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**Corporate Governance – More
than Good Management**

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CORPORATE GOVERNANCE – MORE THAN GOOD MANAGEMENT

One year ago a speech on governance would have been prescribed to cure insomnia. Out of adversity the subject is again enlivened – back on Board room agendas with a vengeance.¹

INTRODUCTION

I did not have any reservation about speaking at your conference again on the subject of corporate governance – an issue that has been receiving increasing scrutiny in the general community as well as significant ongoing coverage in the professional and academic journals and papers. Also, as the result of collateral damage, the role of the corporate regulators and auditors has been given an elevated profile. However, from a public sector perspective, there seems to be still a focus primarily on process and even just on selected elements of the governance framework, rather than a holistic integrated approach which takes account of both strategic and operational issues and other imperatives for the organisation.

The importance of good corporate governance was certainly brought into sharp focus by the corporate excesses during the second half of the 1980s and, more recently, with the widely published corporate failures of Harris Scarfe, HIH, OneTel and now Ansett. Indeed, the cover story of the July 2001 edition of the Australian Institute of Company Directors' magazine was *'Directors Under Fire'* with the lead writer, Ivor Francis postulating that *'it may be time to have a hard look at the corporate governance processes'*.²

In keeping with the theme of your congress – RIDING THE NEXT WAVE - the challenge, as I see it, is not simply to put the various elements of good corporate governance in place but to ensure that those elements are effectively integrated, well understood, applied effectively and, importantly, an appropriate balance is maintained between the conformance and performance roles of the board or other governance body. As such, governance is more than simply employing good management approaches. As Trevor Sykes of the *Australian Financial Review* stated in an interview with the Chartered Institute of Company Secretaries in Australia:

*'Expressing the sentiments of corporate governance is dead easy... What is going to be harder is making it work, putting flesh on the bones'*³

If implemented effectively, corporate governance provides the integrated strategic framework necessary to achieve the required outputs and outcomes performance, as well as discharging the organisation's accountability obligations. There is no doubt that good corporate governance is inexorably linked to good performance and achieving required results in a reasonable timeframe. However, I reiterate that it is not a case of one size fits all. Organisations do have different needs at different times. But there are intrinsic issues where we are able to point to better practice that can help all of us to establish sound frameworks that can address the particular needs of the time. Perhaps, more importantly, the measures can be preventative or facilitative, depending

on whether we need to avoid, counter, or take advantage of the circumstances confronting us.

My presentation today, while canvassing the principles of good corporate governance, will progress the debate and focus on ‘Applied Corporate Governance’ a term borrowed from Russell Barnier which is a theme I have been advocating for some time.⁴ In my forward to the Australian National Audit Office’s (ANAO’s) Better Practice Guide on Corporate Governance I stressed that:

*The challengeis not simply to ensure that all the elements of corporate governance are effectively in place but that its purposes are fully understood and integrated as a coherent and comprehensive organisational strategy focussed on being accountable for its conduct and results.*⁵

Or, to paraphrase Senator Murray, we should make corporate governance a habit not a fashion.⁶

By way of a recent example to illustrate my point, Jim Psaros and Michael Seamer in a recent Charter article⁷ make the observation that, while the Corporate Governance Statement contained in the Harris Scarfe’s 2000 financial statements indicates that the ‘directors are committed to the principles underpinning best practice in corporate governance’ their analysis, however, suggests that ‘the corporate governance practices of Harris Scarfe were less than ideal’.⁸ Organisations can have very good corporate governance structures and policies on paper but the substance of good corporate governance is clearly more important than the form. Another important ingredient that cannot be glossed over is the ‘soft’ subjective factors such as composition of boards and the quality of directors. As one commentator recently said ‘Governance is about how people work together and the recent crop of failures are about human frailty, and that no system will ever fix’.⁹

While it is too early to draw conclusions about the recent corporate failures (we await the Justice Owen Royal Commission into HIH and the anticipated legal battles), it is expected that the relevant enquires will consider ‘applied’ corporate governance very closely in each case.

Against this background, my presentation falls into four parts, viz:

Part A – will focus on broad governance issues; explore differences in public and private sector board frameworks; discuss achieving a reasonable balance between the various conformance-performance demands; and, finally, canvass the importance of ethical behaviour as part of good corporate governance;

Part B – is devoted to the key governance issue of addressing risk and risk management as a cornerstone of good governance. I touch on the framework, the important role of audit committees, business continuity, control structures and dealing with fraud. I then round out the discussion with recent initiatives taken by CPA Australia, Comcover, Standards Australia, Monash University, the Western Australia Chamber of Commerce and the Institute of Engineers, Australia in this area;

Part C – examines the audit role and particularly the role and independence of external auditors following the latest round of corporate collapses. This increased scrutiny of the auditor’s role has meant that the general community and the media is again asking what do auditors actually do; and

Part D – finally, I will briefly discuss performance assessment in the Public Sector as a major focus of both ongoing reforms and a central element of corporate governance.

Not surprisingly, I will speak from a public sector perspective but will endeavour to make suitable comparisons with, and observations about, the private sector experiences as well, where I can.

PART A – CORPORATE GOVERNANCE ISSUES

SETTING THE SCENE

‘Most of the dotcom start-ups of the last few several years had appalling corporate governance standards. And now they are mostly gone. If good corporate governance standards had been required of them many would have never got off the ground in the first place’¹⁰

There have been many pressures for corporate governance reform commencing with the corporate collapses in the 1980s, as well as the development of any number of statements about sound corporate governance principles, starting with the Cadbury Committee Report in 1992 which has served as a template for reform worldwide. Since then, academics, national governments, regulatory agencies and international organisations such as the World Bank, the OECD, the Commonwealth Association for Corporate Governance and the European Union have all developed new principles and codes of practice. In the United States (US) the Securities and Exchange Commission (SEC) has also been very active and the Chairman quite vocal.

Closer to home, at the Federal Government level, the ANAO has published ‘Principles and Better Practices – Corporate Governance in Commonwealth Authorities and Companies’, ‘Core Public Sector Corporate Governance’ and ‘Applying Principles and Practices of Corporate Governance in Budget Funded Agencies.’¹¹ The main themes of these practice guides include: leadership, the management environment, risk management, monitoring and accountability. The Joint Committee of Public Accounts and Audit (JCPAA) has also prepared a report entitled ‘Corporate Governance and Accountability Arrangements for Commonwealth Business Enterprises (GBEs)’¹². I recommend these references as a good starting point for consideration of approaches in the public sector. Most State Auditors-General have also been active in this area, including Ken McPherson¹³.

On the private sector side, the Australian Institute of Company Directors (AICD) has published two significant works:

- ❑ The Code of Conduct to promote the ‘highest ethical and professional standards in directorship’: and
- ❑ the very comprehensive Company Directors Manual dealing with company law, Finance, Taxation and Superannuation, employment and other laws affecting

directors. The AICD has also published the ‘The Duties and Responsibilities of Directors and Officers’ by Professor Robert Baxt.

In recent years conventional corporate governance wisdom in the Australian private sector has favoured a model which has:

- ❑ a majority of non-executive, independent directors, typically not executives elsewhere;
- ❑ one or possibly two executive directors including the CEO;
- ❑ separation of the chairman and chief executive roles;
- ❑ maximum board size around ten directors;
- ❑ audit, remuneration and nomination committees chaired by non-executive directors;
- ❑ monthly board meeting of a day or less;
- ❑ directors not involved in management; and
- ❑ the board representing shareholders [but taking account of other stakeholders – my addition].¹⁴

Interestingly, the Australian Stock Exchange (ASX) has not been definitive in the guidelines it has issued in Listing Rule 4.10 as to what it expects to be contained in statements about corporate governance in annual reports. The ASX notes the diversity of listed companies, their different approaches and developments over time. There are clearly practical problems in prescribing strict definitions of requirements for all organisations, other than at a quite general level. Many commentators have made a similar observation to the following:

*If there’s one corporate governance certainty, it is that one size does not fit all.*¹⁵

THE CORPORATE GOVERNANCE FRAMEWORK

Drawing on this wealth of ‘best practice’, Corporate Governance boils down to 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. Or put simply, it is ‘the system by which companies are directed and controlled’.¹⁶ The governance framework is concerned with structures and processes for decision-making and with the controls and behaviours that support effective accountability for performance outcomes and results. This encompasses:

- ❑ defining and monitoring the strategic direction;
- ❑ defining policy and procedures to operate within the legal and social requirements;
- ❑ establishing control and accountability systems;

- reviewing and monitoring management and the organisation's performance; and
- risk management.

The key components of corporate governance in both the private and public sectors are business planning, internal controls including risk management, performance monitoring and accountability and relationships with stakeholders. The framework requires clear identification and articulation of responsibility as well as a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outputs and outcomes.

In the Australian Public Service (APS) these requirements become that much more important for both accountability to, and performance for, a wide range of stakeholders. Clearly, there are clear differences between the public and private sectors, a point made recently by the Attorney General:

*The public sector necessarily has numerous responsibilities to the Parliament and to the taxpaying public that the private sector does not*¹⁷

Corporate governance, including agency controls, is becoming increasingly important in relation to the changing, increasingly privatised and internationalised public sector. Certainly, the demand by citizens and other stakeholders for openness and transparency of public sector agency governance (including financial status) exceeds that currently required of private organisations. Accountability in the areas of community service obligations, equity in service delivery and a high standard of ethics within a legislatively-based values system, are particularly critical to public sector agencies. Accordingly, one of the fundamental ways to ensure that we can meet our performance and accountability requirements is through a robust corporate governance framework with its focus on both conformance and performance or, put another way, through compliance and results. The challenge is to achieve the 'right' balance both at particular points in time and over time – an issue I will come to shortly.

Central to any corporate governance framework is a governing body, most likely a Board of Directors. This was clearly indicated by Sir Ronald Hampel's Committee on Corporate Governance (UK) which has been extensively quoted in governance papers and related discussions:

*It is the Board's responsibility to ensure good governance and to account to shareholders for their record in this regard.*¹⁸

Indeed, in the recent corporate collapses attention has primarily focused in each case on the board with little or no attention given to how management has performed. This is a fundamental difference between the public and private sectors, an issue I will now address.

THE GOVERNANCE BODY IN BOTH THE PUBLIC AND PRIVATE SECTORS

In the private sector, there is a clearly defined relationship structure between the main parties – shareholders, directors and management. That is, the generic private sector governing structure consists of a board of directors, including the chairperson of the board, appointed by shareholders to act on their behalf, and management (the CEO) appointed by the board to carry out the day to day functions of the company within the framework of policies and strategic guidance established by the board. Their relationship and accountability is based on the principle of limited liability that underpins the company structure. This model is, however, not readily transportable to the public sector, even with Government Business Enterprises (GBEs), because of the different roles and relationships between the responsible Minister(s), the CEO and (possibly) the Board. As well, Australian citizens (stakeholders) have no choice as to their investment and no direct voice in the governance arrangements except, to a degree, in the partially privatised Corporations, such as Telstra, in their role as shareholders.

In the ANAO's 'Applying Principles and Practices of Corporate Governance in Budget Funded Agencies' the establishment of Executive Boards of Management is canvassed. Depending on legislative requirements an agency head could formally designate an executive board, charged with a shared responsibility for the governance framework for specific aspects of governance of an agency or, on the other hand, a less formal executive or advisory board may be appropriate. No matter what form is adopted, the implications for the relationship between the CEO and the Minister would need to be carefully thought through given both the legislative requirements and the conventions of Ministerial government. These executive boards (or in most cases advisory boards) differ in a number of respects from their Australian private sector counterparts. However, three important differences are as follows:

- In the main these are advisory boards and, while they are an important part of the corporate governance arrangements, the CEO, in the final analysis, has legal responsibilities and is accountable to the Minister for the performance of the agency. In the private sector, the board is held accountable, particularly by influential shareholders. Even in the National Safety Council of Australia situation, the board and Max Eise, the chairman, were liable for significant damages even though they were misled by management. Currently, we witness the focus on the Air New Zealand board with the collapse of Ansett. However, we have also seen instances of a drift in governance power from the board room to management which is not effectively accountable to shareholders.
- Second, there is the issue of board structure, including an approach that runs counter to the Australian model of corporate governance structure involving a unitary board consisting of non-executive directors (NEDs) with one or at most two executive directors. The public sector agency executive/advisory board is usually made up of predominantly 'executive directors' who also have a day to day management role in the agency. If non-executive members are appointed they would be very much in the minority. This type of board structure may lead to conflict of interests that require careful handling. Clearly, to be effective, members will need to take an agency-wide approach in their decisions, including challenging areas of responsibility of their colleagues and themselves.

- Third, in corporate Australia there is usually a separation between the CEO and board chairman. In the Australian public sector environment both roles are traditionally be undertaken by the agency head/CEO, similar to the US model.

Also, it is important to recognise the distinction between budget funded agencies (governed by the CEO, possibly with the assistance of a board of management in a delegated and/or advisory capacity) and those organisations that have a governing board to which the CEO should preferably be accountable, such as GBEs, which of course have more in common with the private sector. The latter also have added complexities as a result of the additional party (the governing board) in the accountability chain. Public sector organisations need to tailor their governance practices to take account of such important differences.

I should mention here another apparent difference between the public and private sectors which is reflected in a public sector organisation's relationship to its stakeholders. Most agencies recognise broad stakeholder accountability with particular responsibility to their Minister(s). Private sector approaches tend to focus primarily on shareholders, while recognising other stakeholders such as employees, customers, suppliers, creditors and the community generally.

While I agree that a Board's primary responsibility should be to its shareholders, I would suggest that concepts of greater social and community responsibility are increasingly being embraced by the private sector, as a matter of course. Boards are beginning to recognise that being seen as 'good corporate citizens' is integral to the long-term viability of an organisation and, therefore, in the interests of shareholders. I will say more on this later under Triple Bottom Line Reporting. The shake-up of the AMP Board in April 2000, precipitated perhaps by shareholder/investor criticism about the company's business performance and share price, appeared to commentators to be about the particular corporate governance context in which that organisation was operating. The result could be seen as an example of an organisation responding to public concern in order to regain an appropriate level of community and shareholder confidence in both the business and ethical nature of the company's activities.

In the public sector, we can identify citizens in a similar role to shareholders. But, in practical terms, boards, CEOs and management have to be very aware of their responsibilities to the government (as owners or custodians, and regulators); to the Parliament (as representatives of citizens, and legislators); and to citizens (as ultimate owners, as well as in their particular roles as clients).

The ANAO discussion paper on *Corporate Governance in Commonwealth Authorities and Companies*¹⁹ suggests that there may be opportunities to formalise relationships between the Board, the CEO, including management, and responsible Minister(s), perhaps through the development of a Board Charter. Alternatively, a written agreement, or memorandum of understanding, could be prepared outlining roles and responsibilities as is done, say, in New Zealand. Consideration also needs to be given to adequate training both of the Board members and management to ensure that there is full understanding of their requirements and obligations, legal and otherwise.

In Commonwealth authorities and companies, the Board is responsible for directing and controlling the organisation on behalf of the stakeholders and is ultimately accountable for its own performance as well as that of the organisation. Therefore, it is

important to note that maximising performance within an organisation requires an effective ‘partnership’ between the Board and management in guiding organisation strategy and performance. Similarly, CEOs of government departments and agencies will need to ensure effective partnerships with senior management if they are to effectively govern their organisations.

Thus, the threshold requirement of sound governance must be agreement between the key parties, whether this is the board and management (including the CEO) and/or the CEO and management, on the broader corporate objectives. These parties should jointly develop the corporate objectives that the CEO is responsible for achieving. In turn, these have to be communicated to, and well understood by, all other stakeholders.

The issue of corporate governance in the public sector has been taken up more recently during an inquiry conducted by the JCPAA, which I referred to earlier.²⁰ The inquiry has, in my view, added much to the consideration of appropriate accountability and corporate governance arrangements for the public sector, in this case for GBEs. As an indication of the importance of this sector, the JCPAA’s report notes that Commonwealth GBEs account for approximately a quarter of the Commonwealth’s total assets, generating significant revenue and providing sizeable dividends to consolidated revenue. Among other things, the JCPAA examined the appropriateness of the *Commonwealth Authorities and Companies (CAC) Act 1997* and, in particular, its continued application to GBEs. It recorded the view that:

... where public moneys are involved, there is a need for additional accountability to Ministers and Parliament ...

and concluded that

... the Committee does not support removing GBEs from their responsibilities under the CAC Act.²¹

I must say that this conclusion supports my own view that present governance arrangements provide a robust and flexible framework for the management and accountability of GBEs. This is not to say that further improvements are not possible for both GBEs and for other elements of the public sector such as departments and statutory authorities. The Minister for Finance and Administration responded positively to the Committee’s recommendations in a paper tabled in the Senate on 27 September last.

Having dealt with corporate governance in broad terms, I now wish to probe two important issues in more depth. They are about striking an appropriate balance between the conformance and performance in governance arrangements, and recognising the key elements of values and ethics as being central to good corporate governance.

CONFORMANCE VERSUS PERFORMANCE

With every aspect of corporate governance increasingly being put under a virtual microscope, exacerbated by cycles of business failures, we have seen more rigorous regulation no doubt resulting in a tendency for boards to focus more on compliance to cover off the legal, regulatory and other risks. However, more recently, indeed before

the latest spate of corporate collapses, concerns were being expressed that companies were concentrating too much on that end of the spectrum and should be focusing more on performance goals, that is, the drive for profits and other required corporate results.

Clearly, there has been an increasing emphasis on the strategic role of the board, in particular the need for the board to be aware of the major trends impacting on the organisation and its major risks and opportunities. Ian Dunlop, CEO of the AICD has observed that the compliance or conformance responsibilities which have dominated boards' thinking remain critically important and must be performed to impeccable standards, but in essence they are hygiene issues. The real added value for boards is at the strategy level. This requires boards to be forward looking, proactive, innovative, and not risk averse.²²

Nevertheless, the debate goes on. For example, a prominent Chairman of three major Australian corporate boards has challenged boards' 'obsession' with conformance rather than performance and their predisposition to be risk averse.²³ In his words:

... there's just been too much concentration in recent times on the conformance, the governance, the ticking of the boxes, who comes to meetings and I think it's far from clear that that adds value, improves the performance of companies, delivers benefits for shareholders.²⁴

In the public sector, the Secretary of Defence, Dr Alan Hawke, has observed that good corporate governance sets the direction and ensures that progress is being made towards long term goals. He went further in adding that good governance is what we need in order to honour the spirit of the Government's public sector reform agenda.²⁵

The wider board role embracing both performance and conformance aspects to corporate governance is also found in Adrian Cadbury's²⁶ landmark report on corporate governance :

(Company boards) must be free to drive their companies forward within a framework of effective accountability. This is the essence of any system of good corporate governance.

This notion of corporate governance that emphasises both performance and conformance also sits easily in today's public sector context. As I noted earlier, the challenge is to strike the appropriate balance that suits the circumstances of an individual organisation at particular periods. Tactics are important element of strategy.

It has to be acknowledged that the issues of compliance extend well beyond legislation and rules. The culture of compliance is similar to that of corporate governance which starts from the top of an organisation, with an emphasis on leadership, shared vision, ongoing commitment, effective mechanisms, continuous improvement, performance, transparency, and accountability. As Justice Alan H Goldberg (Federal Court of Australia) suggests:

Every director and every executive, indeed all staff, must be evaluating their conduct by reference to compliance principles.²⁷

No less should be said of the public sector. It could be argued that compliance programs have been a feature of bureaucracies in the past as part of their close association with legislation. The question is, however, whether public sector organisations are sufficiently aware, and equipped, to put such programs in place now, having regard to the requirements of Australian Standard on Compliance AS3806. For those interested, the Australasian Risk Management publication (Vol. 11, No. 2, March 2001) includes a “compliance compendium” on ways to increase the effectiveness of compliance systems.

Most would accept that, in the past, the public sector has primarily focussed on ensuring conformance with legal and procedural (including budgetary and financial) requirements, with attention to program outcomes and improved performance being a secondary consideration. There is no doubt that we have been particularly concerned to ensure that we have met the requirements of relevant legislation. There has also been a marked emphasis on fraud control and probity issues in a more risk conscious environment. In short, we have been concerned to do ‘things right’. The question that is being asked is whether that approach is still being applied, as well as the reform emphasis on doing the ‘right thing’ as part of an organisation’s overall effectiveness.

To explore this concept a little further, I will draw on a framework developed by Professor Tricker.²⁸ This is portrayed in an adapted form in Figure 1 included in the Appendix.

Figure 1 portrays very simply the continuum of the various elements of the focus of a board ranging across:

- its orientation, that is, looking inwards towards corporate business or outwards towards the corporate environment;
- its time perspective, that is, looking forward, or being concerned with the past and present; and
- its performance and conformance roles.

Central to the model is the recognition that the board has to work with, and through, the CEO.

I make no observations regarding which quadrant the board should use as its focus except to observe that a greater emphasis has to be placed on performance rather than mainly on conformance (compliance). Clearly, the challenge is to ‘*see the future first*’, to become proactive in strategy evaluation, development and implementation – the right side of the diagram, while at the same time not ignoring compliance imperatives. Clearly, the board has more than a watching brief in this area. The question is again deciding on the appropriate balance to be struck, for example, in the public sector, according to the circumstances of the agency, perhaps at a particular time of its corporate development and the circumstances of its programs and associated outputs and outcomes.

As the public sector continues to move to a more private sector orientation, we are increasingly seeing a growing adoption, or adaptation, of private sector approaches, methods and techniques in public service delivery. Consequently, there is an issue of

trade-offs between the nature and level of accountability and private sector cost efficiency, particularly in the delivery of public services and in the accountability regime itself. A sound corporate governance framework, with its focus on control and monitoring mechanisms that are put in place by an organisation, can assist in enhancing stakeholders' value of, and confidence in, the performance, credibility, viability and future prospects of that organisation in a rapidly transforming public sector. But the issue of the nature and level of accountability is primarily one for the Government and Parliament to resolve in the first instance.

ETHICAL BEHAVIOUR – A CORNERSTONE

Importantly, good corporate governance is based on a clear code of ethical behaviour and personal integrity exercised by the board, management and staff and communicated openly to stakeholders. Such a culture of integrity and disclosure (accountability) is also essential for the establishment of sound risk management approaches and the confidence it can give to stakeholders in both the organisation itself and in what it does. Moreover, there should be a mutually supportive relationship across all elements of the corporate governance framework, particularly risk management and the achievement of objectives. A robust accountability approach that encourages better performance through sound risk management is integral to any corporate governance framework.²⁹

While there are similarities, it is also important to recognise the basic differences between the administrative/management structures of private and public sector entities and between their respective accountability frameworks. The political environment, with its focus on checks and balances and value systems that emphasise issues of ethics and codes of conduct, implies quite different corporate governance frameworks to those of a commercially-oriented private sector. It is equally important to recognise that the diversity of the public sector is also likely to result in different models of corporate governance. There will be common elements of any such models, at the very least in the principles involved, even if the practices may often vary.

The necessity for openness and transparency is accepted as a basic element of public sector accountability. The public sector has both to act in the public interest, however that is determined, and, in common with the private sector, avoid unnecessary conflicts of interest. These will be particular challenges for agency managers in establishing credible corporate governance frameworks within public sector agencies that are increasingly being asked to act in a more private-sector manner. This could become a shared issue if private sector providers are also asked, and are prepared, to accept, for example, public service values and codes of conduct when operating in the public sector.

The values, standards and practices that underpin corporate governance in public sector agencies flow from peak public service values, obligations and standards, which in turn are derived from legislation, policy and accepted public service conventions. At the Federal level, public service values are a key element in the Government's public sector reform program and are part of the new *Public Service Act 1999*. The following are some of the values that agency heads are required to uphold and promote within their organisations:

- ❑ the Australian Public Service (APS) is apolitical, performing its functions in an impartial and professional manner;
- ❑ the APS has the highest ethical standards;
- ❑ the APS is accountable for its actions, within the framework of Ministerial responsibility, to the Government, the Parliament and the Australian public;
- ❑ the APS delivers services fairly, effectively, impartially and courteously to the Australian public; and
- ❑ the APS focuses on achieving results and managing performance.

The ANAO, to take one example, has, as its key values, independence, objectivity, professionalism, and knowledge and understanding of the public sector environment. These values are guided by the ANAO Code of Conduct, which has been developed within the framework of the new APS Values and the APS Code of Conduct, together with the Codes of Ethics promulgated by the professional accounting bodies.

In the private sector also, there is increasing public demand for higher standards in business with stakeholders (consumers, employees and investors) looking to be associated with ethical companies. Ethical investment is big business in the US and growing in Australia with the Ethical Investment Association being formed in May 2000. In this era of transparency together with heightened media awareness, the shareholder has been joined by an array of other corporate stakeholders.

Corporate citizenship, community activity, shareholder relations and triple bottom line reporting are now part of the business lexicon. As Donald Perkins, the former Chairman and CEO of Jewel Companies Inc, commented in Ivor Francis' book 'Future Directions – The power of the Competitive Board':

In my redefined role, a director's responsibility is to do everything possible to assure the long term health of the enterprise....you will immediately recognise that this may be inconsistent with the short term wealth of shareholders' ³⁰

This requires thoughtful consideration of a wide range of constituents including customers, pressure groups, unions, suppliers, and employees. Socially responsible investments (SRI) are on the increase. The Australian Ethical Investment Ltd is attempting to improve the ethics of corporate Australia and promote ecologically sustainable and socially just enterprise through selected investments. In the US, the Dow Jones Sustainability Group Index (DJSCI) lists five criteria for corporate sustainability performance:

- ❑ Innovation- investing in products that use resources in an efficient and effective economic manner in the long term;
- ❑ Governance- setting the highest standards of corporate governance, including management quality and responsibility and corporate culture;

- Shareholders- meeting shareholders demands for sound financial returns, long term economic growth, long term productivity increases, sharpened global competitiveness and contributing to intellectual capital;
- Society Leadership- leading the industry towards sustainability by setting standards for best practice and maintaining superior performance; and
- Society- encouraging long lasting social well-being in communities where they operate securing superior customer and employee loyalty and ultimately superior financial performance.³¹

In Australia, efforts to make sustainability an investment issue, rather than simply a notion or catchcry, is gathering pace with development of the Westpac Monash Eco Index, modelled on the DJSCI.

IMPROVING BOARD PERFORMANCE

One aspect of governance that is receiving greater attention is improving board performance both as a whole and by individual directors. Much has been written on the subject, including the recent AICD publication ‘The Twenty-First Century Board’ by Ann-Maree Moodie which addresses the question ‘How can boards do better?’³². The main areas of attention are:

- structural issues such as board size, composition (executive/non-executive directors), unitary or compound boards, and the use of committees; and
- the role and culture of the board (for example, the Tricker Model, as discussed earlier) and the quality, diversity and independence of board members.

In relation to structural issues, one question is the appropriateness of the unitary board system used in Australia. I earlier outlined the conventional model for corporate governance in Australia. In a number of organisations now, the non-executive directors, including the non-executive chair, have the controlling power simply because of their numbers. They are seen by the public, and importantly by the courts, investors and politicians to exercise that power in overseeing the management of the company and to be held accountable for the outcomes. The issue being raised for governance in the Australian context is how effective can the non-executive directors be if they do not have the detailed knowledge of the company’s operations and/or suffer from information overload (or in some cases under-load). This sentiment has been reflected as follows:

The dilemma facing the board of the twenty-first century is how a small group of people can successfully lead an organisation competing in the most challenging and fluid trading environment in world business history’ ... ‘Today, boards consist of an average of seven directors who direct companies vying for a share of a global – and in many cases, an online - market place, where flexibility and speed are paramount.’³³

Court decisions have held that:

*‘Because Directors are bound to exercise ordinary due care, they can not set up as a defence lack of knowledge needed to exercise the requisite degree of care...Directors are under a continuing obligation to keep informed about the activities [sic] of a corporation’*³⁴

A number of commentators have canvassed moving away from the unitary board as an option to resolve this dilemma and adopting or adapting the European ‘two tier’ corporate board structure (one is a board of management and the other usually has an advisory role).³⁵ Ivor Francis, in a recent article, discussed the setting up of:

- The Expert Board – that is, appoint operational experts as directors. There are difficulties such as availability of people with the appropriate skills, may need a numbers of experts to cover the field and third an expert can still be misled, and may be seen as usurping the role of management; and
- Compound Boards – the requirement being that the conflicts in the Australian unitary corporate governance model can only be properly resolved by a separation of governance powers to be managed by different bodies. That is separating the corporate governance and business management. This separation of director’s powers could see up to three bodies created:
 - Board of Directors – to manage the companies business;
 - Corporate Governance Board – to manage such things as remuneration, appointment of auditors; and
 - Council of Stakeholders – to communicate risks of operations and ensure an uninhibited flow of independent operational information to directors.³⁶

The discussion on unitary or ‘two tier’ or compound boards will no doubt continue but with the former continuing to be well entrenched in the Australian corporate scene. As one commentator observed, *‘Why should shareholders elect a board of directors and then strip them of their major powers and responsibilities’*.³⁷ In the Australian situation, the retention of the unitary board, while strengthening internal processes and establishing standing committees of the board (such as Audit and Risk Committees), seems to offer a workable approach to improving board effectiveness in the absence of a marked management cultural change.

I notice that the AICD, while not endorsing any particular governance model as being appropriate to all circumstances, offers the comment that:

*‘in the Australian context, a one board model with appropriate board committees is, in the AICD’s view, the model most likely to produce an effective outcome for shareholders and other stakeholders’*³⁸

David Knott, Chairman of the Australian Securities and Investments Commission, also lends his support to that view as follows:

‘I am a supporter of the “Anglo-Saxon model” of the unitary board (usually consisting of both external and management representatives)

*over the “European Model”, which involves a management board (of management representatives) and a supervisory board (of external representatives)’.*³⁹

Turning now to the second theme – the role and culture of the board - I will continue to draw on Ann-Maree Moodie’s recent work.⁴⁰ However, I also recommend the ANAO Better Practice Guide⁴¹ as a useful reference. Ann-Maree interviewed a large representative sample of Australian Chairmen and directors. Their insights provide a pragmatic view of the state of play of Australian corporate governance with a focus on three topics central to good broad practice, viz: board selection, performance, and succession.

*‘Many Australian directors are former chief executives who operated business at a time of protected markets, little global competition, and a lack of technology use. These people do not have the experience or backgrounds to meet the challenges facing Australian business today – globalisation, the speed of change, and technology’*⁴²

Selection

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

To illustrate the point, I have selected the following quotations (from those directors interviewed):

Any board that wants to be performing well must remind itself that while it is continually refreshing its executive gene pool, it doesn’t do it for itself. We must get alignment between corporate strategy and the board skills set. Otherwise, how can we be assured that we can help deliver that strategy

*The selection of a chief executive is like the third degree with a heat lamp; with a director, it’s more like tea and scones*⁴³

or

*Boards have little hesitation in putting a chief executive elect through a rigorous selection process...But when a board is selecting a new director, there is a perception that board members are too senior to go through the standard selection process.*⁴⁴

Performance

Directors need to assess, and contribute to, the effectiveness of the board. One effective mechanism is the implementation of a ‘corporate governance health check’, that is, a formal annual board review with the introduction of formal performance measures. There are advantages in using an independent facilitator to assist with this

process. According to Korn/ferry International ⁴⁵, the five important criteria which Australian boards regard as essential for evaluating board performance, are:

- ❑ an understanding of the company's mission and strategic plan;
- ❑ a comprehension of the organisation's business;
- ❑ a willingness to challenge management when required;
- ❑ a willingness to appraise the chief executive; and
- ❑ the special expertise that board members have to add value to the company.

Other ways to improve board performance include having an induction program for new members, publishing a board charter, and undertaking ongoing professional development. Figure 2 in the Appendix was prepared by Professor Geoffrey Kiels⁴⁶ and shows graphically the improvement process.

On the professional development issue, the AICD runs a *Company Directors Course* which aims to develop the knowledge and skills of directors contributing to board performance. The Secretary of Defence is putting all his senior executives through a tailored Company Directors Course run by the AICD.

Succession

*Succession planning for the board is required just as it is for the chief executive and senior management.*⁴⁷

The trend towards shorter fixed terms has given some structure to succession planning. If a board does actively plan for its own succession, there are several benefits as follows:

- ❑ matching the future configuration of the board with the strategic direction of the organisation;
- ❑ regularly refreshing the board's membership;
- ❑ enhancing the depth of intellectual knowledge; and
- ❑ ensuring opportunities to target new members will be better organised⁴⁸

Ideally, directors should be multi-skilled, experienced in a variety of business areas; prepared to update their knowledge; be flexible, analytical and monitor their individual or collective capabilities; and measure, on a regular basis, their own performance as individuals and as a group.⁴⁹

PART B – ADDRESSING RISK AND RISK MANAGEMENT

GOVERNANCE FRAMEWORK

It is widely accepted that the operational problems and risks at HIH, or at the loss-making BHP West Australian operations, were well known to insiders and subcontractors, even to competitors, well before the respective boards of directors knew.⁵⁰

Risk is an inherent part of business and directors are invariably going to have to take risks in pursuit of improving a company's performance. Publicly listed companies are required to identify key risks and to report on the company's process for identifying and reducing the likelihood of risk impacting on a business. ASX Listing Rule 4.10.3 requires listed companies to show the governing body's approach to:

- identifying areas of significant business risk; and
- putting arrangements in place to manage them.

To me, the governance framework for risk assessment requires the board to be actively involved in ensuring risks are identified; defining appropriate policies; and ensuring that the board receives information which accurately reflects the risk profile or risk appetite of the organisation (set by the board).

Risk management as an essential element of corporate governance underlays many of the reforms that are currently taking place in the APS. It is not a separate activity within management but an integral part of good management process, particularly as an adjunct to the control environment, when we have limited resources and competing priorities. As one expert opinion puts it 'corporate governance is the organisation's strategic response to risk⁵¹.

The effective implementation of risk management practices is a major challenge for public sector managers, particularly as the culture under which they have operated has traditionally been risk averse, because:

The public sector spends public monies, is accountable to representatives who themselves are risk averse given their need for periodic re-election or reappointment and public sector risks attract significant media attention⁵².

While risk management is primarily the responsibility of the CEO and the board, it requires the active involvement of everyone in the organisation. Effective governance arrangements require the identification of business risks, as well as potential opportunities, and ensure the establishment, by management, of appropriate processes and practices to manage all risks associated with the organisation's operations⁵³. As Robert Knapp, National Manager of Comcover has observed, while recognising that the insurance products of his organisation are designed to reduce the exposure of the public sector to insurable risks:

The availability of this insurance does not remove the onus on agency management to properly manage risks⁵⁴.

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

The challenge then for senior executives is to prioritise issues, understand risks across the spectrum of business and find the right solutions quickly⁵⁵.

The Telstra Audit Committee provides advice to the Board on the status of business risks confronting the Corporation through an integrated risk management and assurance function whereby it oversees:

- ❑ the establishment and management of risk limits and tolerances across the organisation;
- ❑ the progress of risk management within its business units; and
- ❑ the existence of an appropriate risk management culture.

The risk management and assurance function has promoted a common language and approach used by the business units in identifying, measuring and prioritising business risks.

KEY ROLE OF AUDIT COMMITTEES

Ian McIntosh, Chief Accountant, ASIC, in nominating his five top tips for directors singles out audit committees. He says:

The audit committee is a vital part of your company's governance structure. It is crucial that you have confidence in their integrity and commitment, and that they have confidence in yours. An independent and fearless audit committee will report accurately back to you on the true state of the company⁵⁶

An independent Audit Committee, as a crucial component of corporate governance, provides a complementary vehicle for implementing relevant control systems incorporating sound risk management plans. This view is shared by the private sector where corporate representatives have agreed that effective audit committees and risk management plans are an indication of best practice and markedly improve company performance, including decision-making. The internal auditing function of an organisation plays an important role in this respect by examining and reporting on control structures and risk exposures and on the agency's risk management efforts to the agency governance team.

An effective audit committee can improve communication and coordination between management and internal as well as external audit, and strengthen internal control frameworks and structures to assist CEOs and boards meet their statutory and fiduciary duties. An audit committee's strength is its demonstrated independence and power to seek explanations and information, as well as its understanding of the various

accountability relationships and their impact, particularly on financial performance. In particular, it can ensure that accepted audit recommendations are followed up and properly actioned, which greatly improves both internal and external audit effectiveness.

The independence theme has been given a lot of air play lately with most authoritative reports recommending that either the audit committee have only independent directors or at least have a majority of independent directors. The fundamental position is that an audit committee should be in a position to discuss matters with the auditors without the constraint of having senior management on the committee. The independence issue raised its head recently in the HIH case where two members were ex members of the accounting firm that, at the same time, undertook the external audit. As Henry Bosch said on Radio National recently:

'I think that's far too cosy. Just having the machinery is not enough. You've got to use the machinery properly. An audit committee has a responsibility to ensure the independence of the auditors, and to have ex-partners sitting on the audit committee...seems to me to be a very unusual practice and not one to be recommended in practice'.⁵⁷

In that connexion, Professor Ian Ramsay's Report on *Independence of Australian Company Auditors*⁵⁸ is of particular interest. However, I was particularly interested to see that he recommended the amendment of the Australian Stock Exchange Rules to require all listed companies to have an Audit Committee.⁵⁹ You may be aware that this is a requirement for Commonwealth bodies under both the *Financial Management and Accountability Act 1997* (Section 46) and the *Commonwealth Authorities and Companies Act 1997* (Section 32).

The CEO or the board of an organisation, as well as senior management, are responsible for devising and maintaining the control structure. In carrying out this responsibility, management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. The entity's executive board, audit committee and internal audit are fundamental to this exercise. Management's attitude towards risk and enforcement of control procedures strongly influences the control environment. This is obviously an area of significant interest to audit and one where it can work positively with the Audit Committee to achieve greater organisation effectiveness.

BUSINESS CONTINUITY

There is little point in establishing a best practice governance framework, with all the associated discipline if, at the end of the day, the business becomes impaired for some foreseeable reason or, worse still, ceases to operate for any length of time. Whilst there is clearly a cost that needs to be taken into account as part of any risk assessment, and indeed of the application of risk management approaches and techniques, I would suggest that a more positive approach by decision-makers would regard such a cost as an investment in the future of the business. Clearly, business continuity is at the core of effective corporate governance.

As a result of the greater interest in, and attention applied to, related issues, the ANAO prepared a Business Continuity Management Guide.⁶⁰ The Guide includes two major features: the first part deals with business continuity management concepts in a risk management context; the second part identifies the processes and procedures required to be undertaken to produce a business continuity plan.

As I said when I launched the Guide in February last year:

*The Guide ... recommends that the business continuity plan be developed in conjunction with the risk management plan for the organisation. There are no short cuts in this area and no substitutes for systematic risk identification, assessment, prioritisation, treatment, monitoring and review, including systems testing.*⁶¹

The Guide makes the point that organisations, through a structured, systematic process, must attempt to manage all significant business risks pro-actively, by implementing appropriate preventative controls and other risk treatments. This risk management process is designed to reduce the residual risk of an event—in terms of its likelihood of occurrence and/or its consequences, to an acceptable level. Moreover, for effective risk management, the Guide notes that it is equally important that organisations design controls that are implemented once a risk event has occurred. After all, it is the business interruption consequences that mainly determine the process. And this is a major concern in any outsourcing arrangement which has to be managed, particularly in transition stages. No-one wants to ‘bet their business’ and/or fail in their responsibilities to stakeholders, particularly citizens.

DEVELOPING A MORE HOLISTIC VIEW OF RISK MANAGEMENT

One result of the emerging convergence between the public and private sectors is that the intuitive, and often reactive, approach to managing risk that has characterised public sector management in the past will not be sufficient in the future. A more strategic approach is required to stay contestable in such an environment. This is a significant management challenge, requiring heavy investment in up-front analysis, and then management, of risks as efficiently and effectively as possible.⁶² The key message is that CEOs and/or board should aim to ensure that decisions made using risk management are not based on ‘risky’ management practices. However, at the same time sound risk management can present real opportunities for improving performance, perhaps even taking new directions. Another way of looking at the issue more positively is that:

*Financial risk management is the process by which unacceptable risks are transformed into acceptable risks.*⁶³

Consistent with Federal Government policy, there has been a greater use of outsourcing to deliver a range of services with the consequent split between delivery and policy. The associated increase in risk, particularly with contract management, is becoming more critical in agency operations. This issue has been treated at length in previous papers⁶⁴ and a large amount of guidance has been issued on contracting, particularly for those processes leading up to contract signature.⁶⁵ I do not intend to revisit the issue here but I commend the references to you.

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

aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the uncertainties the enterprise faces as it creates value⁶⁶

This theme has been picked up in the CPA Australia's publication 'Enterprise-Wide Risk Management' ⁶⁷ discussed below.

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

Some important benefits that can potentially flow from this approach are:

- ❑ the board setting the overall risk appetite or the enterprise-wide risk tolerances for the entity;
- ❑ identifying the relationships between, and among, risks and their drivers which leads to better choices in capital allocation;
- ❑ taking the development of a risk strategy to a higher level focusing on managing the most important key drivers; and
- ❑ creating the linkage to performance.

This approach minimises the influence of the management 'stove pipes'; leading to a more holistic, integrated, proactive and process oriented approach being taken to manage all key risks and opportunities. In part, this reflects the fact that many risks are organisation-wide and often have at least a ripple effect. There is also the management imperative of 'not re-inventing the wheel'. This shift of risk management to the strategic end of the risk continuum is shown in Figure 3 in the Appendix.

The Controller and Auditor General for New Zealand in his July 2001 Report, entitled 'Reporting Public Sector Performance' also touches on this theme where the approach to managing risk is seen to be dependent on the desired outcomes and actual capability of the entity.⁶⁸ I consider this report to be particularly important in canvassing the range of issues relating to both performance assessment and management. While there has been a marked growth in performance auditing, the assessment of both risk and

performance demands a more strategic and analytical audit approach to provide both adequate assurance and better performance assessment and measurement for all stakeholders in an era of increasing demands for better performing public services.

I see risk management as an essential, underlying element of the reforms that are currently taking place in the public sector. Management of risk in the public sector involves making decisions that accord with statutory requirements and are consistent with public sector values and ethics. Such an approach encourages a more outward-looking examination of the role of the agency or entity, thereby increasing customer/client focus including a greater emphasis on outcomes, as well as concentrating on resource priorities and performance assessment as part of management decision-making. As well, with the increased emphasis on contestability and the greater convergence of the public and private sectors, there will be a need to focus more systematically on risk management practices in decision-making that will increasingly address issues of cost, quality and financial performance.

CONTROL STRUCTURES TO MANAGE RISK

Complementary to a sound risk management approach is a robust system of administrative control. Control structures are particularly relevant elements of an effective governance framework because of their importance in promoting effective performance and in ensuring accountability obligations are appropriately discharged. Late in 1997, the ANAO released a publication entitled '*Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes : A Better Practice Guide to Effective Control*'.⁶⁹ The emphasis was on a more systematic approach to decision-making to manage, rather than avoid, risk.

Although it reflects the United Kingdom (UK) situation, the Internal Control Working Party (the Turnbull Committee), and its 1999 report *Internal Control—Guidance for Directors on the Combined Code*⁷⁰ nevertheless have provided an effective lead towards the introduction of internal control arrangements for the private sector and, by extension, for at least the commercial elements of the public sector in Australia. The Committee's report provides guidance to assist UK listed companies to help implement the requirements in the revised Combined Code of the Committee on Corporate Governance.

The Turnbull Committee sought to reflect some of the best practices available in designing and operating systems of control, and in incorporating a risk-based approach to corporate governance arrangements. I note in particular, and support, the Committee's comprehensive statement that an internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company that, taken together:

- ❑ *facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed;*
- ❑ *help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely,*

*relevant and reliable information from within and outside the organisation;
and*

- ❑ *help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.*⁷¹

Mark Stock, a partner in KPMG (UK), more recently provided an overview of progress on the Turnbull report. He also observed that the following should be part of effective systems of internal control:

- ❑ ability to respond quickly to evolving risks;
- ❑ costs and benefits must be balanced;
- ❑ prompt reporting of weaknesses;
- ❑ lead and lag indicators leading to corrective action;
- ❑ reasonable but not absolute assurance; and
- ❑ embedded in an organisation and part of its culture.⁷²

I cannot overemphasise the importance of the need to integrate an organisation's approach to control with its overall risk management approach in order to determine and prioritise the functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively.⁷³

WEAK INTERNAL CONTROLS AND FRAUD

Effective control structures within a corporate governance framework are a vital element in providing assurance to boards and management. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture, as I have already noted. However, weak internal controls provide an environment that increases the risk of fraud. Some signs, signals and patterns indicating fraud include:

- ❑ weak management that fails to enforce existing controls, supervises the control process inadequately, or fails to act on fraud; and
- ❑ poor internal controls with inadequate separation of duties involving cash management, inventory, purchasing/contracting and payments systems which allow the perpetrator to commit fraud.⁷⁴

I note that the requirements for management to establish and maintain policies and procedures that manage the risk of fraud, and on auditors to oversight such arrangements, are to be reinforced at the international level shortly. Action is underway

through the International Federation of Accountants (IFAC) to tighten the International Standard of Auditing (ISA) 240 on fraud and error. While the existing standard provides guidance to auditors as to how to treat fraud and error when they detect it, the revised standard will require auditors and, most importantly, management of entities, to take a more proactive role in both prevention and detection.

The specific requirements under the proposed new standard are as follows:

- ❑ *Auditors will be required to quiz managers and boards of directors about what systems they have to detect fraud and glaring errors.*
- ❑ *Auditors will also need to check whether incorrect statements in the company books, including omissions of amounts and disclosures, are simply honest mistakes.*
- ❑ *Businesses will not only have to notify auditors, in writing of any fraud or suspicious activity; they will also be required to produce any financial statements that turn out to be incorrect and that management claimed were immaterial.*
- ❑ *Auditors will be required to pass these details on to those in charge of governance at the company that is being audited.*⁷⁵

In putting out the revised standard for comment, the Chairman of IFAC's International Auditing Practice Committee, Mr Robert Roussey, made the following points that I certainly agree with, as the CEO of an audit practice. I am sure those who support best practice in corporate governance arrangements would also endorse them:

It is the responsibility of management to establish and maintain policies and procedures that would contribute to the orderly and efficient conduct of the entity's business.

This responsibility includes implementing and ensuring the continued operation of accounting and internal control systems which are designed to prevent and detect fraud and error.

*Further, it is the responsibility of those charged with governance to ensure, through oversight of management, that these systems are in place.*⁷⁶

It would seem appropriate to put the onus on managers and directors, including those in public sector agencies, to ensure that their organisations have internal controls to prevent and detect fraudulent activity as well as any undue errors that can result from lack of vigilance, skills, or even care. My audits do not set out to detect fraud but do strenuously check all entity systems bearing on financial management and reporting. We have limited forensic audit skills. Contrary to the perception of some managers and directors, financial statement audits, in particular, do not set out to determine if there is fraud. A major issue is whether we can depend on organisational systems to deal with fraud and provide reliable information on which we can base an audit opinion.

Given the requirement for public sector agencies to ensure robust fraud control systems are in place, the ANAO has undertaken a series of fraud control audits in selected agencies as well as a survey of some 150 agencies to provide assurance to Parliament on the preparedness of agencies to prevent and/or deal with fraud effectively.

The survey findings indicated that while the majority of agencies had established suitable fraud control arrangements in line with the Commonwealth Policy, a substantial number had not. A particular concern that the survey raised was that one third of agencies had not undertaken a recent risk assessment. Given the changing nature of fraud this is likely to mean that agencies are not identifying emerging risks in a timely manner. As well, a number of agencies (13 per cent) had developed a fraud control plan that was not based on a current risk assessment, raising questions regarding the usefulness of these plans.⁷⁷

Our audit findings highlight the importance of integrating fraud risk management within organisations' corporate governance framework. In particular, agencies should be reviewing their approach to dealing with fraud because of the changing nature of the risk of loss of public funds resulting from, among other things, new service delivery methods such as outsourcing and electronic service delivery and the growing use of the Internet. In many instances it is no longer appropriate to rely solely on established systems to prevent and detect fraud in the current public sector environment.

The management challenge is to put in place an appropriate corporate governance framework (embracing, of course, the various fraud control strategies and measures) to manage the risk as effectively as possible – to reduce its incidence and/or mitigate its effect. On this point, I note that the revised Fraud Control Policy of the Commonwealth encourages agencies to take a holistic approach to managing the risks they face in line with modern corporate governance principles. That is, the revised Policy enables agencies to manage fraud alongside the other risks faced by the agency.

As an aside, the Department of Health and Aged Care has produced a very good booklet titled 'Fork in the Road Café – Workplace Ethics and You'⁷⁸ with its theme, that every so often you face a dilemma, a fork in the road, it's a place to stop and consider the menu on offer in the booklet. The menu covers: travel, hospitality, gifts and benefits, Australian Government Credit Card, use of Commonwealth vehicles, handling of official information, outside and post employment, mobile phones, conflicts of interest, and a code of ethics for procurement activity. I know that other agencies have similar publications but this one struck a particular cord with me with its catchy title and 'user friendly' approach.

RECENT INITIATIVES IN RELATION TO RISK MANAGEMENT

To round out my discussion on risk, I thought it would be useful to flag some recent work undertaken by CPA Australia, Comcover, Standards Australia, Monash University and the Institute of Engineers, Australia in conjunction with the Western Australia Chamber of Commerce and Industry. Such initiatives add a lot to the body of knowledge relating to risk and risk management.

First, the CPA Australia's Public Sector Centre of Excellence established a research project entitled 'Risk Management in the Australian Public Sector'⁷⁹ to examine:

- the current state of play of risk management in the public sector;
- the identification and development of case studies of leading public sector organisations; and
- a 'Better Practice Risk Management Guide' for use by the public sector.

The publication, 'Enterprise-Wide Risk Management Best Practice Guide for the Public Sector'⁸⁰ was released in draft form for comment on 20 September last. The guide forms part of public sector risk management materials which has been developed for members of CPA Australia and people working within the sector. The guide also adopts an enterprise-wide risk management approach which CPA research indicates is increasingly being used by management as a key tool to reinforce and achieve the public sector values and ethical standards. The CPA Enterprise-wide risk management approach is consistent with the concept outlined earlier and applies risk management processes, structures and culture in a way that is:

- Truly holistic – considers risk right across the business (strategic, operational, compliance and financial), the hazard, uncertainty and opportunity elements of risk and the objectives and needs of all stakeholders;
- Synergistic – considers links with and interrelationships between risks and structures, strategies and processes;
- Integrated and aligned – with business planning, objectives, decision making and other elements of the organisation's management framework; and
- Inclusive – involves the whole organisation, from the board, to senior management and employees.⁸¹

I recommend this publication as a useful guide to both the public and private sectors. As well, the Research Report in its final form covering the findings of the survey⁸² of 31 public sector agencies from across the three tiers of government in Australia which was conducted by PricewaterhouseCoopers (PWC) has recently been released.

Comcover, the body responsible for co-ordinating insurance for agencies of the Commonwealth Government has been very active in the risk management area, in particular helping its members to prepare risk management plans before the end of 2000-2001. More recently, Comcover has developed a tool for Australian organisations to use to benchmark the implementation of risk management. The initial group comprising some 80 organisations will be (was) finalised in October 2001. Participants complete an on-line questionnaire and the results will be accumulated to show comparative performance of organisations in this area. The questionnaire is structured in such a manner to ensure that partial progress in areas is appropriately recognised in developing the overall benchmarking result. The organisers hope to attract a substantial continuing group to enable a time series study to be undertaken.

Standards Australia has two working parties developing material to further promote the adoption of risk management by Australian organisations. The first project is the development of a guide for non executive directors. The guide is intended to provide enough information to enable the user to ask a series of appropriate questions to gauge

the extent to which risk management has been embraced by an organisation- to see past the rhetoric to the underlying reality. The second project is work on a document to reinforce the importance of risk management to organisations and how it can be properly incorporated into the corporate governance culture. Through presentation of key material, supported by credible survey results, the project is directed at establishing the links between risk management, governance and successful outcomes. One of the relatively recent additions to the risk management standard (AS/NZS 4360:1999) is the requirement to identify stakeholders and communicate and consult with them regarding their perceptions of risk at each stage of the risk management process.

Earlier in the year, I spoke at the launch of the Australasian Risk Management Unit at Monash University. The Unit's charter is to establish the concept of risk within an academic context and to build bridges from the university to industry and ensure that risk management evolves as a formal discipline in the future. The training programs being offered will focus on the development of workplace competencies needed by people working on risk management. The competencies are aligned to national risk management standards, Australian Standards and current acts, regulations and state and federal guidelines associated with risk management. The establishment of this unit and other educational initiatives indicates that risk management is becoming part of the management mainstream.

The Institute of Engineers, Australia, in conjunction with the Western Australia Chamber of Commerce and Industry, recently reported on the findings of their survey on risk allocation in major WA construction projects.⁸³ Some of the more significant findings were:

- ❑ over a third of respondents did not undertake a formal risk assessment process before awarding a contract of tendering for a contract;
- ❑ a significant percentage of respondents believed that risks were not allocated to the party best able to manage them (including to consultants);
- ❑ half of the respondents indicated that risks were not being costed in tenders; and
- ❑ cost savings would have occurred if risks had been more effectively allocated (25% at pre-tender stage raising to 45% at contract delivery stage). The authors drew the conclusion that protection from risk is more important than overall cost.

These findings are disturbing and, *prima facie*, indicate that the parties are entering into contracts without a good understanding of each other's objectives and risks and consequently appear not to provide a best-fit solution.

The ANAO has recently published a Better Practice Guide on contracting⁸⁴ which contains research and experiences of better practice in contract management in Australia and internationally. Importantly, the Guide focuses on the application of risk management to each of the contract management lifecycle stages and provides both practical advice and examples of better practice to assist contract managers to establish a framework for the contract management lifecycle.

PART C – AUDIT INTEGRITY AND EFFECTIVENESS

At this point I turn to the audit role and particularly to the role and independence of external auditors which have recently received unprecedented scrutiny following the collapse of HIH, OneTel, Harris Scarfe and Ansett. I have already touched upon the critical issue of the independence for audit committees and my comments are equally applicable here. However, the increased scrutiny of the auditor's role has meant that the general community and the media are again raising questions of audit effectiveness as well as about the 'audit expectation gap'.

THE ROLE OF AUDITORS-GENERAL

Before I move to the private sector and the reaction to HIH and other corporate failures, I will comment briefly on public audit in the current changing governance environment. While there are variations in the mandate, focus and operating arrangements across constituencies, the fundamental role of Auditors-General remains substantially the same. That role is to provide the elected representatives of the community (the Parliament) with an independent, apolitical and objective assessment of the way the government of the day is administering their electoral mandate and using resources approved by democratic processes, albeit in differing governance frameworks.

In my view, Auditors-General are an essential element in the accountability process by providing that unique blend of independence, objectivity and professionalism to the work they do. Indeed, the four national audit agencies making up the Public Audit Forum in the United Kingdom believe that:

there are three fundamental principles which underpin public audit:

- ❑ *the independence of public sector auditors from the organisations being audited;*
- ❑ *the wide scope of public audit that is covering the audit of financial statements, legislatively (or legality), propriety (or probity) and value for money; and*
- ❑ *the ability of public auditors to make the results of these audits available to the public, and to democratically elected representatives.*⁸⁵

Corresponding with the public sector changes over time, the role of the Auditor-General and the place of auditing in democratic government has also changed. In today's environment, my role includes providing independent assurance on the overall performance and accountability of the public sector in delivering the Government's programs and services and in implementing effectively a wide range of public sector reforms. And I cannot overstate the importance of the independence of the Auditor-General in those respects. As the public and private sectors converge; as the management environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them.

I would argue, therefore, that the role of Auditors-General is more important to effective, accountable and democratic governance today than at any time in the past. As the Public Audit Forum in the United Kingdom has also observed:

*Public audit plays an essential role in maintaining confidence in the stewardship of public funds and in those to whom the responsibility of stewardship is entrusted. Public auditors are, of course, themselves accountable for their performance and are duty bound to undertake their work in a professional, objective and cost-effective manner and with due regard to the needs of the organisations they audit.*⁸⁶

I would also suggest that, as we move into the future, and as the pace of change remains unabated, this trend will not decline, rather it is likely to increase as the roles and responsibilities of the public and private sectors converge and, perhaps, the differences between the two become more apparent than real.

The interests of the ANAO now go well beyond the efficient and effective stewardship of public finances which is said to be fundamental to good national governance.⁸⁷ While I will refer to the importance of legislation as a central element of public sector management, I stress the Parliament's concerns with the 'rule of law' as a fundamental element of governance. The ANAO is increasing its expenditure on legal advisings each year as a consequence.

From my Office's perspective, reduced central oversight has meant a broadening of our approach to auditing which once focussed largely on compliance and conformance, to a more pro-active involvement with agencies and entities with the goal of making real-time contributions to enhancing public administration. For example, our better practice guides are designed to assist organisations test their own systems and where applicable, improve their practice and performance in line with recognised principles of better practice.

That said, we are nevertheless conscious of the ANAO's responsibility, particularly to the Parliament as our major stakeholder, to report, for example, significant and/or material breaches of approved guidelines, standards and/or legislation. From my experience, agencies generally understand this obligation even where such breaches are inadvertent. My preferred position would be to work with agencies to implement effective processes which are preventative and not just detective, so avoiding such situations. This can be largely achieved through the operations of an Audit Committee which, as I stressed earlier, is an essential element of any corporate governance framework.

The ANAO has undertaken a number of audits that address corporate governance and I would encourage you to visit our website at www.anao.gov.au for reports which touch on governance matters. The website allows you to search by theme, agency, title, keywords to allow you to quickly come to the issues of interest. You may register on our email list for copies of our reports as they are tabled.

THE AUDIT INDEPENDENCE DEBATE

Shareholders, employees, the media and the general public are asking why audits are failing. Similar comments were made after the last round of corporate collapses

(Quintex, Bond Corporation, Rothwells and the National Safety Council of Victoria). Recent events have brought independence issues to the forefront; it is a complex one with far reaching consequences for both the auditing profession and the general public.

A critical component of the ethical conduct of auditors is that they remain sufficiently independent in fact and in perception, to provide an unbiased and hence creditable audit opinion. The accounting industry is in the midst of a dramatic transformation. Some of the larger public accounting firms have merged and expanded rapidly both domestically and internationally. In order to survive in a highly competitive and dynamic market, accounting firms have been forced to become more diversified and multi-disciplinary. This, coupled with international growth, has resulted in a vast expansion of new non-audit services being offered to clients. These additional services range from outsourcing of many corporate business functions through to strategic business and financial planning. Lynn Turner, the Chief Accountant of the Securities and Exchange Commission sums up the current environment aptly;

*Today it is rare for public accounting firms to advertise themselves as auditing firms, but rather, as one-stop financial service firms that offer a broad array of financial services.*⁸⁸

The potential effect of non-audit services on auditor independence has long been an area of concern. This has been compounded of late due to the significant increase in the amounts of these additional services being performed. An interesting statistic that demonstrates the magnitude of this growth is that revenues from management and advisory services of the five largest public accounting firms is estimated to constitute half of total revenues for these firms compared to only 13 per cent of total revenues in 1981.⁸⁹

Despite this diversification, when performing the role of external auditor, accounting firms continue to fulfil a critical social role. In order for the audit report to carry any weight the auditor must have the freedom to perform the audit, report findings and express an opinion free from external influence. The performance of these additional services has led many users of financial statements to express some scepticism that this required level of independence can be maintained.

The Securities and Exchange Commission (SEC) in the USA has recognised the need to modernise the rules for determining whether an auditor is independent.

*“Yet increased economic pressure on the profession, coupled with greater competition and consolidation, mandated that we bring clarity and light to the necessarily subjective nature of independence.”*⁹⁰

In February this year, the SEC released a final ruling on the requirements for auditor independence. The release of the final rule followed a long and difficult process of review. Draft proposals generated significant comment and broad debate. The final ruling sets forth restrictions on financial, employment and business relationships between an accountant and an audit client and restrictions on an accountant providing certain non audit services to an audit client. The ruling provides four principles by which to measure an auditor’s independence. These state that an accountant is not independent when the accountant:

- ❑ has mutual or conflicting interest with the audit client;
- ❑ audits his or her own firm's work;
- ❑ functions as management or an employee of the audit client; or
- ❑ acts as an advocate for the audit client.

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

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

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

I have referred to Australian Auditors being under scrutiny. An important part of this scrutiny has been the Federal Government inquiry into the state of audit independence in Australia. The result is the Ramsay Report, released on 4 October, which I referred to earlier in the discussion on audit committees. In welcoming the Report, the Minister for Financial Services and Regulation observed that:

*We must ensure the independence of auditors is preserved and that stakeholders are secure with the knowledge that the auditor is objective and independent.*⁹¹

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

The Australian Securities and Investment Commission is also examining the issue of auditor independence. In June, the Chairman of the ASIC announced that the ASIC would conduct a survey of Australia's top 100 listed companies on audit independence. The survey will question companies about relationships with their external audit firm, including any business or professional relationships that exist outside their role as external auditors. Mr Knott stated that "the survey is designed to improve the level and quality of factual information available to the industry, Government and regulators who are considering these issue."⁹²

The results of the inquiry and survey are sure to generate further debate on this very important issue. The current legal and professional requirements provide some assurance over independence. However, in the absence of more detailed and specific legislation, some audit practices will continue to skirt the edges. It is inevitable that some form of change is coming, whether or not we follow the path of the US on the issue remains a question. What is clear is that the public's perception of auditor independence is critical and, in the words of the Chief Accountant of the SEC, "*Enduring public confidence begins with the auditor.*"⁹³

PART D - PERFORMANCE MEASUREMENT AND ASSESSMENT

PERFORMANCE ASSESSMENT IN THE PUBLIC SECTOR

Performance continues to be more than just about a financial bottom line in both the private and public sectors. Assessments now typically cover a range of measures, both quantitative and qualitative. For example, in the public sector, an agency or entity has to be accountable for the implementation of the Government's requirements with respect to public sector reforms and for meeting relevant legislative, community service and international obligations; for equity in service delivery; and for high standards of ethical behaviour.

In order to adequately assess performance, we will need to identify both the financial and non-financial drivers of agency business. Within the Commonwealth sector, such assessment is underpinned by the introduction of the outcomes and outputs framework associated with the implementation of accrual budgeting. The outcomes and outputs framework is intended to assist management decision-making and performance by focussing attention on the Government's goals and objectives (outcomes). The identification of appropriate performance indicators, together with reporting of actual results against these performance indicators, becomes a key plank within this new accountability framework. In the Commonwealth arena, a major difficulty is not only to define outcomes in a credible manner but also to relate organisational outputs in a meaningful (measurable) way to those outcomes, or at least to intermediate outcomes. Assessing performance in the new environment will involve the use of techniques such as the balanced scorecard which:

*...complements the financial measures with operational measures on customer satisfaction, internal processes, and the organisation's innovation and improvement activities - these operational measures are drivers of future financial performance.*⁹⁴

The scorecard approach underlines the importance of the various linkages and their understanding and management such as between strategy and operations, budgets and performance. It also requires that attention be given to measuring performance where practicable and to articulating a credible basis for assessing qualitative or so-called 'soft' indicators of success. A parallel is the distinction between price and the value for money concept, with the latter often embracing many non-price factors. It is useful to bear in mind a recent observation as follows:

The paradox of measurement holds for many public service functions. That is, the stronger the attempts to measure the inherently incommensurable, the more such quantification tends to become a substitute for judgement, experience, and commonsense in the governing process⁹⁵.

Many Commonwealth agencies have adopted the balanced scorecard, such as Centrelink, and indeed as has the ANAO.

Even though the focus of public sector reform is very much on results, it also matters how those results are achieved. Organisations that are successful in achieving a credible, trusted performance management framework, will earn the confidence and support of all its stakeholders, including those who work, and want to work, in the public sector. From an accountability viewpoint the following observation by the Comptroller General of the United States is apposite:

Performance management ensures accountability because it generates valid and reliable data on program impact on the allocation of resources and on the economy, efficiency, effectiveness and integrity with which the government's finances are run.⁹⁶

The New Zealand Controller and Auditor General's recent report on 'Reporting Public Sector Performance'⁹⁷, which I referred to earlier, lays down the challenge to CEOs, boards, managers and central agencies to embrace more effective performance reporting.

My New Zealand counterpart sees performance in public sector terms as follows :

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

Public sector performance embraces outcomes, capability, and a transformation cycle – inputs, processes and outputs. These performance elements need to be integrated and managed as a whole as focussing on separate elements at the expense of others gives an unbalanced view of performance. For example, too much focus on outputs may result in ineffectiveness (achieving the wrong things) or put capability as risk

(achieving in the short term at the expense of the longer term); while too much focus on capability and process can put program achievement at risk.

Reporting at regular intervals is essential with the need to compare planned performance with actual performance – these elements of performance, including the passing of time make up a comprehensive model of performance shown in Figure 4 in the Appendix.

The New Zealand report highlights that, as performance and accountability become more complex, external accountability reporting needs to change. I have indicated that this report is a significant contribution to the body of knowledge in this important area and I recommend it to you. The report also discusses two topical reporting frameworks – *The Balanced Scorecard* which I have just touched on, and *Triple Bottom Line* reporting, which I will now briefly discuss.

Triple bottom line reporting

Demonstrating the growing convergence between the public and private sectors is the increasing focus by private companies on their wider responsibilities in order to secure their competitive advantage and ensure their long term viability. A good example is the so-called triple bottom line (TBL) reporting approach which, in addition to financial and economic factors, also takes account of the environmental and social consequences of business activity. In Australia, some private sector corporations, such as Rio Tinto, have lead the way in this kind of reporting. BP Australia is another example of a company that has long embraced TBL in recognition of its wider accountability requirements.

Such recognition in the private sector is not new. For example, General Robert E Wood, who led Sears, Roebuck & Company from 1924-1954 believed a large corporation was more than an economic institution; it was a social and political one as well. In the Sears Annual Report for 1936, he wrote:

*In the days of changing social, economic and political values, it seems worthwhile...to render an account of your management's stewardship, not merely from the viewpoint of financial reports but also along the lines of those general broad social responsibilities which cannot be presented mathematically and yet are of prime importance*⁹⁸.

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

*...Australians would not lose sight of social implications of our pursuit of economic growth.*⁹⁹

Proponents of TBL consider that public and other stakeholders' expectations in an increasingly globalised business and communications environment would provide the drivers for a shift away from the traditional input-output based model of accountability towards a focus on economic prosperity, environmental quality and social justice.¹⁰⁰

As well, new corporate governance rules are challenging the traditional non-disclosure, or minimal disclosure of company policy. This is slowly giving rise to new expectations and standards of transparency in the general community. However, a recent study indicates that there is general corporate resistance in Australia to the provision of environmental information to external stakeholders in satisfying accountability obligations, unless the information provided reflects positively on the organisation¹⁰¹. Alan Kohler has noted that:

*The trouble is lumping three bottom lines together in this way, companies are mixing woolly, subjective and arguable ideas with objective and auditable financial requirements*¹⁰²

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

*The real recognition will start when broader social issues are addressed in critical resource allocation decisions, for example fuel and utility pricing, education and research*¹⁰³.

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

- there is an Exposure Draft before the Australian Accounting Research Foundation put out by the International Auditing Practices Committee (IPAC) for comment on Assurance Engagements on Environmental Reports;
- a social accounting standard was released in 1998 by the Council for Economic Priorities entitled SA8000;
- in November 1999, the Institute of Social and Ethical Accountability launched AA1000, which is concerned with the process of setting up social and ethical accounting and auditing systems;
- the Global Reporting Initiative (GRI) has been convened by the Coalition for Environmentally Responsible Economies in partnership with the United Nations Environment program to develop and disseminate globally applicable sustainability reporting guidelines for voluntary use; and
- the International Standard Organisation's (ISO's) Consumer Policy Committee has agreed to explore the possibility and desirability of developing ISO standards to benchmark corporate social responsibility and report its recommendations by June 2002.¹⁰⁴

This is clearly still a ‘greenfield’ area for research and development. Moreover, because of the transborder and global issues inherent in TBL, the development of appropriate methodologies and indicators would benefit from international input. Both the major professional accounting bodies in Australia have been devoting increasing attention to TBL in their publications and conferences. This puts added pressure, in my view, on the Commonwealth public sector to make commensurate effort, if not to take a more leading role in such reporting as part of good corporate governance. It has been said that local government has taken somewhat of a leading role in social and environmental reporting. A draft Code of Accounting Practice is being prepared for the environmental reporting through the efforts of the Australian Bureau of Statistics and CPA Australia. The draft Code references a range of different methods proposed for environmental valuation; damage evaluation; avoidance or prevention costing; restoration costs; and market evaluation.¹⁰⁵ But more needs to be done to promote awareness generally in the interests of greater openness and transparency and for public and private sector organisations to improve their performance reporting to meet the increased expectations of all stakeholders.

CONCLUDING REMARKS

The recent round of corporate failures has made the wider Australian community focus on corporate governance with renewed interest and intensity. In part, this is because more of the population are shareholders, but I also suspect it is because of the greater appreciation of the wider ramifications of these events for our society. While good corporate governance will never assure corporate success, it does provide a sound platform for organisations to perform. However, David Knott also notes that corporate failure does not necessarily imply poor standards of governance.¹⁰⁶ Returning to my opening theme of ‘applied corporate governance’, Greenwood and Johnstone in their recent article¹⁰⁷ list some key corporate governance lessons learnt. These are:

- ❑ Non-executive directors must ask difficult questions – they need to probe, follow up when insufficient information is provided by management and seek independent advice where necessary (eg regarding the performance of the CEO, external auditor’s reports, and legal advice).
- ❑ Beware the dominant director – particularly where that individual may be an executive director.
- ❑ Having an audit committee isn’t enough – it must be robust, independent and it must understand its role and report regularly and fully to the board.
- ❑ Board papers must be effectively presented – and management accounts in particular must be organised in such a way as to be readily accessible to directors.
- ❑ Ensure that there are effective risk management systems in place and get regular reports on legal, financial, operational and OH&S risks – these cannot just be ‘rubber stamped’.
- ❑ Shareholders – including major institutional shareholders, are becoming increasingly demanding – they expect more information, more quickly and greater transparency regarding executive remuneration and major investment decisions.

They increasingly hold the board to account through the AGM and media campaigns.

- ❑ Beware 'optimistic' accounting.
- ❑ Listen to your internal and external auditors and consider the need to change external auditors on a regular basis to avoid 'capture'.

In the public sector, Bob Sent, my NSW counterpart, provides the following principles of effective governance for public sector boards.¹⁰⁸

- ❑ Legislation should clearly distinguish between advisory and governing boards.
- ❑ The respective roles, responsibilities and accountabilities of Government and its Ministers and boards should be clearly defined.
- ❑ Legislation should provide boards with the powers to match their governance responsibilities.
- ❑ There should be a consistency of approach for government boards in terms of the function of the board and the role of the government regardless of the nature, size, assets or income of the organisation being governed.
- ❑ Roles of Ministers and boards should be clear and separate.

In summary, there is a large authoritative body of knowledge about what makes good corporate governance. Many accounting and legal consulting firms are active in promoting and helping to implement such knowledge, particularly in the training of managers and board members. The challenge, as I see it, is to select those approaches that best meet the individual organisation's needs and apply them rigorously. While there are no easy solutions to raising corporate governance standards in Australia, work undertaken by the ANAO in the federal public sector with APS agencies has clearly highlighted the contribution that good corporate governance can make to an organisation's performance and to the confidence of all stakeholders. For example, from the ANAO's observation, the Australian Taxation Office's governance framework has facilitated:

- ❑ achievement of corporate objectives;
- ❑ identification and management of risk;
- ❑ promotion of high ethical standards; and
- ❑ clarity of various management roles and accountabilities.

This is a message that has to be promulgated widely. It includes the realisation that governance arrangements being put in place have to be well understood and accepted by all concerned. Such arrangements have to be dynamic and flexible to meet the needs of all participants including those of the general public. It has to be an holistic approach embracing both the strategic and operational imperatives identified by management and Boards. As the private and public sectors converge even more in the

future, there will need to be both sharing of experiences, knowledge and better practice approaches and the realisation that there may have to be some re-examination of embedded cultures and preconceptions of performance and accountability associated with operating in the public sector on a more commercial basis. From a public sector viewpoint, any significant changes will need to be determined and approved both by the Government and the Parliament.

APPENDIX

FIGURE 1: FUNCTIONS OF THE BOARD - THE TRICKER MODEL ¹⁰⁹

Compliance Roles		Performance Roles	
External Role	<p>Provide Accountability</p> <ul style="list-style-type: none"> ✓ Report to Shareholders ✓ Ensure legislative & regulatory compliance ✓ Review audit reports 	<p>Strategy Formulation</p> <ul style="list-style-type: none"> ✓ Initiate & review strategic planning ✓ Set corporate direction ✓ Determine strategy 	
	Appoint and work with & through the CEO		
Internal Role	<p>Monitoring & Supervising</p> <ul style="list-style-type: none"> ✓ Executive performance ✓ Review results ✓ Monitor budgets ✓ Investigate and check corrective action 	<p>Policy Making</p> <ul style="list-style-type: none"> ✓ Approve budgets ✓ Determine remuneration policy for senior executives ✓ Decide corporate policy ✓ Create corporate culture 	
	Past & Present		Future Oriented

FIGURE 2: THE CORPORATE GOVERNANCE CHARTER



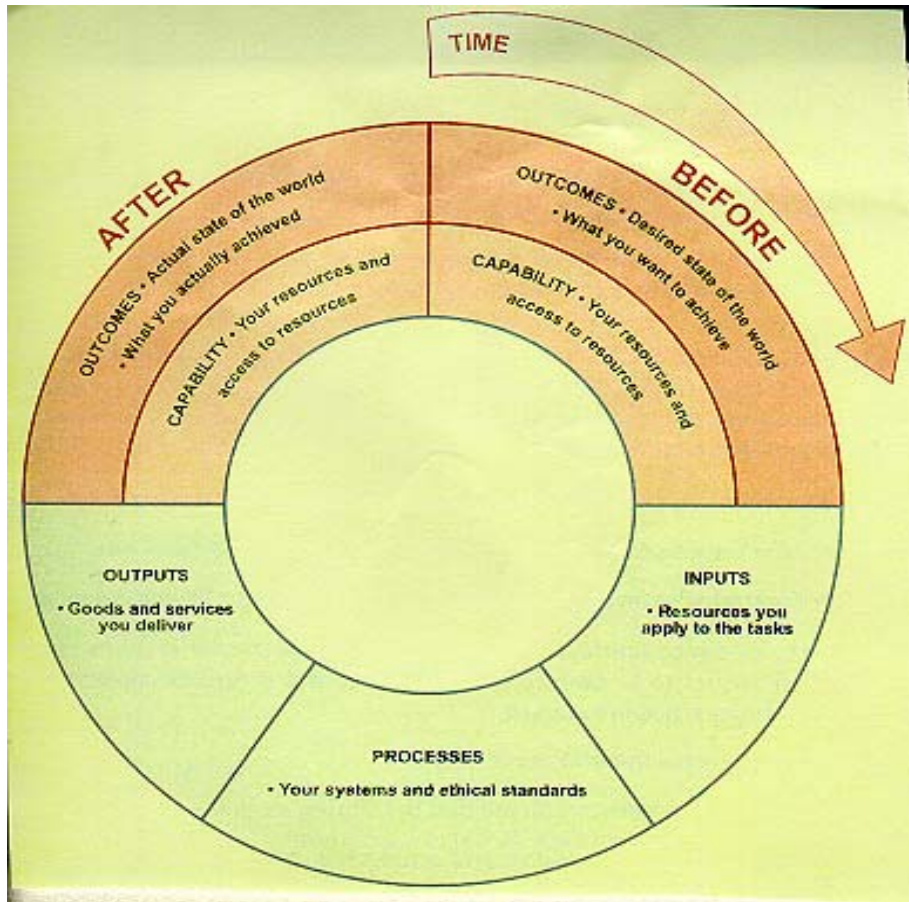
(Source: Professor Geoffrey Keil, *AICD Improving Board Effectiveness*, Module 10 of the AICD's Company Directors Course, June 2001.

FIGURE 3: THE ENTERPRISE-WIDE RISK MANAGEMENT MODEL



SOURCE: ARTHUR ANDERSEN

FIGURE 4 – ELEMENTS OF A COMPREHENSIVE MODEL OF PERFORMANCE REPORTING



Source: *Reporting Public Sector Performance*, Report of the Controller and Auditor-General for New Zealand, 12 July 2001.

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