IT) Audits

For many years, the ANAO has invested in the use of technology to provide more efficient and effective audit products to the Parliament. The ANAO's IT Audit section exists to provide an integrated audit support service to all business units within the ANAO, with responsibility for management and delivery of both performance and assurance audit activities.

Specifically, the ANAO's IT Audit section provides the following services:

- technical consultancy and advice on IT risks, controls and emerging issues;
- review and assessment of client corporate and business IT systems, processes and procedures; and
- technical audits over networks, operating platforms and database management systems; and the use of computer-aided audit techniques to interrogate and analyse data.

The results of these services include a number of value-adding recommendations for the individual clients. These are aggregated, with other recommendations relating to internal controls, and tabled in the Parliament as part of the ANAO's annual 'Controls Report' to provide the Parliament with an overview of the strengths and weaknesses in its IT environments. The report for 2003-04¹⁴ was tabled in the Parliament on 30 June last.

Better Practice Guides

The *Auditor-General Act 1997* (Section 23) gives the authority for the Auditor-General to provide information to public sector bodies. This has facilitated the development of a program of Better Practice Guides (BPGs) (as well as client seminars) designed to assist public sector agencies in improving their performance. BPGs aim to improve public administration by ensuring that better practices employed in some organisations are promulgated to the whole of the APS. The ANAO is in a unique position to compare operations across the public sector, and sometimes with the private sector, allowing it to add value to a wide range of stakeholders. This is important as agencies increasingly develop individual approaches to deal with common issues, often a matter of virtually re-inventing the wheel. In some cases, they were employing the same consultants to provide the same, or similar, advice.

The program for BPGs is based on the ANAO's understanding of the emerging issues impacting on the performance of the public sector. BPGs may be produced in conjunction with a performance audit or, alternatively, a BPG might be prepared as a result of a perceived need to provide guidance material in a particular area of public administration. The development of BPGs may involve examining practices in the public and private sectors, in Australia or overseas.

BPGs are important outputs in the achievement of the ANAO's outcome of 'Improvement in Public Administration'. BPGs add value by bringing together lessons learnt across the public sector and have been well received by program managers looking to learn from the experiences of others. BPGs also provide a very valuable source of audit criteria for future audits, which is their justification from an audit viewpoint. That is not to say that they need to be undertaken by the ANAO. However, BPGs can be often completed at a relatively small marginal additional cost to that of the audit.

BPGs and similar publications are becoming increasingly important source documents for managers operating in an environment of devolved authority and responsibility. These documents are of particular value to small agencies that find it difficult to develop and maintain in-house expertise on the wide range of public sector management issues, and which have tended to rely heavily on detailed legislative and policy frameworks and guidance from central agencies. The ANAO has often worked with other agencies in the production of some BPGs, including the recent guides developed on Goods and Service Tax (GST) Administration, compiled with the Australian Taxation Office,¹⁵ and on annual performance reporting prepared in association with the Department of Finance and Administration.¹⁶

Information services

The ANAO also provides information services, including assistance to the Parliament, national and international representation, and client seminars. Assistance to the Parliament includes the provision of submissions to Parliamentary committee inquiries and reviews and briefings on audit reports tabled in the Parliament.

ANAO staff also organise and participate in conferences, seminars and workshops to share expertise and disseminate better practice and lessons learnt from the auditing activity. A growing element of this role is communicating the ANAO's activities and outcomes through representational activities with a wide range of stakeholders and

contracts, including Parliamentary committees, boards of government authorities and companies, as well as professional organisations.

The ANAO also produces a quarterly magazine, *Opinions*, published to provide audit clients with details of recently completed performance audits and BPGs. It also lists audits scheduled for completion in the near future and information on developments in financial reporting and disclosure. These are important complementary initiatives as part of our overall audit approach, to meet our assurance and performance objectives.

3. ANAO efforts to encourage better public sector governance

As I mentioned earlier, the ANAO provides an independent review of the performance and accountability of Commonwealth public sector in its use of public resources. In its efforts to add value to public sector performance and accountability, the ANAO encourages improvements to public sector governance and administration.

However, I cannot overemphasise the fact that the ANAO, and all other external public sector auditors, operate in an advisory capacity, rather than participating directly in decision-making by public sector managers. As I stated earlier, while I urge my officers to ‘stand in the managers’ shoes’ in order to understand the complexities of the particular business environments under review, it is for the managers themselves to decide whether or not they will act on ANAO or other advice with reference to their particular risks and opportunities.

I have always viewed public sector governance very broadly. In my view it encompasses 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. In many ways, corporate governance is a combination of legal and ‘better practice’ organisational structure and management requirements, aimed at facilitating accountability and improving performance.¹⁷

Therefore, organisational governance goes 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’ that is essential for sound governance.

*Simply following procedures is not sufficient for good governance. Embedding desired values, organisational culture, and attitudes are all elements of governance.*¹⁸

Because my office views organisational governance very broadly, most of its activities are focussed on improving governance in public sector agencies. In particular, common themes emerging from our audit reports that highlight where weaknesses have arisen in public administration which agencies should take account of in their core governance arrangements include:

- monitoring and reporting—performance assessment;

- control structures;
- risk management;
- the application of corporate governance principles; and
- board issues.

I would temper these comments by highlighting some of the strengths of corporate governance in the APS. Virtually all Commonwealth government entities have, at least structurally, the main elements of governance in place and have improved their efforts to integrate them in a holistic framework. Further, I am of the view that the APS Code of Conduct and other values systems have provided a sound basis for an ethical public service, dedicated to achieving organisational objectives. The role of internal audit, and the existence of independent external audit, have also provided the APS with a stronger capacity than the private sector to examine controls and performance and to report frankly and fearlessly about management to Ministers and the Parliament. In general, the public sector does have greater accountability and transparency than the private sector, contributing to improved governance, albeit in a more complex environment.

I will now briefly outline some of the recent ANAO audit products that have encouraged improvements in public sector governance.

Performance audits

In February 2004, the ANAO tabled an audit that focused on governance arrangements of the National Health and Medical Research Council (Council).¹⁹ The audit involved a review of a range of issues, including: administrative arrangements; accountability structures; legislative obligations; planning, monitoring and reporting of performance; and administrative systems. The audit concluded that the legislative framework and resulting administrative arrangements under which the Council operates did not facilitate sound administration. In addition, the audit found that the framework necessitated administrative arrangements that were cumbersome and included multiple lines of accountability, as well as unclear roles and responsibilities. The ANAO also acknowledged the complexity of the Council's operating environment and the efforts of the Council over recent years to improve its governance arrangements. The audit made six recommendations, all of which were agreed, some in principle.

The ANAO has also conducted governance audits of the Australian Electoral Commission²⁰ and the Australian Broadcasting Commission.²¹ Both audits identified areas for improvement in the agencies' governance frameworks, with a number of recommendations aimed at strengthening these frameworks.

The ANAO has also tabled many audits that address process, control and performance monitoring aspects of public sector administration. For example, Audit No. 4 of 2004-05, *Management of Customer Debt*, assessed whether Centrelink effectively manages customer debt, excluding debt relating to Family Tax Benefit, consistently across its network, ensuring integrity of payments made on behalf of the Department of Family and Community Services (FaCS).

The audit found that Centrelink had significantly improved the effectiveness of many debt management processes and practices over the past one to two years. However, customer debt continues to increase rapidly. Despite Centrelink's overall commitment

to providing consistent services to customers across its network, the ANAO concluded that Centrelink did not manage debt consistently across its network. Centrelink was not able to inform the ANAO about the standard of service it provides to customers with debts, as it does not collect information about customer satisfaction with debt servicing activities. This lack of monitoring also made it more difficult for Centrelink to ascertain whether its debt recovery activities placed customers in 'real financial hardship'. The ANAO made nine recommendations to improve Centrelink's debt management capacity. Centrelink agreed to all recommendations, one with qualification.

An important area of interest in ANAO's general performance audits is fraud control. The ANAO has had a long-term policy of referring matters of fraud to the Australian Federal Police for investigation in accordance with sub-section 36(2) of the Auditor-General Act, and therefore has only limited forensic audit capability. Nevertheless, we have conducted a series of audits examining the ways in which entities deal with fraud control, including having appropriate fraud control plans.²² However, we are having to think strategically about the need for future forensic auditing capability, as this has become an important element of the assessed 'audit expectation gap' related to internal control. As well, a revised auditing standard to apply from later this calendar year requires auditors to be more pro-active in considering the risk of fraud in an audit of financial statements. This includes discussion of how those statements may be susceptible to material misstatement due to fraud and what audit procedures would be more effective for their detection (my underlining).

The focus of the United States Sarbanes-Oxley legislation (Section 404) on Internal Control has had an impact on thinking in Australia in the above respects, with greater attention being given to this element as an aspect of better practice demanding greater audit attention. In particular, Section 404 of the Act requires an annual assessment by management of the effectiveness of internal control over financial reporting and an attestation report by the external auditor on that assessment. Not surprisingly, the most difficult aspect of control relates to information technology systems and data.

Business Support Process audits

In July 2004, the ANAO tabled Audit No. 3 of 2004-05, *Management of Internal Audit in the Australian Public Service*. The objective of the audit was to assess whether selected Commonwealth organisations had utilised better practice principles when establishing the role, and managing the use of their internal audit groups. In order to evaluate internal audit, the ANAO first considered the status and accountabilities of internal audit within the overall governance framework of the organisations audited, in particular its accountabilities to the audit committee.

The audit concluded that each of the audited Commonwealth organisations had established an internal audit group, with responsibilities and accountabilities that were largely consistent with better practice guidance and professional requirements, as well as the legislative requirements of Commonwealth audit committees, including independence. The audit also found internal audit charters adequately articulated the role of internal audit, and were supplemented by business plans and other procedural documents. Overall, the ANAO considered that, in line with heightened expectations and requirements relating to governance, risk management and audit assurance, there is a need for priority to be given to the improvement of the management and use of internal audit by Commonwealth organisations. The ANAO made eight

recommendations for the improvement of internal audit, which may be relevant to all Commonwealth organisations.

In August 2004, the ANAO tabled Audit No. 6 of 2004-05, *Performance Management in the Australian Public Service*. The audit assessed the efficiency and effectiveness of the administration of performance management, and the extent to which agencies' performance management systems, strategies and plans complied with relevant guidelines.

While this audit found that progress has been made in consolidating the processes of performance management, the ANAO concluded that there is scope for agencies to do more to establish that their systems are effective, and effectively contribute to organisational outcomes. The ANAO considers that, in 2004, performance management in the APS can still best be described as 'work in progress' and these same two issues are still at the forefront of the major challenges that remain. The audit also found that some agencies have scope for improvement in demonstrating that their performance management systems, strategies and plans are consistent with the strategic framework set out by the Management Advisory Committee.

Assurance Audits

The Control Structures Report²³ updates the ANAO's ongoing assessment of audit findings relating to major entity internal control structures, including governance arrangements, information systems, and control procedures through to March 2004. The report also provides a summary of the financial, accounting, and Information Technology (IT) control processes adopted by entities. It includes an update on the broader corporate governance issues that impact on financial management and reporting.

As part of the financial statement audit process, the ANAO assesses whether an entity's internal control environment comprises measures that contribute positively to sound corporate governance. The measures should mitigate identified risks and reflect the specific governance requirements of each entity.

Prior year reports noted that improvements were required by some entities in a number of control areas. Entities generally acknowledged that enhancements were necessary in areas such as:

- increased risk awareness assessment and better management, including the use of performance management tools such as data metrics to monitor trends in risk and its treatment;
- enhancing the quality and presentation of monthly financial reporting;
- integrating financial and non-financial data as part of the development of credible performance measurement assessment frameworks; and
- improving the capacity of internal audit functions to deliver a blend of compliance, performance, and risk-based audit services.

ANAO audit observations this year indicate that progress has been achieved across most entities in the above areas. However, in some cases, further progress and refinement are still required. This is particularly the case in respect of expanding the level of reporting of non-financial performance measures.

In addition, the review of the underlying causes of corporate failures that occurred in Australia and overseas in recent times has continued to increase the focus on sound

corporate governance within the APS. Of significance, is the need for continual diligence with conformance issues together with heightened awareness of the need for continuous improvement in performance management.

The ANAO rates its findings according to a risk scale. Audit findings which pose a significant business or financial risk to the entity and which must be addressed as a matter of urgency, are rated as 'A'. Findings that pose a moderate business or financial risk are rated as 'B'. These risks should be addressed within the next twelve months. Findings that are procedural in nature, or reflect relatively minor administrative short comings, are rated as 'C'. The timing of action on these findings is at the discretion of the entity.

The report found that overall, the results of audit activity over the past year indicate that control procedures over business and accounting processes have generally been maintained at a reasonable level. This was demonstrated by:

- the number of entities with 'A' category issues remained constant at one in 2003-2004;
- the total number of 'B' category audit issues across all entities increased from 68 in 2002-2003 to 98 in 2003-2004;
- seven entities reported an improvement in the number of 'B' category audit issues, 10 entities showed a deterioration in their position, with five entities remaining in the same position; and
- the number of categories with no category 'A' or 'B' audit issues remained at three.

Perhaps the biggest challenge for organisational governance and assurance auditing is in the area of sustainability reporting embracing social, economic and environmental performance. The ANAO prepared a verification statement on the first such report prepared by the Department of Family and Community Services last year. This year, that agency will be joined by the Department of The Environment and Heritage with its first report.²⁴

Better Practice Guides

The ANAO has provided a series of BPGs on public sector governance. The first such guide was released in 1997 and promoted governance principles and better practices in budget-funded agencies.²⁵ A complementary guide was released in 1999, examining governance in Commonwealth authorities and companies.²⁶ The third and latest guide²⁷ was released on 25 July 2003. It discusses better practice governance for all types of APS organisations.

The new guide is different in nature to the previous two, which were structured to address specific purposes. The first guide dealt with the application of governance in public sector agencies and, in particular, made the case for the establishment of executive boards for agencies. It predated the FMA Act and the CAC Act. The ANAO issued the second guide as a discussion paper in 1999, which was designed to assist members of the boards and senior managers of CAC Act bodies to evaluate their governance frameworks and make them more effective.

With the publication of the third, and current, guide the scope has widened again. In essence, it provides more practical guidance. While the latest guide incorporates recent legislative changes and reflects current concerns, the previous two guides

remain useful, as the practices and principles they endorse continue to provide the foundations of better practice public sector governance.

The ANAO has produced these guides on public sector governance to provide some clarity for organisations that may be audited, but also because there have been few alternative sources of better practice information on governance focussed on the public sector. While there has been quite a rapid increase in documented guidance on 'corporate governance', especially by professional bodies, such as the Australian Institute of Company Directors and the Institute of Chartered Secretaries (Australia), and by legal firms, these remain mainly directed towards private sector needs and requirements.

Other BPGs that the ANAO has released in recent years that support agencies to deliver elements of governance include:

- Fraud Control in Australian Government Agencies (August 2004);
- AMODEL Non-Commercial Authority Illustrative Financial Statements for the Year Ended 30 June 2004 (May 2004);
- Annual Performance Reporting (April 2004);
- Administration of Grants (May 2002);
- Performance Information in Portfolio Budget Statements (May 2002); and
- Business Continuity Management (January 2000).

ANAO contribution to governance projects

The ANAO is also involved in two distinct projects that aim to improve public sector governance. These are, the:

- ARC Linkage Grants Project on corporate governance; and
- ANU-Monash project on accountability.

ARC Linkage Grants project on corporate governance

The ANAO is currently participating in a \$1.4 million Australian Research Council linkage grants project with the University of Canberra and other organisations, to examine governance on a multi-disciplinary basis, with the aim of producing an integrated cross-governance framework.

This framework will provide customized guidance according to organisational type. The major outcome will be to advance knowledge of corporate governance and its applications within government, communicated through scholarly, governmental, and web-based resources.

Andrew Podger, the Australian Public Service Commissioner, launched the project in May this year. Professor John Halligan, one of the academics undertaking the study, made the point at the launch that:

Good public corporate governance relies on keeping pace with best practice in the private sector corporate governance. That is, harnessing the potential that corporate governance principles can offer. Importantly, however, it also requires an understanding of the tensions and gaps that arise in the transposition of corporate governance from

*the private to the public sector, so that public sector corporate governance can be modified accordingly.*²⁸

The project is in the first year of a three-year schedule. The project methodology has been determined and interviews have begun with a range of public sector executives and board members, seeking their views on a range of governance issues. These issues include communication between the CEO, board members and Ministers, inclusion of stakeholders views via governance mechanisms, monitoring governance as opposed to entity performance, and appointment of board members.

ANU Monash project on accountability

The ANAO, and the Australian National University, are also contributing to research being undertaken by the Centre for the Study of Privatisation and Public Accountability at Monash University. The aim of the Centre is to:

..investigate crucial questions that concern the relationships between government and community in a privatised state.²⁹

The ANAO, together with Professor Richard Mulgan, is specifically contributing to a project on public-private partnerships, *Risky Business?* The project investigates the concept of risk in contracts, including the level of risk; the financial arrangements in place to cover these risks; and analyses the degree to which political, social, policy or other risks are recognised and managed in public-private partnerships.³⁰

4. Topical Issues in Public Sector Governance

Before proceeding to discuss some topical issues in corporate governance in Australia, I will briefly review the fundamentals of corporate governance, as outlined in the ANAO's recent better practice guide on public sector governance.³¹ In doing so, I will I thought it might be useful to put the public sector governance challenge in context by emphasising the complexity of this sector.

Adopting Better Practice Public Sector Governance

Notwithstanding the recent increase in professional and public attention, governance practices and principles have been the subject of ongoing debate in both the public and private sectors over the past couple of decades. The debate first emerged in the 1980s, where the reaction to that decade's corporate turbulence stimulated some improvement to private sector governance practices.

In parallel, public sector governance has been extensively reviewed. The public sector has adopted many of the reforms initially targeted at the private sector, and also led in many other governance areas, especially related to accountability and transparency to stakeholders.

These reforms have focussed on the two main requirements of organisations, namely conformance and performance.

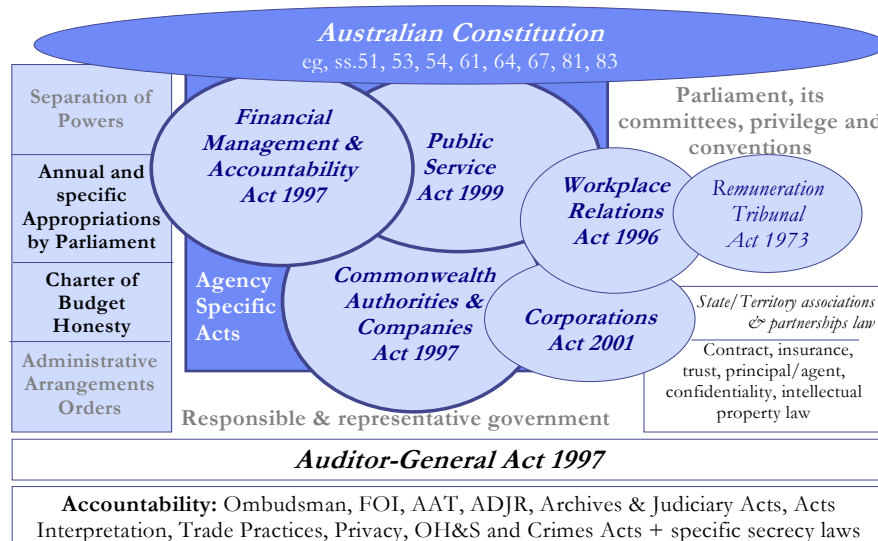
- **Conformance** is the organisation using its governance arrangements to ensure it meets the requirements of the law, regulations, and standards; as well as community expectations of honesty, accountability and openness.
- **Performance** is the organisation using its individual governance arrangements to enhance its overall performance and the delivery of its goods, services or programmes.

Organisations need to achieve both sets of objectives, and not trade one off against the other. Using an integrated risk management framework will help develop the right control environment and provide reasonable assurance that the organisation will achieve both, within an acceptable degree of risk. That is not to say that those who govern may not give more of an emphasis to one requirement over another at particular points in time.

Dealing positively with risk has been, and continues to be, a challenge for APS organisations. The traditional risk averse approach taken by most public servants has been reinforced by comments and criticisms in the Parliament, particularly, in estimates examinations. More positive support for risk management has come from the JCPAA. As the new standard for risk management indicates: “it is an integral part of good management practice and an essential element of good corporate governance”³². However, most agencies are still endeavouring to embed the notion in their organisational culture and business processes and practices.

As shown in the following Figure, the Commonwealth public sector has an extensive legal, regulative and policy framework (that government organisations must comply with and conform to) that regulate the activities of the Australian Public Service, CEOs and their staff.

Figure 1: Legal elements affecting governance in the Commonwealth



Source: Department of Finance & Administration.

The legal framework for governance in the APS is largely derived from:

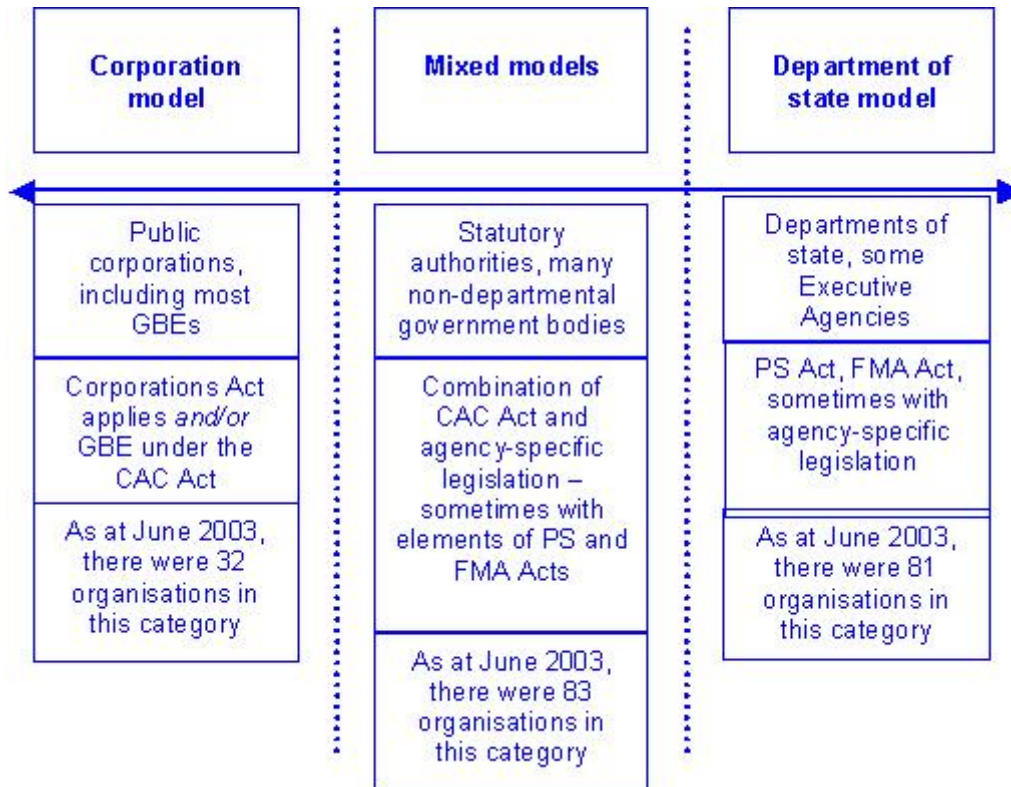
- the *Financial Management and Accountability 1997* (FMA Act) which mainly applies to entities that are financially and legally part of the Commonwealth and do not own their own assets. These are typically ‘core’ government departments responsible for policy development but also include statutory authorities (some 17 Departments of State, five Parliamentary Departments and 58 prescribed agencies);
- the *Commonwealth Authorities and Companies Act 1997* (CAC Act) which applies to those Commonwealth entities which have been established as separate legal entities and can hold moneys in their own right (some 84

Commonwealth authorities and 28 companies). Some of these entities are predominately Budget-funded; others operate on a commercial basis; and

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

The main governance structures in the Commonwealth public sector can be illustrated by the following Figure drawn from the Better Practice Guide.

Figure 2: Structures of governance in the Commonwealth public sector



Source: Department of Finance and Administration, *List of Bodies Subject to the CAC Act 1997* and *List of Agencies Subject to the FMA Act 1997*.

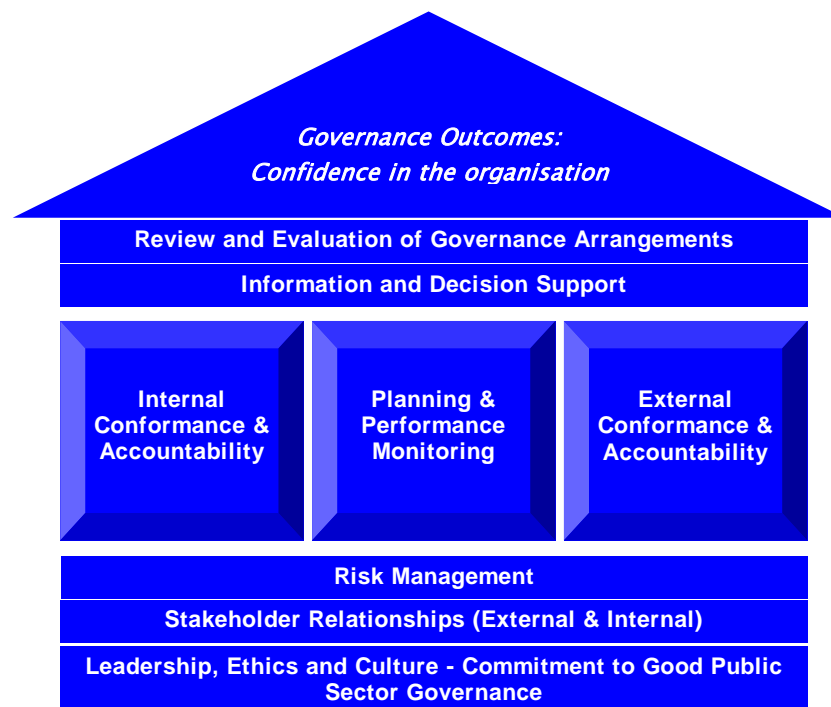
As most Commonwealth agencies now have procedures in place to help them comply with the legislative requirements depicted in Figure 1, the next major task is to draw these procedures together so that the day to day operations of organisations supports robust governance, which in turn supports good performance. The ANAO has adapted a model developed by the Queensland Department of Transport to show the elements of good governance and how they relate to each other as shown in Figure 3.

It is important to understand that, while each element is important and useful in itself, the relationships that are established between them are crucial to the successful performance of an organisation. Consequently, the aim is not only to have the necessary elements in place, but to create positively reinforcing links between them. These elements are dynamic factors in a governance framework which has to be well understood by all concerned. It is not someone else's responsibility. There needs to be shared ownership and commitment if the necessary integration of activities and approaches is to occur.

The overall governance outcome that we seek is stakeholder confidence in the integrity and performance of an organisation. You can see the progression from the

foundation of leadership, ethical conduct and a culture that is committed to achieving good public sector governance, through good stakeholder management and development of a risk management culture, to the performance and conformance windows. On top of that, information and decision support, and review and evaluation of governance arrangements, impact heavily on the ability of the public sector organisation to achieve desired governance outcomes.

Figure 3: The house of public sector governance



Source: Adapted from a model developed by the Queensland Department of Transport in its *Corporate Governance Framework for Queensland Transport and Main Roads: Final Report*, July 2001.

However, as I mentioned earlier, having the correct frameworks in place is not sufficient to guarantee good governance practices. In Australia, this was emphasised by Justice Owen in his report on the HIH collapse. After noting that HIH had a stated corporate governance framework, consisting of matters usually included in corporate governance frameworks, he 'found (him)self asking rhetorically: did anybody stand back and ask themselves the simple question - 'is this right''?³³

Justice Owen was effectively asking whether the directors and senior managers at HIH were personally satisfying the principles of good corporate governance.

The ANAO has primarily used the group of principles first articulated by the Nolan Committee of the UK in 1995, which have stood the test of time. They are:

- *Accountability*: where public sector organisations and the individuals within them are responsible for their decisions and actions, and where they are subject to external scrutiny.
- *Transparency*, or openness: is required to ensure that stakeholders have confidence in the decisions and actions of public sector organisations and the individuals within them.

- *Integrity*: is based on honesty, objectivity, and high standards of propriety and probity in the stewardship of public funds and resources.
- *Stewardship*: reflects the fact that public officials exercise their powers on behalf of the nation, and that the resources they use are held in trust and are not privately owned.
- *Leadership*: is one of the more crucial principles. It sets the tone at the top of the organisation, and is absolutely critical to achieving an organisation-wide commitment to good governance.
- *Efficiency*: is about the best use of resources to achieve the goals of the organisation, and is also about being able to prove that the organisation has indeed made the best use of public resources.

It is through applying these principles, within an appropriate public sector governance framework tailored to the characteristics of each entity, that public sector entities will be able to conform with all legislation and relevant policies, and moreover, perform strongly against their specified objectives.

Current issues in public sector governance—standardising governance structures

Uhrig review of corporate governance of statutory office holders

In August 2004, the Government released its response to the much awaited *Uhrig* report on the *Review of Corporate Governance of Statutory Office Holders*. The focus of the Uhrig review was on a select group of agencies with critical business relationships, including the Australian Taxation Office, the Australian Competition and Consumer Commission, the Australian Prudential Regulation Authority, the Reserve Bank of Australia, the Australian Securities and Investments Commission, the Health Insurance Commission and Centrelink.

The review aimed to identify reforms that could assist these agencies improve their performance, without compromising their statutory duties. The terms of reference of the review required an examination of structures for good governance, including relationships between statutory authorities and the responsible Minister, the Parliament and the Public, including business.

While recognising there is no universal definition of corporate governance, John Uhrig defined corporate governance, for the purpose of the review, as being:

*...the arrangements by which the power of those in control of the strategy and direction of an entity is both delegated and limited to enhance prospects for the entity's long term success, taking into account risk and the environment in which it is operating.... Governance should be enduring, not an instrument that is exercised from time to time depending on the circumstances.*³⁴

The review identified what it termed as elements central to the governance of agencies, whether they are in the public or private sectors. The elements included:

- understanding success: there needs to be a clear understanding by those in control about what the entity is to achieve, and this must be communicated to management;

- organising for success: an entity should be organised to allow it to achieve its purpose. This includes:
 - implementing the right organisational structures; and
 - ensuring that power is in existence, delegated, limited and exercised; and
- making sure success is achieved: ensuring that those responsible for performance are aware of the outcomes they are required to achieve and are provided with the resources to achieve them.

The review found that, for several of the authorities examined, there was a lack of effective governance. Specifically, the review identified that the lack of governance stemmed from unclear boundaries in the authorities' delegation, a lack of clarity in the authorities' relationships with their Minister, and a lack of accountability for the exercise of their power. John Uhrig believed Statutory Authorities would also benefit from greater clarity in the definition of their purpose.

This finding is also recognised in the newly released CCH Manual on Public Sector Governance- Australia which identifies that:

*good governance is more achievable if there is clarity among the various players, the responsible Minister, the board or Chief Executive and the employees of the organisation concerned....*³⁵

The Uhrig Report also identified the structure of the board, and its power, as major issues facing the effective governance of statutory authorities. Some authorities were found to have boards which lacked any governance powers, such as the power to appoint a CEO. These Boards' powers rested in their ability to influence the Minister. However, in an authority where the primary relationship is between the CEO and the Minister, this influence was further discounted. Like many organisations, public sector organisations were found to experience difficulties in recruiting experienced directors, particularly the larger Commonwealth authorities.

The review made seven recommendations, with the Government agreeing to all but one of these recommendations, that is, the establishment of an Inspector General of Regulation. The recommendations included:

- Ministers issuing Statements of Expectations to Statutory Authorities, and these Authorities responding with Statements of Intent, to be approved by the Minister, to help clarify the roles of the Authorities. These statements should include the values that are pivotal to the Authorities' success;
- reinforcing the role of portfolio departments as the principal source of advice to Ministers;
- ensuring that Governance Boards are only implemented in Statutory Authorities where they can be given the full power to act. In particular, Statutory Authorities of a commercial nature were generally more suited to operating under a board. Statutory Authorities, whose main purpose was to provide services on behalf of the Commonwealth, or were regulatory authorities, were found to be better suited to operating without a board, as it is unlikely that a board in these Authorities would possess the full power to act;

- the establishment of a centrally located group to advise on the appropriateness of governance and legislative structures for Statutory Authorities; and
- ensuring financial frameworks of Statutory Authorities are applied, based on their governance characteristics. Authorities which are legally and financially part of the Commonwealth should apply the *Financial Management and Accountability Act 1997*. Authorities which are legally and financially separate from the Commonwealth, and are best governed by a Board, should apply the *Commonwealth Authorities and Companies Act 1997*.

Uhrig developed a number of governance principles, accompanied by two governance templates incorporating these principles. The templates consisted of a 'board' template and an 'executive management' template. The templates aimed to improve the transparency and accountability of Statutory Authorities, as well as their efficiency and effectiveness.

The Report also drew attention to the current purchaser/provider agreements in place between the Department of Family and Community Services and Centrelink, and the Department of Health and the Health Insurance Commission. However, it could not identify any net benefit to the Commonwealth by these agreements due to the absence of purchasing power by the portfolio Department. The Report noted the considerable resources being used to manage these agreements. More specifically, the purchasing department obtained little leverage from these agreements as:

- the cost of these services was paid for prior to them being delivered;
- there were no alternative providers; and
- the service providers could not identify transaction costs for the services being delivered.

The Government agreed that Ministers are to assess their portfolio bodies against the governance principles and templates recommended in the Uhrig Report. Letters have been forwarded to portfolio secretaries with the Schedule for assessment. The intention is for Ministers to complete assessments by 31 March 2006 and to implement any improvements resulting from assessments, including any legislative changes, by 31 March 2007. Of course, that action will depend on the election outcome.

Accountability: Whole-of-Government Approach

Traditionally, the public sector has performed its business in a fragmented way, with discrete agencies having monopoly responsibility for particular areas of interest. The Prime Minister observed recently that a particular challenge for the future of the APS is:

*the capacity of departments to successfully interact with each other in pursuit of whole of government goals and more broadly, for the entire Service to work in partnership with other bureaucracies, with business and with community groups as resources and responsibility are devolved closer to where problems or opportunities exist.*³⁶

The APS is moving towards a more collaborative or whole-of-government approach. This has led to an increasing complexity of relationships to deliver services traditionally provided by individual organisations, including:

- Australian Government agencies undertaking activities with other Australian Government agencies;
- cross-government co-operation—such as Australian Government agencies undertaking activities with State and/or local government agencies; and
- public/private arrangements, including contestability and contracting out and government as a shareholder.

The increasing number of whole-of-government, collaborative, or ‘joined-up’ government projects developed to implement the Government’s policies, places additional demands on the capacity of agencies to maintain an appropriate level of corporate governance. ‘Joined-up’ government inevitably involves at least dual accountability of participants both for their individual organisations and for the ‘joined-up’ arrangements. Robust governance arrangements are required to facilitate the management and successful acquittal of those accountability obligations. In particular, in situations where a number of agencies contribute to an outcome, sufficient information should be collected and reported for the overall effectiveness of a program to be determined.

Many agencies in Australia, like their counterparts overseas, have reviewed, or are currently reviewing, the way they do business to take advantage of opportunities for networked or ‘joined-up’ service delivery with other public sector agencies. Canada has experimented with networked partnership arrangements to good effect. The UK has indicated that ‘joined-up’ government is central to its modernising government initiative. Examples of ‘joined-up’ government or extensive interaction with other agencies in the APS include:

- Centrelink—provides delivery services for the Department of Family and Community Services (FaCS) and fifteen other Australian Government 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 Australian Government, State Governments and the private sector;
- AusIndustry (within the Department of Industry, Tourism and Resources)—coordination agency responsible for delivering the Government’s Business Information Service Program which interacts with all three levels of government; and
- Department of Health and Ageing—promotes, develops and funds health and aged care services through partnerships involving the Australian Government and State Governments.

Arrangements between public sector agencies, such as these, tend to be quasi-contractual, based on ‘relational’, rather than ‘legal’, agreements. The trend toward ‘networked’ or cross-agency approaches is one that is likely to continue as agencies take advantage of the opportunities offered by more responsive service delivery mechanisms.

It is important for the ANAO to ensure that arrangements are clearly articulated, including:

- the objectives of the arrangement, including desired outcomes, and timeframes for achievement;

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

An example of the need for cross-agency governance arrangements was highlighted in the ANAO performance audit of the Federation Fund Programme.³⁷ That audit found that no Australian Government department had the responsibility for monitoring the collective performance of Federation Fund projects against the programme's objectives. Consequently, up to the time of the audit, very little performance information on the achievement of the programme's overall objectives had been collected or reported to the Parliament. The audit noted that, where more than one portfolio is responsible for delivering the Government's programme objectives, the concept of whole-of-government performance reporting through, for example, the identification of a 'lead agency' is an area of potential improvement in Australian Government reporting and accountability.

In some instances, the concept of 'one-stop shops' has been extended beyond the Australian Government to include other levels of government and the community sector. For example, the Natural Heritage Trust (NHT) was founded on a one-stop shop approach involving State/Territory agencies, local government and non-government bodies. The ANAO examined some of the challenges of this approach in its audit of the two billion dollar NHT program.

As public sector services change, and new ways of delivering services are introduced, the ANAO's auditing methodologies and practices will need to adapt, for example to provide continuous reporting and greater focus on risk management strategies adopted by agencies, as well as accountability and performance structures and measures across the organisations involved.

In cases where both State and Australian governments are responsible for the delivery of service through 'joined-up' government arrangements, Australian/State government Auditors-General may need to consider taking some form of joint responsibility for providing assurance to the various legislatures.

Emerging views on accountability in the public sector

Professor Richard Mulgan, in his book "Holding Power to Account, Accountability in Modern Democracies", also deals with the issue of accountability in the modern public sector. Mulgan identifies that:

Under strong prompting from their business sectors, governments have transferred the provision of many functions from public service departments to private contractors and have transferred the ownership of many public assets to the private sector. While the move to outsourcing and privatisation has been mainly justified in terms of approved efficiency and a strengthened private sector, an accountability

*agenda has also aimed to circumvent some of the intensive accountability standards applied to the public sector. Indeed, the superior efficiency of the private sector has been partly attributed to the absence of the public sectors obsession with following correct procedures, an obsession forced on it by the constant pressure to be publicly accountable. In this respect, accountability has been traded off for increased efficiency.*³⁸

The transformation of the public sector from the traditional layers of bureaucracy, to a structure more akin to a private sector business model has also shifted the focus of accountability. The traditional model of public sector operation held public servants accountable for breaches of rules and processes. The modern public service is now facing the challenge of being held accountable for the traditional private sector values of efficiency, or value for money; and effectiveness, or delivering on outcomes.

However, Richard Mulgan argues that accountability can act as a value in its own right, and as a means to improving efficiency and effectiveness. Private sector organisations operate with the precise and quantifiable commercial objectives, which allow them to be held highly accountable for their performance, and provide further incentive to improve performance. Public sector agencies, however, tend to have less precise objectives, and are often called on to fulfil a number of conflicting roles such as policy advice and implementation and monitoring performance, which can further confuse their objectives and consequently hinder their accountability. Richard observes that:

*If objectives remain obscure and agencies are not held accountable in terms of clear performance criteria, government agencies are not only encouraged to be inefficient and ineffective, but are also less easily subjected to political control.... Lack of clear objectives and performance criteria therefore encourage bureaucratic capture of policy-making and compromise the democratic accountability of governments to the legislature and the public through the authority of political control.*³⁹

Therefore, the current emphasis on objectives and performance has assisted in making government bureaucracies more accountable in some respects:

*The very process of attempting to formulate goals and directions provides a framework in which agencies and officials are required to direct their activities towards goals formally endorsed by their political leaders.....In addition, accountability to other external monitoring bodies, particularly government auditors and other specialist regulators, has been facilitated by the publication of detailed performance information. In general, public accountability has benefited from greater awareness of what governments are intending to achieve and of how well they are trying to achieve it.*⁴⁰

Nevertheless, there is an issue as to just how far public accountability for more traditional public, politically sensitive, services can be extended to private sector suppliers and how it will be determined if it is. There is also the question as to whether the issue is more about changing the structure of government than that of accountability.

CCH Manual on Corporate Governance

The CCH Manual on Public Sector Governance in Australia was launched by the Secretary of the Department of the Prime Minister and Cabinet, Dr Peter Shergold, in August 2004. At the launch, Dr Shergold identified a number of key changes that have occurred in the service over recent years including:

- the devolution of responsibility to agency heads;
- the increasing focus on outcomes and results;
- the need to manage effectively organisational and individual performance; and
- the delivery of government services by third parties under contract.⁴¹

Dr Shergold identified that the concepts of accountability, responsibility, transparency, ethics and probity are rightly central to this Manual. Dr Shergold stated that ‘what the Manual does so well is to assess the complexity of the Government arrangements within which these standards must be exhibited’⁴². He also noted that new contributions to the Manual will need to address the governance implications of whole-of-government approaches within and between public sector agencies, particularly with these new challenges to agency-based accountability.⁴³

5. Concluding Remarks

The Australian National Audit Office occupies a unique role as the external auditor for the Commonwealth of Australia. Public reports from an independent Auditor-General ensure that the Parliament, and beyond it the Australian citizenry, has a degree of assurance in relation to the proper administration of Commonwealth resources.

The ANAO has a dual role in contributing to corporate governance in the public sector. The first role is to provide independent assurance, including through the assurance audits of public sector agencies. This is the more traditional ‘watchdog’ audit role. Our second role is to suggest improvements in public administration. Performance audits, such as the audit of governance structures at National Health and Medical Research Council, allow the ANAO to identify shortcomings in corporate governance structures and practices, and make recommendations to agencies on ways to improve these. Our Better Practice Guides, particularly the series of guides on corporate governance, bring together lessons learnt across the public sector, and provide guidance for public sector managers operating in an environment of devolved authority and responsibility. These guides filled the void left, until recently, by most sources of corporate governance which tended to focus only on the private sector.

While the ANAO is integral to the changing governance environment, it is also set apart from it due to its unique independent position within the Commonwealth. While it shares the profession’s concern over issues such as independence, the role of audit committees and boards, and the harmonisation of accounting and auditing standards internationally, it also faces unique challenges due to the particular dynamics influencing public sector administration. Concepts such as trust and ‘the public interest’, as well as the often-competing concepts of citizens versus clients, and citizens as clients, have significant implications for the public sector. The ANAO is responding to these challenges as it participates in broader debates over the challenges

facing the profession at large in achieving greater confidence, respect and support from its various stakeholders.

Of course, the contribution to corporate governance in the public sector is not confined to the operations of the ANAO. The release of the Uhrig Report identified the governance issue facing statutory authorities, particularly the ineffective use of boards in FMA agencies, and the apparent lack of any real benefit to the Commonwealth provided by the current purchaser/provider agreements with FaCS and Centrelink, and Health and HIC. As well, the contributions of academics and practitioners to the issue of corporate governance also promise to provide valuable information and guidance for the APS. Nevertheless, as the CCH Manual on Corporate Governance observes:

*Good governance is not an end in itself. The reason governance is important is that good governance helps an organisation to achieve its objectives.*⁴⁴

Staying with this theme, the Manual lists some of the benefits of good governance in the public sector as follows:

- It ensures an organisation remains relevant to the government and to the community.
- Decisions are made quickly and clearly, communicated widely and well understood.
- The reputation of the organisation is maintained and enhanced.
- The organisation is able to respond effectively to changing demands placed upon it.
- Risks are anticipated and managed.
- Responsibility and accountability are well balanced.
- The organisation makes good use of performance measures to meet both internal and external demands for information.⁴⁵

However, I will leave the last word to Dr Shergold in his answer to a question about motivators of the public sector:

*The motivation in the public sector is to ensure that governments make decisions informed by considered analysis of the national interest. Its “customers”, “clients” and “stakeholders” need to be recognised first and foremost as citizens, entitled to a fair and honest delivery of government services by a public service free of corruption and nepotism. There is no more significant motivator than recognition of the role of public sector integrity in upholding Australia’s system of representative government and the freedoms of its civic society.*⁴⁶

NOTES AND REFERENCES

¹ I prefer to use the term ‘public sector governance’ when discussing corporate governance in the public sector.

² The reforms outlined in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9) aim to enhance auditor independence, achieve better disclosure outcomes and improve enforcement arrangements for corporate misbehaviour, while fostering innovation and wealth creation. The Bill was introduced in the House of Representatives on 4 December 2003 and passed on 16 February 2004. It was introduced to the Senate on 1 March 2004 and passed on 25 June 2004.

³ Mr John Uhrig AC was appointed in November 2002 by the Australian Government to conduct a review of the corporate governance of Commonwealth statutory authorities and office holders. The Minister for Finance and Administration, Senator the Hon Nick Minchin, announced the Government response to the Uhrig Report on 12 August 2004.

⁴ The *Commonwealth Procurement Guidelines* are issued by the Minister for Finance and Administration under regulation 7 of the *Financial and Accountability Act 1997* (FMA Act). The Department of Finance and Administration issued the latest guidelines in July 2004.

⁵ All agency financial statement audits are charged on a notional basis reflecting the full cost of understanding, and reporting on, each individual audit. While audit fees are charged for all such audits of statutory authorities and government companies, these fee receipts are paid directly to consolidated revenue. The ANAO’s costs are directly funded by Parliamentary appropriation.

⁶ International Federation of Accountants 2003. *Rebuilding Public Confidence in Financial Reporting—An International Perspective*, New York, July.

⁷ Institute of Chartered Accountants in Australia and CPA Australia, 2002. *Professional Statement F1—Professional Independence*, pp. 2-3. While Professional Statement F1 reflects Australian conditions, it is based on the standard agreed in November 2001 by representatives of the 120 nations that comprise the International Federation of Accountants (IFAC).

⁸ ANAO 2004, *Audit Work Program 2004-2005*, Canberra, July, pp. 6-9.

⁹ ANAO Report No.22 2003-04, *Audits of the Financial Statements of Australian Government Entities for the Period ended 30 June 2003*. Canberra. 9 January

¹⁰ The Parliament of the Commonwealth of Australia, 1996. *Auditor General Bill 1996—Explanatory Memorandum*, House of Representatives, Canberra, paragraph 25, p.7.

¹¹ See, for example, ANAO Audit Report No.28 2003-04, *Audit Activity Report: July to December 2003*, Canberra, 12 February.

¹² ANAO Report No. 58 2003-04, *Control Structures as Part of the Audits of Financial Statements of Major Australian Government Entities for the Year Ending 30 June 2004*. Canberra. 26 June.

¹³ See, for example, ANAO Report No. 22 2003-04, op. cit.

¹⁴ ANAO Report No.58 2003-04, op. cit.

¹⁵ ANAO 2003, *Goods and Services Tax (GST), Administration*, Better Practice Guide, Canberra, May.

¹⁶ ANAO 2004, *Annual Performance Reporting*, Better Practice Guide, Canberra, April.

¹⁷ O’Grady, John, 2002. *Corporate Governance in the Public Sector*. Address to the IIR Conference on Corporate Governance in the Public Sector, Canberra, 14 August.

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¹⁹ ANAO Report No.29, 2003-04, *Governance of the National Health and Medical Research Council*, Canberra. 20 February.

²⁰ ANAO Report No.1, 1998-99, *Corporate Governance Framework*, Australian Electoral Commission, Canberra. 3 July.

²¹ ANAO Audit Report No. 40 2001-02, *Corporate Governance in the Australian Broadcasting Commission*, Canberra. 8 April.

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- ²⁹ Found at <http://www.law.monash.edu.au/ppac/index.html>
- ³⁰ Found at <http://www.law.monash.edu.au/ppac/research.html>
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- ³⁵ CCH, 2004, op. cit., p. 1151.
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- ⁴⁰ *ibid.*, pp. 163–164.
- ⁴¹ Shergold, Peter Dr. 2004. *Public Sector Governance in Australia*. Address at the launch of CCH Manual. Parliament House, Canberra, 5 August. p. 1.
- ⁴² *Ibid.*, p. 1.
- ⁴³ *Ibid.*, p. 2.
- ⁴⁴ CCH 2004, Op.cit., p. 3.
- ⁴⁵ CCH 2004, Op.cit., p. 4.
- ⁴⁶ Shergold, Peter Dr. 2004. Op.cit., p. 3.