

# Australian Communications Authority's Business Planning Workshop

## **Better Practice Public Sector Governance**

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# BETTER PRACTICE PUBLIC SECTOR GOVERNANCE

## 1. Introduction

Thank you for inviting me to your annual Business Planning Workshop. I appreciate that the scheduled strategic planning sessions will mainly focus on addressing the challenges of predicting and responding to changes in the technical, market, policy and regulatory environments of the rapidly evolving radiocommunications and telecommunications industries.

However, I am grateful that you have provided me with the opportunity to discuss the important topic of governance. This no doubt reflects the Australian Communications Authority's (ACA's) view that good governance is important to its success in meeting its business objectives and that it also recognises there have recently been significant changes in governance policies and practices in the private and public sectors in Australia and globally that are having a marked impact on the governance framework and could have important implications for the Authority.

Discussing governance in a planning session is a slightly unusual role for an Auditor-General, albeit sanctioned under Section 23 of the *Auditor-General Act 1997*. I usually focus on compliance and performance improvement benefits for Australian Public Sector bodies by closely scrutinising current practices and recent performance, rather than contributing to such strategic planning sessions. However, there are obvious benefits from providing information on better practice corporate governance so that board members and senior managers of APS organisations can use their expertise and knowledge to adapt this to their own operating environment. We have been recognising this possible audit contribution in recent years through our better practice guides.

In this respect, I need to emphasise that I am not attempting to provide specific advice on the governance arrangements that would be most suitable for the ACA. This would require a substantial performance audit, which the ANAO has not undertaken. While the ANAO audited aspects of service delivery in the Australian Telecommunications Authority and the Spectrum Management Agency<sup>1</sup> (the agencies that were combined to form the ACA), it has not undertaken performance audits of the ACA as such.<sup>2</sup> However, in speaking about governance, I will focus largely on those issues that are relevant to the ACA, recognising its legislative basis under the *Commonwealth Authorities and Companies (CAC) Act 1997*.

As I will discuss later in this address, the key to better practice corporate governance in the public sector lies in the effective integration of the main elements of corporate governance within a holistic framework, which are communicated effectively throughout the entire organisation and underpinned by a corporate culture of accountability, transparency, commitment and integrity. As the public sector is often perceived to be risk averse, a particular challenge is to strike an appropriate balance between performance and conformance, with all decisions made within a risk management framework that properly weighs potential benefits as well as potential

costs. Importantly, a cultural change is necessary in many agencies to accept risk as an opportunity as well as something to be minimised or avoided.

## What is corporate governance?

In the forthcoming Better Practice Guide on Public Sector Governance (due early in 2003), the ANAO has chosen to use the term 'public sector governance' or simply 'governance' when discussing the governance of public sector bodies. I do not intend to debate the choice of particular terminology, important though that can be on occasions.

I continue to consider public sector governance to encompass how an organisation is managed, its functional structures, its culture, its policies and strategies, and the ways in which it deals with its various stakeholders. In many ways, governance is a combination of legal and 'better practice' organisational structure and management requirements, aimed at facilitating accountability and improving performance.<sup>3</sup>

I note that some commentators treat governance quite narrowly, often focussing almost entirely on the operations of a board and its relationship with the CEO and with Ministers. I would like to emphasise that, while boards and the CEO are crucial, public sector governance also relies very heavily on the systems, processes, policies and strategies that direct operations, assure quality, monitor performance and manage their obligations to stakeholders. For example CAC agencies are directed through legislation such as the *CAC Act 1997* and the *Public Service Act 1999* and through more informal guidelines including Chief Executive's Instructions (CEIs) and Department of Finance and Administration Directions.

Having said that, guidelines, regulation, structures and systems can provide a robust and useful framework, but it is only through the actions and decisions of organisations and their staff that their benefits can be realised. It is those who govern who make the crucial decisions and direct the use of resources. They delegate authority to management.<sup>4</sup> Importantly, they provide the 'tone at the top' that is essential for sound corporate governance. Whoever governs exercises ultimate authority within an organisation and is finally held accountable for overall organisational performance by stakeholders.

This does not mean that a well-governed organisation will necessarily always show positive financial and performance results. Studies to date suggest that there is not a necessary link between particular governance structures or forms and positive operational outcomes. In other words, good governance structures and forms can support sound performance but they do not guarantee it. There is, however, increasing evidence that *behaviours* consistent with good governance (for example, leadership, communication, encouraging difficult questions to be asked, and holding people to account) increase the probability of positive and sustainable outcomes.<sup>5</sup> At a minimum, good governance is central to ensuring the organisation carries out its responsibilities in a manner that accords with relevant legal and other regulatory requirements. This is a conformance objective.

Briefly considering the converse position, poor governance often involves inflexible, mechanistic approaches that provide an image of compliance (such as simple 'tick-a-box' approaches, for instance to satisfy the auditors) with little real commitment to the

principles of accountability, successful integration of the governance elements, and full disclosures aimed at improving transparency and performance.

## **The legislative framework for the ACA**

The legal framework for governance of the ACA includes three main Acts:

- the *Commonwealth Authorities and Companies (CAC) Act 1997*;
- the *Public Service Act 1999*; and
- the *Australian Communications Act 1997*.

The *CAC Act* deals with matters relating to Commonwealth authorities, including reporting and accountability, banking and investment and conduct of officers. The duties and responsibilities of directors are essentially the same under the *CAC Act* as they are under *Corporations Act 2001*, with suitable modifications to reflect various public sector concerns.

The *Public Service Act 1999* sets out values and the APS Code of Conduct for Commonwealth employees, giving explicit legislative force to the Parliament's expectations in relation to the performance and accountability of public servants in general and of agency heads in particular.

The *Australian Communications Act 1997* outlines the ACA's key powers, functions and responsibilities and its relationship with the Minister for Communications, Information Technology and the Arts (the Minister) and other stakeholders. The powers of the ACA are also outlined in the *Radiocommunications Act 1992* and the *Telecommunications Act 1997*.

The formal governance framework for corporate governance goes beyond the Acts outlined above to include the broader constitutional powers affecting public sector powers, appropriations and responsibilities as well as supporting legislation such as *Administration Arrangement Orders*, the *Remuneration Tribunal Act 1973*, and Privacy legislation. Particularly at a time where there is ongoing loss of corporate knowledge, experience indicates that greater effort is required to ensure that there is a good understanding of the legal framework applying to an organisation's operations and activities not only to deal with, say, reputation risk, but also to ensure that it is actually meeting its legal, including ethical, obligations.

## **ACA governance framework**

The ACA is responsible for regulating telecommunications and radiocommunications, including promoting industry self-regulation and managing the radio frequency spectrum. The ACA also has significant consumer protection responsibilities.<sup>6</sup>

As an agency subject to the *CAC Act*, the ACA has a board that reports to Parliament annually.<sup>7</sup> It also reports to the Minister on significant matters relating to the performance of telecommunications carriers and carriage service providers. Under the

CAC Act, ACA directors have a collective responsibility to meet the requirements of the Act.

Table 1 outlines the main governance arrangements of the ACA. It is not exhaustive and is based mainly on a quick review of information published by the ACA in its Annual Report 2001-02 and on its website ([www.aca.gov.au](http://www.aca.gov.au)).

**Table 1. Outline of ACA Major Governance Processes and Structures**

<b>Organizational Structures and Processes</b>	<b>External Reporting</b>	<b>Control</b>	<b>Standards of Behaviour</b>
<ul style="list-style-type: none"> <li>• Statutory &amp; other accountability               <ul style="list-style-type: none"> <li>➢ CAC Act, ACA Act &amp; other enabling Acts, Minister for Finance directions, etc.</li> </ul> </li> <li>• Communication with Stakeholders               <ul style="list-style-type: none"> <li>➢ Australian Communications Industry Forum</li> <li>➢ Nine advisory or consultative committees</li> </ul> </li> <li>• Roles and Responsibilities               <ul style="list-style-type: none"> <li>➢ Three to six member board. Involved in day-to-day management</li> <li>➢ Four board committees: executive, audit, finance, mgmt</li> <li>➢ Two senior managers</li> <li>➢ Arms-length from Minister</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Annual Reporting (incl. Performance measures)               <ul style="list-style-type: none"> <li>➢ Annual Report</li> <li>➢ Telecommunications Performance Report</li> <li>➢ Consumer Satisfaction Survey</li> <li>➢ Monthly internal reporting</li> </ul> </li> <li>• Use of Appropriate Accounting Standards               <ul style="list-style-type: none"> <li>➢ Unqualified ANAO opinion 2001-02</li> </ul> </li> <li>• External Audit               <ul style="list-style-type: none"> <li>➢ ANAO</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Risk Management               <ul style="list-style-type: none"> <li>➢ Implementing framework based on AS 4360</li> </ul> </li> <li>• Internal Audit               <ul style="list-style-type: none"> <li>➢ Contract KPMG that provides plan and services</li> </ul> </li> <li>• Audit Committee               <ul style="list-style-type: none"> <li>➢ Nine members: eight exec (incl. chair), one independent, eight meetings per annum</li> </ul> </li> <li>• Internal Control               <ul style="list-style-type: none"> <li>➢ Numerous guidelines, policies, etc on intranet</li> <li>➢ CEIs being updated</li> <li>➢ Overseen by CFO</li> </ul> </li> <li>• Financial Management               <ul style="list-style-type: none"> <li>➢ Finance 1</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Codes of Conduct               <ul style="list-style-type: none"> <li>➢ APS Code of Conduct</li> </ul> </li> <li>• Staffing               <ul style="list-style-type: none"> <li>➢ Recruitment policies</li> <li>➢ Personal development program</li> </ul> </li> </ul>

**Sources:** Format based on *Corporate Governance in the Public Sector: A Governing Body Perspective 2000*, IFAC Public Sector Committee, July (page 18). Information based on ACA Annual Report 2001-02 and material from web-site ([www.aca.gov.au](http://www.aca.gov.au)).

The ACA is unusual in that the board members, especially the chair and deputy chair, are involved in both setting broad strategy and managing its implementation on a day-to-

day basis. The latter are the leaders of an executive team that also includes other board members, the two Senior Executive Members, eight Executive Members and a General Counsel. Members and executive staff also combine on three of the four Tier One committees, including the executive (planning) and management (implementation) committees. The audit committee comprises eight executive members, including the chair, and one independent member. They determine the audit program, through examining a strategic plan compiled by the consultant auditor, KPMG.

## Recent developments in corporate governance

The past year has seen an acceleration of the already rapid increase in the focus on corporate governance, in terms of both community and industry interest, and actual or potential new legislation and guidelines from a number of relevant parties in Australia and globally (see Table 2).

**Table 2.**  
**Major recent and imminent developments affecting corporate governance in Australia and the United States**

<i>Date</i>	<i>Entity</i>	<i>Nature of event</i>
February 2001	HIH	Corporate collapse
May 2001	OneTel	Corporate collapse
October 2001	Ramsey report	Recommendations relating to auditor independence
January 2002	Enron	Corporate collapse
June 2002	WorldCom	Accounting fraud revealed
July 2002	Sarbanes-Oxley Act (USA)	Stringent requirements and penalties associated with financial reporting and the audit function.
August 2002	New York Stock Exchange	More stringent corporate governance requirements
	John Howard, Prime Minister of Australia	Warns Australian business leaders over corporate ethics
October 2002	JCPAA report No 391	Review of the Independence of Registered Company Auditors
	CLERP9 report	Proposals to reform laws affecting corporate disclosure and audit
November 2002	John Howard, Prime Minister of Australia	Announces review of corporate governance of statutory authorities and office holders
January 2003	Australian Stock Exchange (ASX)	Changes to listing rules to clarify continuous disclosure and mandating audit committees for top 500 companies
March 2003	ASX Corporate Governance Council	Creation of best practice principles and recommendations

**Sources:** Internet and media searches.

The impetus for the widespread attention to corporate governance in recent years has been provided by the large commercial collapses in the private sector (for example, in Australia and the United States), which typically revealed poor governance practices. The initial responses by regulators and related authorities have been aimed at the private

sector. These have included the Sarbanes-Oxley Act and the upgraded corporate governance requirements of both the New York Stock Exchange and NASDAQ in the United States. Australia has responded with the recommendations of the Ramsey Report<sup>8</sup> concerning auditor independence largely being accepted in the CLERP9 process<sup>9</sup>, which had a broader mandate and provided a range of suggestions building on those by the Joint Committee of Parliamentary Accounts and Audit.<sup>10</sup>

It is interesting that Henry Bosch recently noted<sup>11</sup> that these private sector failures were similar to those occurring towards the end of the previous stock market upswing in 1987 and were a feature of private sector market cycles and operation. However, he also noted that corporate governance in Australia had improved over the past couple of decades. He agreed with many commentators that corporate governance in Australia was relatively strong, believing Australia was correctly taking a principles-based approach to the regulation of corporate governance rather than the much more legalistic approach adopted in the United States. To provide a context for the role of corporate governance regulation in improving corporate governance, he commented that more important influences were:

- standards being enforced by courts;
- computerisation of legislative systems;
- legislation outside corporations law (eg OH&S and consumer protection); and
- stakeholder activism.

Corporate governance reforms in the private sector typically flow quite quickly to many areas in the public sector. This is especially the case for government business enterprises (that are subject to the Corporations Act) and CAC authorities. Thus, private sector corporate governance reforms need to be examined for their likely impact on the public sector. I will discuss these issues later in the address.

### **A supportive corporate governance environment**

The impact of private sector corporate governance practices on the public sector is highlighted by the following major reforms to the Australian Public Service (APS) in recent years:

- streamlining the budgetary and financial systems, including less centralised control over resourcing and budgeting;
- placing a greater emphasis on results than inputs;
- the application of systematic approaches to risk management;
- increasing contestability and competition in the delivery of programs including legislative implementation and the contracting and oversight of service delivery; and
- enhancing service delivery and the relationships with stakeholders.

Over the past five years, these changes have been accompanied by a program of major financial reform across the APS, starting with the replacement of the *Audit Act 1901* with the *FMA Act 1997*, the *CAC Act 1997*, and the *Auditor-General Act 1997*, culminating in the implementation of an accruals based outcomes and outputs model with the full integration of accrual based budgeting, management and reporting.

As outlined earlier, the CAC Act and FMA Act also clearly stated where accountability lay within organisations, typically with the CEO in FMA Agencies and with the Board in CAC Agencies.

I would like to emphasise, however, that there are considerable differences in governance between the public and private sectors. For example, the general public have higher expectations of government and the public service and demand more effective, efficient and economical levels of service. This is despite particular challenges for public sector governance including the frequency of complex governance structures, the existence of unclear and conflicting objectives, and the intricacies of relationships with Ministers.

Public sector managers are responding to the demands of their particular operating environments by developing tailored approaches; streamlining and adapting traditional ways of providing services, particularly through technological advances; and by taking advantage of partnerships and similar alliances that blend the public and private sectors.

### **Review of corporate governance of statutory authorities and office holders**

I will conclude this section by briefly discussing the recently announced review of corporate governance of statutory authorities and office holders.

On 14 November 2002, Prime Minister John Howard announced a review into the corporate governance of Commonwealth statutory authorities and office holders in order to improve their accountability frameworks and overall performance.<sup>12</sup> The review, to be undertaken by Mr John Uhrig AC, will examine structures for good governance, as well as the relationship between statutory authorities and office holders and portfolio ministers, the Parliament and the public, including business.

The review is expected to develop a broad template of governance principles, which the Federal Government may consider extending to other public sector bodies than those originally scheduled for review. It will also try to develop best practice corporate governance structures, including formal accountability and risk management requirements.

As a second stage to the process, and following the review, the Government will ‘assess statutory authorities and office holders against these principles. Reforms will be undertaken on a whole-of-government basis’.<sup>13</sup> This later statement puts all statutory authorities, including the ACA, on notice that they may be subject to considerable corporate governance reforms, depending on the findings of the Uhrig review.



## Structure of paper

On the basis of your invitation to discuss better practice public sector governance as it is likely to affect the ACA, my presentation covers two further areas of interest, followed by some concluding remarks. The following Section 2 outlines better practice public sector governance. This includes the establishment of the major elements of corporate governance and their implementation within a holistic framework. Section 3 provides a more detailed discussion of selected aspects of better practice governance considered relevant to the ACA, such as the operation of boards, audit, the control framework including risk management, and performance monitoring. The final Section 4 reiterates some of the main observations and emphasises the importance of the changes taking place in corporate governance with recent, and near future, reviews which need to be addressed for both board assurance and performance improvement.

## 2. Elements and Principles of Better Practice Corporate Governance

*What is better practice corporate governance?*

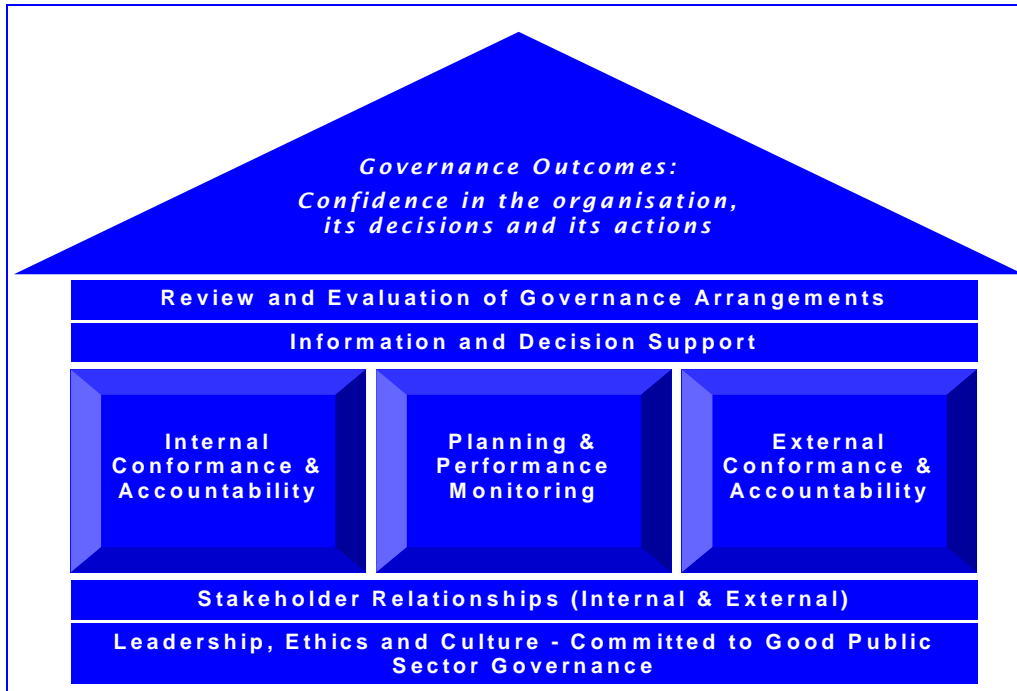
As I stated earlier, there is a strong consensus view from the audit profession about the nature of better practice public governance. This involves properly integrating the main elements of governance within a framework that best meets the objectives, legislative requirements, and operating environment of each agency. Moreover, it requires the application of effective governance principles (including soft controls<sup>14</sup>) by the management and staff within each organisation to implement the designated governance frameworks, controls and guidelines. Importantly, it requires genuine leadership and strategic direction, supported by a robust ethical culture based on well promulgated and supported organisational values.

### Corporate governance framework and elements

Given these requirements, the elements and principles of good corporate governance need to be applied within corporate government frameworks that may differ considerably according to the size, complexity, structure and legislative background of the organisations concerned.

Figure 1 ('The House of Governance') shows the key generally accepted organisational and process elements of good public sector governance.<sup>15</sup>

**Figure 1: 'The House of Public Sector Governance'**



**Source:** ANAO Better Practice Guide on Public Sector Governance (draft, forthcoming). Adapted from a model developed by the Queensland Department of Transport in its *Corporate Governance Framework for Queensland Transport and Main Roads: Final Report*, July 2001.

As will be discussed in the ANAO's forthcoming Better Practice Guide on Public Sector Governance, the relationships established between the various elements of good governance are crucial. Leadership, ethics and organisational culture support and sustain the overall framework. Together, they provide the foundation for sound governance. Stakeholder relationships influence the effectiveness of all three central components of the structure, that is, the 'windows' of internal conformance and accountability, external conformance and accountability, and planning and performance monitoring. These 'windows' represent the core activities of governance for Commonwealth organisations. They are the subject-matter on which governance boards and committees are focused. Each 'window' exerts an influence on the other two as the following indicate:

- planning and performance monitoring sets the management framework within which internal and external conformance and accountability processes take place, as accountability—far from being 'bolted on—is integral to the performance of public organisations;
- internal conformance and accountability needs to be aligned with, and generate the information required for, external conformance and accountability; and
- external conformance and accountability establishes the 'base line' for internal processes, as information required for external purposes should generally form a subset of what is required internally.

The usefulness of the three 'windows' depends on:

- information and decision support, which ensures the right information gets to the right people at the right time to support their decision-making, and which also generates the information needed to account for decisions and performance achieved; and
- ongoing review and evaluation of governance arrangements, which ensures the organisation learns from its experience, including any problems, and adapts to changing circumstances affecting its governance structures or practices.

It is fair to say that most agencies and bodies (entities as a collective description) have put in place many of the elements of good corporate governance. These include corporate plans setting out corporate objectives and strategies; public sector and/or agency values; business planning; audit committees; control structures, including risk management; performance assessment; and performance monitoring (including evaluation and review). Table 1 earlier indicates that the ACA has in place the required elements of public sector governance.

However, what many agencies seem to lack, is a credible way to integrate those elements into a unified, mutually reinforcing whole. This involves a consistent, strategic approach to governance so that good governance practice is successfully integrated with the way Commonwealth departments and agencies do business.<sup>16</sup> Good governance should not only be found at the corporate level; it should also be apparent to all staff and evident in their behaviour and attitudes in the workplace at all levels of the organisation.

There are other ways to represent good corporate governance in the public sector. Again, this reflects the complexity of the governance framework and the diversity of approaches taken by individual public sector entities. Regardless of which particular framework is used, good corporate governance in both the public and private sectors at least requires:

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

I will now elaborate on these and other related requirements and the ways in which they might be implemented.

## **Key principles that enable effective corporate governance**

The frameworks for corporate governance in the public sector can only be implemented effectively through the application of key corporate governance principles. As the Queensland Audit Office notes:

*These principles are essentially common management tools drawn together into a logical, inter-related system focussed on achieving results.*<sup>17</sup>

Through the findings of audits undertaken by the ANAO, and by examining the corporate governance literature, we can identify six main principles that public sector entities must adhere to in order to apply effectively the various elements of corporate governance to achieve better practice governance (see Figure 2). Three of these elements – leadership, integrity and commitment - relate to personal qualities of those in the organisation. The other three elements – accountability, integration and transparency – are mainly a product of strategies, systems, policies and processes in place.

**Figure 2: Principles of good governance in public sector entities**



Source: ANAO

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

Concern has been expressed that there has been more emphasis on the form rather than the substance of good corporate governance in both the public and private sectors in Australia. I want to stress that better practice public sector governance requires a strong commitment by all participants to effectively implement all elements of corporate governance. An effective framework is very much people oriented, involving better communication; a more systematic approach to corporate management; a greater emphasis on corporate values and ethical conduct; risk management; relationships with citizens and clients; and quality service delivery.

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

Accountability is fundamental to our democratic system of government. The principles of corporate governance require those involved to identify and articulate their responsibilities and their relationships; consider who is responsible for what, to whom, and by when; acknowledge the relationships that exist between stakeholders and those who are entrusted to manage resources; and deliver required outputs and outcomes. It provides a way forward to those, whether in the public or private sectors, who find themselves in somewhat different relationships than perhaps they have previously experienced. Hence, a clear understanding and appreciation of the roles and responsibilities of the relevant participants in the governance framework, importantly, those of the responsible Minister(s), Board and CEO, are key components of sound accountability.

The 'privatisation' of the public sector, including as part of so-called New Public Management, involves less direct relationships between stakeholders and service providers, and greater flexibility in decision-making. As well, it strengthens the need for accountability, regardless of the manner in which that is determined. In this regard, the Joint Committee of Public Accounts and Audit (JCPAA) rejected GBE arguments that the accountability requirements of the *CAC Act* created additional compliance costs compared to private sector counterparts and was therefore inconsistent with competitive neutrality provisions. The JCPAA stated that, where public money is concerned, there is a need for additional accountability to Ministers and the Parliament and, in view of the significant responsibility involved, was not prepared to recommend any relaxation of the accountability requirements applying to GBEs.<sup>18</sup>

Openness, or equivalent transparency, involves providing stakeholders with complete confidence regarding the decision-making processes and actions of public sector agencies in managing their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information, leads to effective and timely action, thus enhancing the processes of scrutiny. Such transparency is also essential to help ensure that public bodies are fully accountable and is therefore central to good governance overall. Future trends in governance practices will probably require greater transparency, as the use of the Internet and other electronic media will aid continuous disclosure, particularly of financial performance.

As I have just indicated, the real challenge for corporate governance is not simply to define the various elements of effective corporate governance but to ensure that they are holistically integrated as an important element of a coherent corporate approach by individual organisations and well understood and applied throughout those organisations. If implemented effectively, corporate governance should provide the integrated strategic management framework necessary to achieve the output and outcome performance standards required to fulfil organisational goals and objectives. These are of increasing audit interest in a more results oriented public sector. A

particular hallmark of an organisation that has well-integrated governance arrangements is that officers tend to think, speak and act in support of the corporate goals of the organisation as a normal part of their decision-making and actions.<sup>19</sup>

It is important to appreciate that information is the currency of good governance which underlies both the principles and frameworks of corporate governance. Therefore, it is important that public sector entities develop quality information systems that communicate widely corporate objectives and the plans and strategies to achieve them. These imperatives also point to the requirement for sound records management, particularly in electronic form, which also puts a focus on privacy, security and accountability concerns.

Another common principle of corporate governance is stewardship. Public officials (ministers, public servants and office holders) exercise their powers on behalf of the nation. The resources they use are held in trust and are not privately owned. Officials are therefore stewards of those powers and resources. This requires that they ensure financial sustainability and the efficient and effective management of resources, as well as maintaining less tangible factors, such as the trust placed in the organisation and/or government as a whole.

### **Leadership, ethics and culture**

The ANAO's forthcoming Better Practice Guide on Public Sector Governance will emphasise that good governance is primarily a function of the behaviours and values of the organisation's leaders and of the overall culture of the organisation as a whole. Rules, structures and processes are certainly important, but they are primarily the vehicles by which the crucial values and behaviours are applied.<sup>20</sup> In the latter respect, they need to demonstrate an active commitment to the principles of good public sector governance outlined above.

This is supported by research undertaken by the NSW Independent Commission Against Corruption (ICAC), that found the overwhelming influences on unethical behaviour were:<sup>21</sup>

- their managers behaved unethically;
- organisational values are unclear;
- ethical behaviour is not rewarded;
- sanctions for unethical behaviour are unclear; and
- there is no practical ethics training.

In short, the ICAC considers that unethical, or conversely ethical, behaviour is influenced more by leadership practices or the 'tone at the top' than the ethics and morals that an individual brings into an organisation. This underlines the importance of promoting and demonstrating ethical work practices in order to improve the effective functioning of an organisation.

Ethical frameworks in CAC agencies, such as the ACA, would typically flow from peak public service values, obligations and standards, which in turn are derived from legislation, policy and accepted public service conventions, particularly those embedded in the *Public Service Act 1999*. Regulations require agency heads to integrate these values into the culture of their agency.

It is difficult to objectively measure factors such as leadership, ethics and organisational culture, or to identify problems before they become manifest in individual's performance. Unfortunately, it is often only through significant failures (e.g. frequent corrupt behaviour, staff or management acting contrary to the interests and objectives of the organisation, or high staff turnover in critical work units) that problems in these areas are detected. Nevertheless, it is possible to use tools such as staff surveys, performance appraisals and leadership group self assessment techniques to determine the degree to which these factors match expectations articulated in, for example, the APS Values and Code of Conduct, the organisation's corporate plan and in key statements made by the CEO and other leaders.<sup>22</sup>

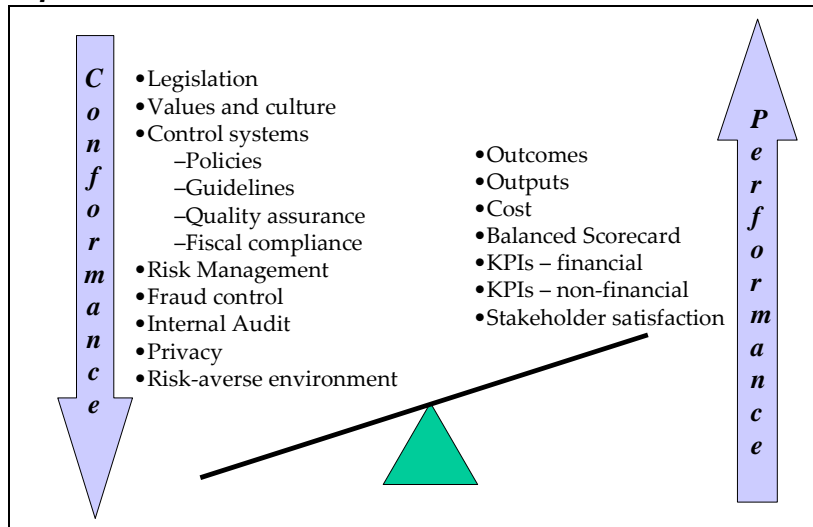
### **Nexus between conformance and performance**

The various elements of corporate governance inevitably raise the question of achieving the 'right' balance between conformance and performance at particular points in time and over time. This balance is determined by leadership decisions, values and identified preferences and should be understood, and achieved, throughout the organisation as well as ethical values and practices are meant to be.

It is generally accepted that a degree of trade-off exists between conformance and performance, for example, where an undue emphasis on compliance breeds a risk-averse culture that inhibits exploitation of emerging opportunities. At the same time, it is apparent that a solid conformance control structure, embedded in risk-management, protects an entity from '*corporate governance delinquency*',<sup>23</sup> and the possible severe impacts of this on individual and organisational performance.

I think most would agree that, in the past, the tendency in the public sector has been to focus primarily on ensuring conformance with legal and procedural (including budgetary and financial) requirements rather than striving for exceptional performance (see Figure 3). This has encouraged a risk-averse attitude among public servants. It has been observed that such an environment has largely focussed bureaucratic attention on process rather than on achieving the stated objectives of governments. It is also said that there needs to be a cultural change in the public sector if public servants are to focus more on achieving required results and to be accountable for their performance including effective management, rather than avoidance, of risks.

**Figure 3: The performance conformance nexus**



Source: ANAO

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

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

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. This is a major challenge for the Parliament, the Government and the APS. It would be generally agreed that it would not be appropriate for significant changes in accountability to be determined solely by public servants, virtually by default.

In both the public and private sectors, 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, a former CEO of the Australian Institute of Company Directors (AICD) has observed that the compliance or conformance responsibilities that have dominated boards’ thinking remain critically important and must be performed to impeccable standards, but in essence they are ‘hygiene’ issues. The real added value for boards is at the strategy level. This requires boards to be forward looking, proactive, innovative, and not risk averse.<sup>24</sup>



### 3. SOME CURRENT ISSUES IN CORPORATE GOVERNANCE

As part of research for the ANAO's forthcoming updated Better Practice Guide on Public Sector Governance, interviews were held with CEOs and board members of a number of CAC and FMA entities, focussing on the main governance issues they considered important. I will now discuss a number of the issues raised in that forum, as they are also often common topics for discussion in ANAO audit reports and are likely to be relevant to the ACA. They include:

- boards and the governance framework – including factors affecting public sector governance; tensions in public sector governance; roles and responsibilities; board charter; board independence; partnership arrangements; selection and remuneration of boards; performance appraisal; and conflicts of interest;
- audit committees and audit independence;
- the control environment – particularly risk management; and
- monitoring and assessment - performance reporting.

#### Boards and the governance framework

At the outset, I thought it might be useful to briefly outline the concept of, and difference between, boards within the Australian public sector. These boards fall into three broad groupings which I will now discuss.

**Management Boards** associated with those agencies subject to the *CAC Act*, and particularly of GBEs. These boards are reasonably similar to those in the Australian private sector, where the CEO reports to the Board, which in turn is accountable to either a Minister and/or shareholders, respectively. Henry Bosch has some interesting views on factors that work against good board practice in the public sector, which I will come to later.

**Advisory Boards** of agencies under the FMA Act. Applying basically to the core public sector, the FMA Act confers legislative responsibility only on a CEO for the efficient, effective and ethical use of resources. Therefore, in the absence of legislation to the contrary, boards established by agency CEOs are only advisory, with the CEO retaining legislative responsibility for the administration of the agency. Many Budget-funded agencies have such Executive Boards, which nevertheless provide a cornerstone for building, or renewing, corporate governance of the agency. The latter is very much at the prerogative of the CEO in such situations.

Where Executive or Advisory Boards exist, they should be concerned about both performance and conformance issues and about securing an appropriate balance between them. If boards are to add value, they must involve themselves actively and regularly in the functions of strategic planning and risk management. Thus, the Board should be primarily responsible for strategy formulation, strategic analysis and internal policy making. This separates the governance and management functions and the relevant

responsibilities involved, thus enhancing both accountability and performance in an integrated corporate governance framework.

The ANAO supports the traditional audit view that the Board should not be involved in operational, or day-to-day, management, but rather it should initiate strategic links across program, functional or business units and actively seek out and/or endorse opportunities for adding corporate value to the agency. As well, it should set the tone for the corporate culture, along with the CEO. In this way it fulfils a stewardship and strategic leadership role, rather than a management role focussed on implementing organisation culture and strategic direction.

I appreciate that ACA board members are involved in operational management, and that this differs from the better practice recommended. This does not mean that the ACA structure is not working well. As I previously mentioned, the ANAO has not undertaken any performance audit review of the structure and is therefore not in a position to comment on it. Indeed, the academic literature has not been able to establish a clear positive causal link between good corporate governance and performance in the private sector, with other factors obviously being important, such as: the quality of management; organisational culture and behaviours; and the effectiveness of business systems in place. An important rationale for preferring boards to focus on strategy and performance monitoring and not be involved in day-to-day management is the reduced risks that arise from this separation of powers and responsibilities.

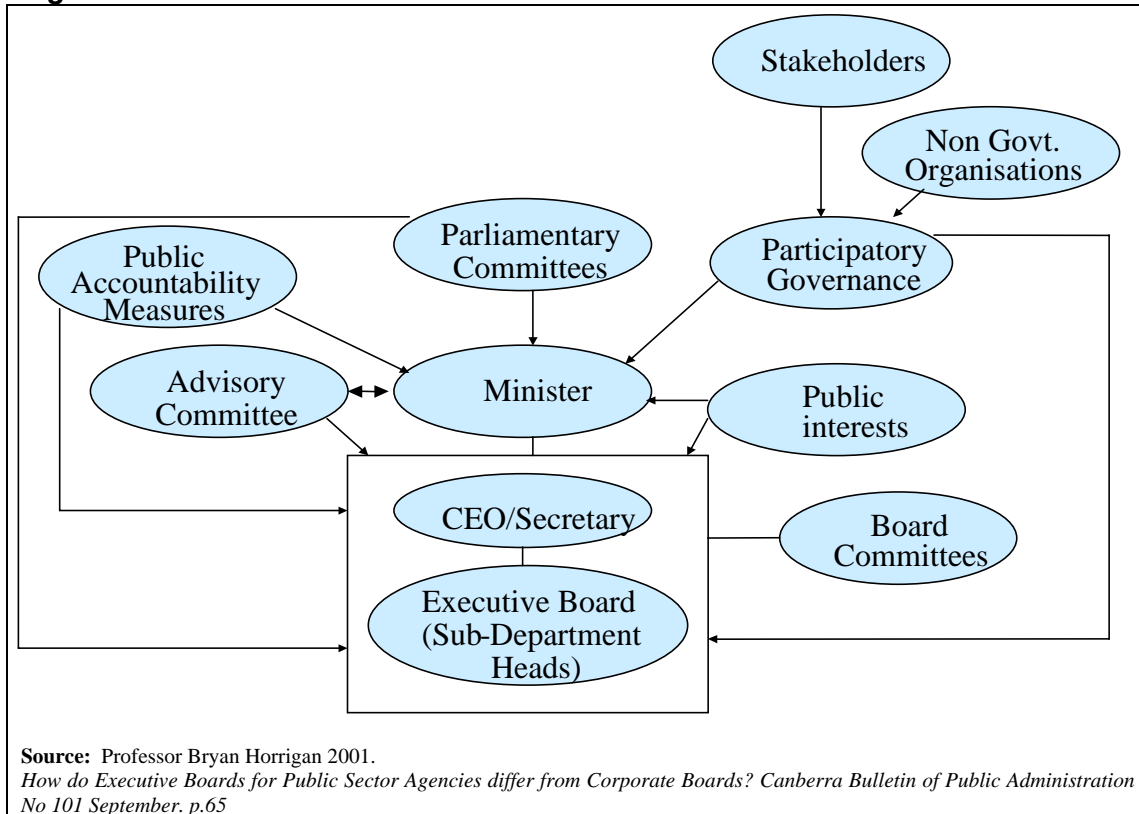
**Committees or Boards** which oversight corporate governance arrangements where two or more agencies (usually under a *Strategic Partnership Agreement* ) have responsibility for the co-ordinated delivery of particular services to users, eg, the delivery of Medicare and Pharmaceutical Benefits Scheme services. A good example of this was illustrated in a recent audit report on ‘The Strategic Partnership Agreement between the Department of Health and Ageing and the Health Insurance Commission (HIC)’<sup>25</sup>. The Agreement is oversights by a joint Senior Management Committee that exercises a leadership role. As the report notes:

*The Strategic Partnership Agreement (SPA) incorporates essential elements of a governance framework for the relationship, including joint management structures, a performance monitoring and reporting framework, and protocols for communication between the policy agency and the administrative agency.*<sup>26</sup>

A former member of the Centrelink Board, the ANU’s Dr Rosalky (and former Secretary of the Departments of Social Security and Family and Community Services) provides some valuable insights into these arrangements in his paper titled – ‘Ministers, Secretaries and Boards’.<sup>27</sup> I will return to this issue later.

There is not time to devote to a detailed discussion of the different models of private and public sector boards. However, for those who wish to pursue the matter further, I can refer you to an excellent article by Professor Bryan Horrigan,<sup>28</sup> University of Canberra. His public sector model is shown in Figure 4, which illustrates the structural and other relationships involved in an easily understood manner.

**Figure 4: Boards – A Public Sector Model**



I would also like to flag a forthcoming report by the National Institute of Governance at the University of Canberra, in which the ANAO was involved, that will discuss a number of tensions affecting Public Sector Boards, and which will highlight the main general legislative requirements of directors of CAC Boards.

### **Boards and Directors Under the Spotlight**

Turning now to the performance of boards and board members. Because boards have the prime responsibility for sound corporate governance in an organisation, their performance has, in recent times, been under considerable scrutiny by the Parliament and media. Well known examples relate to Coles Myer, NRMA, HIH and the Australian Prudential Regulatory Authority (APRA) board activities, with headlines such as ‘*[HIH] Board just not up to task*’, ‘*It [HIH Board] failed abjectly in its critical roles*’<sup>29</sup> ‘*Governance: a study in failure*’<sup>30</sup> and Senator Conroy (Deputy Leader of the Opposition in the Senate and Shadow Minister for Small Business and Financial Services) calling for the APRA board ‘*to resign or be sacked*’.<sup>31</sup>

As regulators, Royal Commissioners, investors, shareholders, creditors and the public sift through the remains of recently collapsed companies, a common theme is emerging. That is, large corporations do not fail solely because of market or economic circumstances (it may be a factor but large companies, if well run, are remarkably resilient even in harsh times) but rather through bad management, ‘out of control’ CEOs and boards not performing.<sup>32</sup> While there is the need to keep corporate governance in perspective (good corporate governance will not necessarily prevent business failure), the underlying message is very clear:

*Corporations should strive to achieve a culture of governance; and resist the temptation to give formal, rather than substantive, compliance to the principles of good governance.*<sup>33</sup>

As noted earlier, this culture of governance starts at the top with the board having overall responsibility for corporate governance and typically delegating day-to-day operations and administration to the CEO and the management team. On a personal level, individual directors who hope to contribute to a high performing board must, as a minimum:

- be familiar with their individual duties and responsibilities including being aware of, and complying with, legal, ethical, fiduciary and financial responsibilities;
- have a full understanding of the workings of the board and the role of their fellow directors as well as the relationship between the board and the various stakeholders;
- be across current thinking and practices dealing with strategy, risk management, compliance and performance; and
- be prepared to have their own performance as directors assessed, individually and/or collectively.

Over and above particular skill requirements, and a readiness to develop them further, some additional requirements for directors are: ensuring access to appropriate, timely, and accurate information; sufficient time to enable them to carry out the specified duties; and a willingness to ask questions that go to the fundamental core of an issue and to pursue independent lines of enquiry.<sup>34</sup>

At the collective level, there is an over-riding requirement for a board to act as a team, come to collective decisions, question and test management proposals and actions and thus create an atmosphere that sets the tone of the organisation. As the Chairman of the Australian Securities and Investments Commission (ASIC) recently observed:

*more than ever company directors need to understand and act on:*

- *The importance of **transparency** and **disclosure**. When there is a true commitment to both it is very difficult for dishonesty to take root. While companies cannot divulge trade secrets or commercial strategies prematurely, it is critical that transparent processes are in place for decision-making at all levels.*
- *The importance of **accountability** to external stakeholders and within our own workplaces.*
- *Finally, **vigilance**. Vigilant defence of what we individually know to be right is our only real safeguard against the insidious erosion of institutional values which are taken for granted.*<sup>35</sup>

Another dimension in changing attitudes in Australian boardrooms has been regulatory pressures together with greater powers of the Australian Stock Exchange (ASX) and ASIC. Indeed, ASIC has played a proactive, and constructive, role in improving governance practices. ASIC embarked on a deliberate strategy of being more visible in the enforcement activity and, in recent times, we have seen ASIC being more willing to exercise its powers and take action, for example, in the banning of such prominent directors as Rodney Adler, Ray Williams and Nicholas Whitlam from being involved in company management for lengthy periods and imposing substantial fines.<sup>36</sup> ASIC has currently about 200 cases on hand that frequently include cases of failed governance.<sup>37</sup>

Many words and papers have been written on how to ensure organisations have high-performing boards. However, Jane Bridge<sup>38</sup> encapsulates the essence of the debate in identifying two critical strategies, namely:

- developing the best possible arrangements for corporate governance; and
- finding the best possible members for the board and treat them accordingly.

While these strategies are easily specified, and in some ways almost axiomatic, there are, however, many practical issues to address in their successful implementation. Nevertheless, they focus attention on the following challenging issues.

### **Factors that Affect Public Sector Governance**

At a recent seminar, Henry Bosch<sup>39</sup> highlighted a number of factors that, in his view, work against good practice in the government sector and which make it difficult for even competent boards to operate effectively. He cites the following six factors:

- Complex Structures, including the legislation that establishes and controls GBEs involving an elaborate set of relationships between Parliament, Ministers, boards and the CEO.
- Ad Hoc Intervention by a Minister or another part of government or the political process. Hence, serious difficulties can arise as a result of inconsistencies or disagreements within government. Clear accountability of the board to the shareholder and of management to the board is the essence of good governance and, given the unquestionable power of a single shareholder, good governance requires wisdom and self discipline. The practice of listing ministerial decisions in the organisation's annual report will cause more thought to be given to them – and may eliminate them entirely. If a direction or request is likely to have a material impact on the achievement of the organisation's commercial goals it may be worth recording the board's view in writing.
- Unclear or Conflicting Objectives - where economic objectives are often confused by the addition of divergent, and sometimes conflicting, 'community service obligation' requirements.
- Direct Appointment of the Chairman – in most cases the chairman of a GBE is appointed by, or on the advice of, the Minister. This can work well in practice but

it does cut across the concept of the Chairman being accountable to the board as a whole and may thus undermine the board's sense of unity and diminish its collective accountability.

- Direct Appointment of the CEO – if a CEO's primary loyalty is not to the board but to a Minister, then it will not be able to hold that person fully accountable. If the CEO is appointed separately, then the board's authority is undermined. Even when there is reasonable cooperation on a day-to-day basis, confidence and accountability will be compromised and thus the board's effectiveness reduced.
- Quality of Government Boards - the processes used for selecting government boards may result in the quality of boards being uneven. Clearly, the effectiveness of boards will be reduced if some members lack experience to deal with the issues put before them or more damaging if directors divide into factions. Board effectiveness will also be reduced if some directors are suspected of owing a special loyalty to those who influenced their appointments and if it is believed that board discussions cannot be conducted in confidence.

Research undertaken for the ANAO's forthcoming Better Practice Guide on Corporate Governance reinforced these concerns. Board members and CEOs of APS agencies that were interviewed for the study most frequently cited concerns with: conflicts of interest; board appointments; tensions between boards, legislation and ministers; and the autonomy of the board.

The complexity of public sector governance does generate tensions arising from the interaction between Ministers, Boards and the CEO. These complications make good governance difficult in the public sector. Clearly, the directors of government boards need to understand the government's objectives in establishing the board and what responsibilities it has been given, particularly in relevant legislation.

Henry Bosch echoes my own publicly stated views when he states:

*The directors will need to be clear about who is responsible for what, who is accountable to whom and in what ways, and what systems of supervision and reporting are in place.*<sup>40</sup>

The ANAO's forthcoming Better Practice Guide on Corporate Governance will examine in detail the roles and tensions of those with key governance responsibility, especially the Minister, Board (including the chair) and the CEO. For CAC agencies, research has indicated a mix of experiences regarding the clarity of roles and the autonomy of board members to discharge their duties. While many cited few problems in this regard, others noted the need for protocols or guidance on the interpersonal dynamics involved in interactions between the Minister, the Chairman and the CEO. Such protocols or guidance could be useful, especially when these interpersonal relations become strained or even begin to deteriorate.

The need to clarify roles and responsibilities is paramount. As Jane Bridge also observes:

*it is critical that the relationship between the board, the Minister, the CEO and the central agencies is well defined and the arrangements [are documented]...In order to clarify board roles and responsibilities they need to be:*

- *defined in legislation;*
- *clarified in guidelines, charters or a Memorandum of Understanding; and*
- *defined with respect to:*
  - *appointment of board members, the chair and the CEO;*
  - *decision-making and control; and*
  - *reporting arrangements.*<sup>41</sup>

Ideally, the enabling legislation should clearly identify and define the roles and responsibilities of all participants and, where this does not occur, Board Charters are becoming more common in assisting to clarify the roles of Boards and their members.<sup>42</sup> Henry Bosch reinforces this point:

*If the board considers that its position is unclear, it is valuable for it to develop a written board charter setting out its understanding of its role, authority and responsibility, the way it intends to work and its proposed relations with management, and for it to request the Minister or the Department to review the Charter and to identify any problems that may be found.*<sup>43</sup>

Charters, or equivalent documents, by documenting procedures on how to deal with the tensions highlighted above can, at very least, establish the necessary 'ground rules'. Their adoption should be viewed as better practice, particularly if they are to be used both as a training vehicle for directors and as an important element in their performance assessment. Again, broadly similar observations apply to any board committees.

The charter, or separate similar document, should also provide a code of conduct for the board. These 'rules of engagement' should set out the board's own code of behaviour, covering the conduct of the business and standards required in personal interaction.<sup>44</sup> These rules should encourage vigorous debate, but with expressions of dissent undertaken in an harmonious fashion.

## **Board Independence**

In developing effective public sector governance, a recurring theme is the critical importance of maintaining the independence of the board from management. This is particularly important in the core public sector where board members are likely to be also managers. This is also the situation at the ACA. The inherent tension is whether these 'executive directors' can sensibly be expected to report openly on what is effectively their own management performance - and be seen to be doing so by those to whom they are accountable. The Canadian Joint Committee on Corporate Governance<sup>45</sup> identified the following four conditions that can materially assist boards in developing a

culture that provides opportunity for both directors and management to feel comfortable when management positions are challenged:

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

The Canadian Joint Committee also noted<sup>46</sup> that some boards are more advanced than others in developing a culture in which the board can act independently in carrying out its responsibilities. Where there are deficiencies in the four conditions noted above, or in any other factors that compromise the independence of the board, appropriate actions should be taken to remedy them. It is important to be pro-active, rather than re-active, in such situations.

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

### **Boards under Partnership Arrangements**

An added complexity to Board operations, as indeed it is for management, is the spread of responsibilities across multiple agencies. This adds to the risk of management failure and requires smooth co-ordination and cooperation between all concerned. The appointment of a board over an agency imposes a distinct form of governance as it breaks the direct control that a Minister has over a secretary outside general managerial responsibilities, notably policy considerations. This raises the corporate governance 'bar' considerably higher, particularly in terms of joint performance, for example, where accountability for performance applies both within an agency and across-agencies. The challenge is exacerbated by the devolution of authority to individual CEOs and managers as part of successive public sector reforms.

At this point I intend to draw heavily on Dr Rosalky's comments on the Centrelink board experiences<sup>47</sup> by providing some vignettes from his paper on his views on the board and governance arrangements at Centrelink. These comments are provided against the backdrop of the differences of view about the appointment of the portfolio secretary to the Centrelink board.



Boards provide professional, as opposed to political, authority over an agency. Public sector boards, in addition to members external to government, commonly include the portfolio secretary to represent the portfolio/minister/ government interest. These interests are not always the same and can be a source of conflict affecting the way the board reaches decisions and potentially undermining the authority behind those decisions. The difference in interests can usually be traced back to those of their separate agencies and, under these motivations, external directors may tend to align with the agency CEO with whom they share influence through the success of their agency.<sup>48</sup>

Clearly, it is for governments to make decisions about the required degree of ministerial control over an agency based on the financial stake involved and the optimal form of managing it; the political sensitivity of the program and its delivery; and the relative importance of policy advising and service delivery in the agencies involved. It follows, then, that the governance processes must be able to provide assurance that the political and fiscal risks are well managed and transparently so.<sup>49</sup>

#### Some features of the Governance arrangements at Centrelink.<sup>50</sup>

The Centrelink model is different in an important way. Its board is not advisory which is the usual arrangement for agencies under the FMA Act. The board's financial accountability is created by designating the chairman as the chief executive for FMA Act purposes. The other significant feature is that the Centrelink board has the Secretary of its largest purchasing agency, the Department of Family and Community Services (FaCS), as a member. According to Dr Rosalky, the focus of the FaCS secretary on the Centrelink board is to safeguard portfolio interests, embracing both program delivery and Centrelink success. The secretary is also a purchaser of Centrelink's products.

Other features include the fact that Centrelink is:

- a service delivery specialist for commonwealth agencies but dominated by the delivery of programs of the department and Minister of its own portfolio;
- expected to acquire its revenue from purchasing agencies but, as part of the Commonwealth under the FMA Act, it effectively receives appropriations passed on by purchasing agencies;
- expected to achieve commercial benchmarks but does not operate in the market;
- controlled essentially by Ministerial and purchaser interests (all components of government) but it is set up under a board charged with deciding strategic direction and ensuring performance; and
- the client data base is managed by Centrelink and subject to its corporate strategy but is critical to policy and evaluation, the responsibility of the purchasing departments.

#### The Tensions in Partnership Arrangements

Disputes can surface as issues for the board, as opposed to management, to resolve. Dr Rosalky indicates that the secretary has used the board processes to express

dissatisfaction with Centrelink's performance vis-a-vis financial reporting. Centrelink has expressed dissatisfaction with FaCS' interference with management responsibility. Debate on the board can be helpful in resolving these disputes and therefore to ensure effective policy delivery and because the board see FaCS as a key partner, not a predatory monopsonist, and it is able to steer a middle path and to mediate between a purchaser and its own agency.<sup>51</sup>

Nevertheless the board has struggled to define the interests that underlie Centrelink's success. The CEO of Centrelink saw this as building the organisation's business, by delivering a sensitive and accurate service to its clients. Whereas the FaCS secretary's goal was to ensure that the programs are run effectively in terms of government's stated policy objectives. When the risk of conflict was high, FaCS and Centrelink, with their joint responsibility for the success of their shared portfolio and the interests of their shared Minister, coalesced their interests and their accountabilities.<sup>52</sup>

Does the presence of the FaCS secretary on the board involve a conflict of interest (Henry Bosch's earlier comments re problems in this area are apposite) or a diminution of accountability? Dr Rosalky is very firm in his view that a model in which the secretary does not have a role in Centrelink's governance weakens accountability. The secretary's influence through his/her position on the board is critical.<sup>53</sup>

These factors go to the heart of the issue – are there practical ways of delivering and assessing the dual roles? The reality is that, under partnership, network or joined-up arrangements, conventional corporate governance is placed under stress. Board members simply cannot represent only their own immediate areas of responsibility, in effect act as shadow directors, but must also act in accordance with their cross-portfolio, or inter-agency responsibilities. This is a live issue and one that I consider revolves around effectively 'lining up' performance, outcomes, responsibilities and accountability, in a transparent manner, as the following indicate:

*It is an issue of devolution of authority and the tensions associated with principles-based legislation, which makes it clear that individual agency heads are responsible for what happens in their agencies. While we have always recognised there has been coordination, the fact is that there are now tensions when you have shared responsibilities. Who is actually accountable? This is where the tension arises.*

and

*In a purchaser/provider situation there is even more tension, and the notion of contracts or agreements between agencies in themselves are points of tension that are not being satisfactorily resolved. That is why you have this issue of horizontal management. I do not care what you call it, but the fact is we have a tension and that needs to be resolved. The private sector model focuses very much on the institution. You might ask, "What does corporate governance mean if you have shared responsibilities?" It comes back to who is the coordinator and who is responsible and where is the shared responsibility.<sup>54</sup>*

## **Selection and remuneration of board members**

Another important issue raised by Henry Bosch is the quality of public sector boards and the processes used to select members to serve on boards. However, I am not sure whether we can be so selective in just highlighting the government sector in these respects. The literature on board performance places great weight on selecting appropriate directors and, particularly in the private sector, the CEO. It also advocates choosing board members who are multi-skilled, experienced in a variety of business areas, prepared to update their knowledge, and who are flexible and analytical, as well as being prepared to monitor and assess their individual or collective capabilities and performance.

In the current climate of major corporate failures both internationally and in Australia, a common identified cause has been a lack of effectiveness of board members. This can arise for a number of reasons, including: the dominance of individual directors or the CEO; inappropriate selection, skills, induction and training; lack of performance assessment and reporting; and/or a lack of independence of directors. Separation of the positions of board chair and CEO is also seen as important for board independence.

However, recent research undertaken to update the ANAO's Better Practice Guides on Corporate Governance, has revealed more concern by CEOs and board chairmen of FMA and CAC agencies with the process for selecting Board Members than with the composition or mix of directors. While there may be opportunities provided for the chairman of the board to input to the selection of directors, the ultimate selection is often made by the Minister or Ministers. There may be scope to increase the involvement of the board chairman in the process, for example, to more fully take into account the likely mix and interaction of directors as part of a cohesive team.

Another issue that has been raised during this research is the remuneration of board members, with many examples provided of directors and chairs receiving relatively minimal remuneration for the effort and value they provide. This is an issue that may be given more attention in future discussion between government organisations and the Remuneration Tribunal, or equivalent system for setting rates of pay for directors of government boards. This is a policy matter outside my remit.

## **Performance of Boards**

Amongst the top responsibilities of boards, whether advisory or executive, the following three would be in any 'top five' identified:

- setting corporate strategy, as well as mission;
- control, supervision and monitoring of top management; and
- reviewing and approving the use of resources.

It could be argued that, in a strictly commercial environment, the overall measure of an organisation's performance (financially or more broadly – triple or quadruple bottom line measures) is also a measure of the board's performance. No doubt, the two are linked but it is also important for boards to independently review their own performance

both as a board and as individual directors. This is a topical issue that I highlighted earlier.

Directors need to assess, and contribute to, the effectiveness of the board. This promotes greater accountability of the board and individual directors; may identify weaknesses in the board skill-set; and, hopefully, may build a more collegiate approach. 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<sup>55</sup>, the five important criteria which Australian boards regard as essential for evaluating board performance, are:

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

The Canadian Joint Committee on Corporate Governance broadly supported this view, stating that:

*regular assessment of the board's effectiveness, and the contribution of individual directors, is essential to improve governance practices. The governance system should include a process for the evaluation of the work of the board, its committees, and individual directors.*<sup>56</sup>

Professor Scissons, Vice-President of PSA International Consultants, has pointed out the difficulties inherent in undertaking governance reviews of Boards and CEOs and the often simplistic and inadequate measurement methods that are commonly used.<sup>57</sup> He argues that more care and effort is often required in such reviews in order to receive any real value from the exercises. He advocates improvements to existing techniques, particularly behaviour rating scales; 360-degree feedback techniques; self-assessment; selecting output and productivity measures; and qualitative approaches.

Performance reviews of boards and individual directors (including chairs) are more effective if roles, responsibilities and capabilities have been clearly specified in a board charter or equivalent document, as noted earlier. This enables assessment criteria to match these specifications, in a similar way to those applied routinely to management positions. The same comment applies to board committees.

Henry Bosch makes the good point that it is important to distinguish between assessments of the functions of the board as a whole and the assessment of the performance of individual directors. The former almost always makes a significant contribution to team building while the latter can be divisive if not handled well. It is prudent to undertake such assessments at separate times.<sup>58</sup> Not surprisingly, to date in Australia, overall board performance assessments are more common than individual director assessments.

## **Conflict of interest of directors**

The ANAO's recent research on Corporate Governance, referred to earlier, has also revealed that conflicts of interest by board members are one of the main corporate governance challenges facing public sector agencies, and for which there are apparently few available relevant protocols. These conflicts of interest occur most frequently regarding:

- technical advice from external independent directors on agriculture, industry or scientific boards;
- other public service representatives, especially from the portfolio agency; and
- directors with associated business interests.

A particular issue arose in the ANAO's report on Magnetic Resonance Imaging Services<sup>59</sup> dealing with a potential conflict of interest involving the then ex-Chairman of the Health Insurance Commission Board. The ANAO suggested that there would be considerable merit in the Board's Charter anticipating, and providing for a system of dealing with, any conflict of interest involving a Board member.<sup>60</sup>

The ANAO intends to produce protocols to address the issue of conflict of interest in the updated Better Practice Guide on Corporate Governance scheduled for release in the first part of this calendar year.

## **Audit committees and audit independence**

The many recent corporate collapses (particularly Enron in the United States and HIH in Australia) have stimulated debate about the role of audit committees and the independence of auditors.

### **Audit committees**

Ian McIntosh, formerly Chief Accountant at the Australian Securities and Investments Commission (ASIC) and now dealing with country financial management in the World Bank, in nominating his five top tips for directors, singles out audit committees as being of particular importance, as follows:

*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 company.*<sup>61</sup>

An effective audit committee, as a crucial component of corporate governance, provides a complementary vehicle for implementing relevant control systems incorporating sound risk management plans. It can assist CEOs and boards meet their statutory and fiduciary duties by: overseeing risk management; reviewing accounting and reporting structures; monitoring internal controls and performance; and ensuring compliance with controls.

An effective audit committee can also improve communication and coordination between management and internal, as well as external, audit. There is no shortage of better practice guides for audit committees.<sup>62</sup>

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, notably 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 questions about possible conflicts of interest, audit rotation and selection of auditors are central to the roles and responsibilities of audit committees as part of the corporate governance framework. One challenge is, therefore, how to strengthen those roles to enhance Committees' effectiveness and credibility in the eyes of both internal and external stakeholders. In my view, this comes with authority, support and commitment.

In order to maintain independence, most authoritative commentators recommend that, in the private sector, either the audit committee comprise only independent directors or at least include 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 ACA is in the interesting position of not having any board members on the audit committee. Instead the audit committee comprises executive managers, including the chair, with one independent member. Thus, the audit committee reports to management rather than to the board. This is not a structure that I have often seen, nor would necessarily recommend as better practice in the normal course of events.

For many years, I have been gently advocating that public sector agencies appoint independent members to their audit committees, including giving consideration to the selection of an independent person to chair those committees. At the very least, I would suggest that the Board Chair or CEO should not chair the committee. At the ANAO, we have an independent chair for our audit committee. Some argue for a completely independent audit committee that is comprised of non-executive members.

As with Executive Boards and/or Boards of Management, it is important that audit committees select appropriately qualified members and rotate them on a regular, on-going basis. According to Hunt & Carey, essentials of an audit committee member include common sense, wide experience, good judgement, a general understanding of the role of an audit committee, healthy scepticism, an ability and willingness to ask difficult questions that challenge management's actions and not to put up with unintelligible 'techno speak'<sup>63</sup>.

I agree with the Canadian Joint Committee<sup>64</sup> that audit committees should adopt a formal written mandate that is approved by the board and that sets out the scope of the committee's responsibilities. Such a formal agreement should charge the audit committee with the responsibility to provide a formal sign-off on issues relating to audit independence to the Board. Central to such responsibility is an imperative to be informed about audit issues, including the work of both internal and external audit, as well as being in a position to assess both management and audit performance.

In its submission to the JCPAA Review of Independent Auditing by Registered Company Auditors<sup>65</sup>, the ANAO noted that the integrity of the audit committee could be strengthened with legislative support. The ANAO observed enhanced corporate governance in the public sector arising from the stronger role being adopted by audit committees', including audit committees having independent members that bring external views and experience to committee meetings.

In addition, the ANAO supports due consideration being given to Ian Ramsay's recommendations that the audit committee:

- comprises a sub-committee of the full board made up of non-executive directors, that appropriately represents the breadth of activity undertaken by the business;
- is responsible for recommending the Board approve the financial reports;
- actively reviews the accounting standards that may effect the financial reporting processes or requirements of the entity;
- actively reviews the operations and recommendations generated by the internal and external audit functions; and
- appoints and advises the Board on the adequacy of remuneration of external auditors.<sup>66</sup>

### **Audit independence**

I will briefly discuss the issue of audit independence, beginning by outlining its importance in the public sector, and then review arguments pertinent to both the public and private sectors, in the wake of recent corporate collapses in both the United States and Australia.

In today's environment, my role includes providing independent assurance on the performance, as well as the accountability, of the public sector in delivering the government's programs and services and implementing effectively a wide range of public sector reforms. I cannot overstate the importance of the independence of the Auditor-General in this respect. As the public and private sectors converge; as the business environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have all the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them by Parliament.

The debate over audit independence is not new. Audit bodies and the accounting profession worldwide have been actively engaged in clarifying and reinforcing independence for many years. However, recent events have put the debate onto a different plane with higher level expectations being generated. While the ANAO takes a professional interest in this ongoing debate, it is also set apart from it by virtue of its statutory and functional independence. Nevertheless, there is also an operational imperative, with the ANAO outsourcing a not insignificant proportion of its audit work to private sector accounting firms. As well, with the increasing use of such firms by the public sector for internal audit, we are often dependent on their work in forming an audit

opinion on organisations' control environments and financial statements. Under the auditing standards, we of course have to be satisfied as to the quality of that work.

In Australia, recent scrutiny of auditor independence owes much to the Ramsay Report<sup>67</sup>, the main output of a Federal Government inquiry into the state of audit independence in Australia. The report recommended that the *Corporations Act 2001* be amended to include a general statement of principle requiring auditors to be independent. It also recommended that an independent supervisory board, the Auditor Independence Supervisory Board (AISB) be established to monitor implementation of, and compliance with, the new regime and international developments in relation to auditor independence. It was envisaged that the AISB would benchmark to test the adequacy of internal systems and processes of Australia's largest auditing firms. In particular, the wide range of personal, business and financial relationships that may arise between an accounting firm and its audit client came under focus. The report's aim was for Australia to continue to work towards achieving an audit regulatory environment that is in step with international standards. That said, audit effectiveness depends very much on the cooperation and support of boards and their organisations as the following statement emphasises:

*Whatever the outcomes of reviews on auditor rotation, or the scope of audit and non-audit services to clients, any change to the arrangements for appointing auditors will have little impact unless directors and management are open and transparent with their external auditors.*<sup>68</sup>

The ANAO supports the Ramsay Report recommendation that the auditor should make an annual declaration, addressed to the board of directors, that the auditor has maintained his/her independence in accordance with the *Corporations Act 2001* and the rules of the professional accounting bodies. I should note that, pursuant to that Act, the Auditor-General is a registered company auditor.

While the debate will continue amongst the profession worldwide, the issue of audit independence also came under further scrutiny in Australia with the JCPAA's recently published report (No 391) on this issue. The Chairman of the JCPAA, in his foreword to that report, stated:

*In this light [a decline in good ethical practice], an associated aim of the Committee's recommendations is to promote enhanced ethical professional culture in the audit and accounting profession and the business community.*<sup>69</sup>

The Committee based its findings on observations of both the audit and accounting profession and of the business community, its longstanding involvement in corporate governance issues, and the audit framework governing accountability in the public sector.

The Committee's proposals are designed to compel companies and auditors to enhance their management of corporate governance and audit independence. The central element of the Committee's reform proposal is to provide a framework enabling a broadening of the scope of the audit function to include, for example, corporate governance, risk



management, internal control matters, and other performance-type issues, as opposed to advocating prescriptive regulation and mandating arbitrary limits or benchmarks. To support this new framework and the process of management improvement (and to promote more transparency), the Committee also proposed an enhanced oversight role for the existing regulator, the Australian Securities and Investments Commission (ASIC).<sup>70</sup>

The key findings and recommendations of the report include that:

- a) the *Corporations Act 2001* be amended:
  - to require the Chief Executive Officer and Chief Financial Officer of a company to sign a statutory declaration that the company's financial reports comply with the *Corporations Act 2001* and are materially truthful and complete;
  - to require all publicly listed companies to have an audit committee of independent members;
  - to require audit firms to report annually to ASIC on independence issues;
  - to clarify the relationship between the need for financial statements to comply with accounting standards and provide a true and fair view; and
  - to include a general statement on audit independence.
- b) the Financial Reporting Council develop a set of corporate governance standards, which would be given legislative backing in the *Corporations Act 2001*;
- c) the Australian Stock Exchange Listing Rules be amended to require additional reporting by companies;
- d) ASIC explore the cost and benefits of introducing performance audits in the private sector and in conjunction with the ASX, evaluate the costs and benefits of requiring pronouncements and other disclosures under the continuous disclosure listing rule to be subject to a credible degree of assurance; and
- e) a framework for protected (or whistleblower) disclosure be established in the *Corporations Act 2001*, including clear accountability mechanisms over the administration and management of disclosures.<sup>71</sup>

In addition, the Committee was particularly attracted to the idea of Independence Boards within audit/accounting firms as proposed by Professor Keith Houghton<sup>72</sup> at their earlier hearings.

The ANAO covered audit independence, and a number of other relevant issues, in its submission to the JCPAA review.<sup>73</sup> Some of the issues raised, including suggestions for the way forward, included:

- underlining the independence of auditors in statute;
- improving the disclosure of ‘other services’ provided by auditors;
- encouraging the profession to tighten current guidelines on ‘other services’ work that auditors are able to undertake; and
- encouraging the wider involvement within the profession of users and preparers of financial statements and reports, particularly in the setting of auditing standards and guidelines.

These options for enhancing the independence of auditors may be pursued under the current co-regulatory model or through other forms of statutory, or non-statutory, regulation. The ANAO favours an approach to improving the audit of companies via principle-based standards and policies, rather than relying on restrictive technical prescriptions. The ANAO considers that caution is warranted in the over-use of prescriptive legislation and standards that may place unnecessary restrictions on the profession to the detriment of the quality, and efficient conduct, of the audit. Principle-based standards and related policies can adequately encapsulate the intention of the standard setters and regulators. As a result, where standards and regulations are principles-based rather than rules-based, it is more difficult to introduce schemes that are designed to manipulate financial results.

More recently, the Chairman of the Committee outlined a number of steps to be taken to broaden the audit framework as follows:

*1) Broadening the scope of the audit function requires developing new standards and establishing a framework for auditors to audit against. This requires:*

- *That a set of attestable corporate governance standards be developed, incorporating governance issues (ie existence and function of audit committees, structure of Board, Board/management relationship), risk management practices and internal control arrangements. There is precedent for this, including the work of the ASX Corporate Governance Council and the OECD Principles of Corporate Governance. (Recommendation No. 3)*
- *Ensuring compliance with these standards would become an integral part of the annual audit process alongside the verification of financial statements. Legislative backing, equivalent to that given to accounting standards, would be required (sect. 334) (Recommendation No. 3); and*
- *Compliance with these standards would also need to be included in the scope of the auditor’s opinion (sects. 307 and 308) (Recommendation No. 10).*

*2) To provide a level of protection for auditors operating under a broader audit regime, audit firms should be able to be structured as*

*limited or proportional liability partnerships (as is the case in a number of countries including the UK, some Canadian provinces and states in the US). (Recommendation No. 12)<sup>74</sup>.*

Also following on from the Ramsay Report, in September 2002, the Treasurer released CLERP9, referred to earlier<sup>75</sup>, 'Corporate Disclosure: Strengthening the Financial Reporting Framework', that reviewed and provided recommendations to strengthen audit regulation and wider corporate disclosure frameworks. In particular, it provided proposals covering:

- auditing and accounting reforms, including:
  - auditor independence (including non-audit services);
  - audit committees (for example, mandating audit committees for the top 500 companies);
  - audit partner rotation after 5 years;
  - relaxing auditor liability by allowing them to incorporate;
  - expanding the role for the Financial Reporting Council;
  - expensing of stock options;
- continuous disclosure (for example, increasing civil penalties for breaches and increasing ASIC powers in this area and more general enforcement of audit contraventions); and
- shareholder participation and information.<sup>76</sup>

The issues paper was the first phase in a public consultation process leading to the proposed introduction of new legislation in Parliament in 2003.<sup>77</sup>

The ANAO was interested to see that the government's approach, as outlined in the CLERP 9 paper, is principles-based, employing a mix of regulation, co-regulation and encouragement of industry best practice.

Further guidance is provided by the Statement of Auditing Standards AUS 1, which requires an auditor not only to be independent, but also to appear to be independent. For the purpose of this Statement:

- (a) *actual independence is the achievement of actual freedom from bias, personal interest, prior commitment to an interest, or susceptibility to undue influence or pressure; and*
- (b) *perceived independence is the belief of financial report users that actual independence has been achieved.*<sup>78</sup>

While the Statement of Auditing Practice provides guidance to auditors when considering independence, the recently released Professional Statement F1, entitled 'Professional Independence' addresses the principles of independence. This standard will be mandatory from 31 December 2003.

## **Control Environment - Risk Management**

*Effective risk management means being able to anticipate, prepare for and mitigate adverse outcomes, without eradicating, or un-necessarily hindering, beneficial risk-taking. Letting risks get out of hand, or being rendered powerless by not taking any risk, can destroy organizations.<sup>79</sup>*

Corporate governance is concerned with achieving results while taking account of risk, thus making formal risk management an essential element of sound corporate governance and management practice. It is becoming even more important in the move to a more networked, or joined-up, government.

Risk management is primarily the responsibility of the board and the CEO. Effective governance arrangements require the identification of business risks, as well as of potential opportunities; and ensure the establishment, by management, of appropriate processes and practices to manage all risks associated with the organisation's operations.<sup>80</sup> The goal for all agencies should be to embed a culture of risk management in their organisations so that the consideration of risks, and any risk mitigation strategies, becomes second nature. This is particularly important as the nature and significance of risks change in the public sector as the role of the public sector itself changes. The lack of suitable risk management practices generally features in examples of poor administration that are highlighted in our audit reports from time to time. Many public sector managers are still coming to grips with the notions of insurable and non-insurable risk.

The devolution of authority and accountability to agency heads and the recent changes to financial and industrial legislation, together with contracting out and contestability, has significantly increased the risk profile of agencies. With the wide range of business risks being confronted, 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 using an enterprise-wide approach which:

*aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the uncertainties the enterprise faces as it creates value<sup>81</sup>*

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. This theme has been picked up in CPA Australia's publication 'Enterprise-Wide Risk Management'.<sup>82</sup> You might be interested in the management self-assessment tool included as Appendix 1 in that publication.

CPA Australia conducted a survey of thirty-one public sector agencies from the three tiers of government (CPA Australia Risk Management Survey 2001). Commenting on the survey results, Adam Awty, the public sector policy adviser for CPA Australia, observed that:

*It [risk management] is now becoming entrenched within the public sector and is resulting in better performance. CPA Australia's*

*survey results show that the public sector has moved to address risk management and is now more accountable, better managed and a better service provider than it was in the mid-1990s... The challenge for the future is to develop mature methodologies such as risk-performance indicators and benchmarking. Public-sector agencies also need more sophisticated skills to monitor, communicate and link risks directly with corporate objectives.*<sup>83</sup>

While there are many positives in the survey, one disturbing response was that less than half the organisations covered considered that their corporate culture considerably, or significantly, encourages individuals to encourage their peers to take responsibility for identifying risks. There obviously needs to be a common understanding of the organisation's risk-taking culture and approach, including risk tolerance and expected standards of conduct.

Complementary to a sound risk management approach is a robust system of administrative control. Again, the notion of a control environment needs to start from the top of an agency and, to be effective, it requires clear leadership and commitment. This imperative is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. The adoption of a sound and robust control environment at the top of an agency will strongly influence the design and operation of control processes and procedures to mitigate risks and achieve the agency's objectives. The clear intent and message to staff should be that such processes and procedures are designed to facilitate, rather than to inhibit, performance. This approach should be promoted as good management. In short, the control environment is a reflection of management's attitude and commitment to ensuring well controlled business operations that can demonstrate accountability for performance.

Importantly, 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. However, the strategic approach being taken to risk identification and treatment is very much the board's responsibility with advice being provided by the other governance stakeholders.

In the ANAO's experience, it is difficult to overstress the importance of integrating the agency's approach to control with its overall risk management approach in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment, treatment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated throughout 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. The results should be regularly reported to the board for information and any guidance or direction.

The key to developing an effective control framework lies in achieving the right balance so that the control environment is not unnecessarily restrictive nor unduly encouraging to risk averse behaviour and, indeed, aims to promote sound risk management. As one commentator observes:

*All organisations face a central problem of autonomy and control. ...Too much autonomy and too little control can undermine coordination and prevent the delivery of a consistent service and product. Too much control at the center can undermine motivation among those who are furthest from the source of power....The challenge is to balance the control necessary for a united strategy with sufficient autonomy to foster initiative and responsiveness*<sup>84</sup>

The control structure must provide a linkage between the agency's strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the organisation's objectives and which adds value by focusing control efforts on the 'big picture' and not simply on particular processes. Finally, it must be kept in mind that control is basically a process, a means to an end, and not an end in itself. It impacts on the whole agency; it is the responsibility of everyone in the agency; and is effected by staff at all levels, not just by management. Effective control is neither accidental or incidental. It is endemic to accountability and performance. Indeed, it has been suggested that boards should formally accept their responsibility for reviewing the effectiveness of internal control.<sup>85</sup>

## Performance Measurement and reporting

The Government has emphasised performance information as an integral part of its public management reforms with the main objective being to improve accountability and results. The move to an accrual-based outcomes/outputs framework was designed to ensure a focus on:

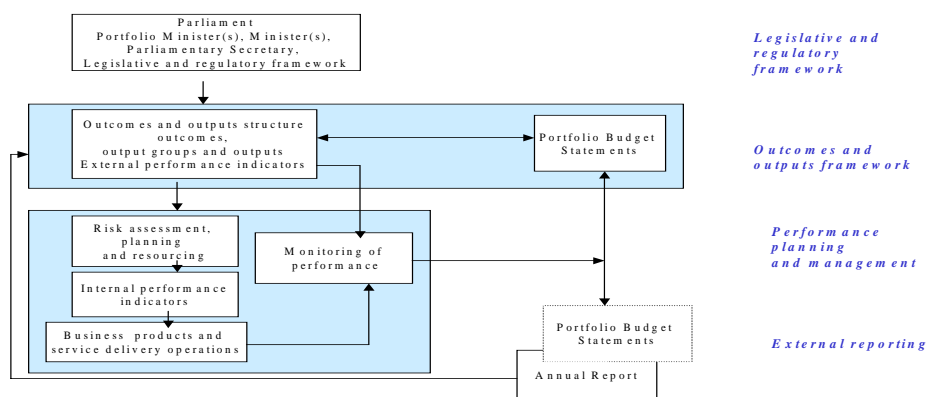
*Resource management with an emphasis on measuring performance, in terms of what is being produced, what is being achieved and what is the cost of individual goods and services...*<sup>86</sup>

A fundamental starting point, once the key elements of the governance framework have been settled, is in good scorekeeping systems (balanced scorecards or executive snapshots) which firstly translate the organisation's strategies into key operational indicators and then systematically report on the health of the business, both in terms of operational responsibilities and future positioning initiatives. This provides the feedback loop on the effectiveness of organisational strategies and the basis for communicating with staff and other stakeholders on how the agency is travelling. Without such reporting, there is a very significant risk of unfortunate surprises and belated, often expensive, recovery action. The emphasis is on ensuring prompt and effective decision-making.

Sound performance information can reduce the workload for individuals within an agency by making management information at all levels in the planning hierarchy readily available and applicable to their activities. Appropriate performance information enables individuals to determine how their activities contribute to agency outputs and, hopefully, its outcomes. For this reason, among others, it is essential that agency staff be made aware that performance information is a valuable management tool and that Portfolio Budget Statement (PBS) performance, accountability related information, and general management performance information are part of the same integrated framework.

I will take this opportunity to draw your attention to the just released ANAO Better Practice Guide on performance information<sup>87</sup> which was developed in response to the Senate Finance and Public Administration Legislation Committee's request to develop a guide to assist the development of performance information for the PBS. This builds on the earlier 1996 guide.<sup>88</sup> The following diagram focuses on the key role performance information plays in the governance framework.

**Figure 5 – Agency planning, management and governance framework**



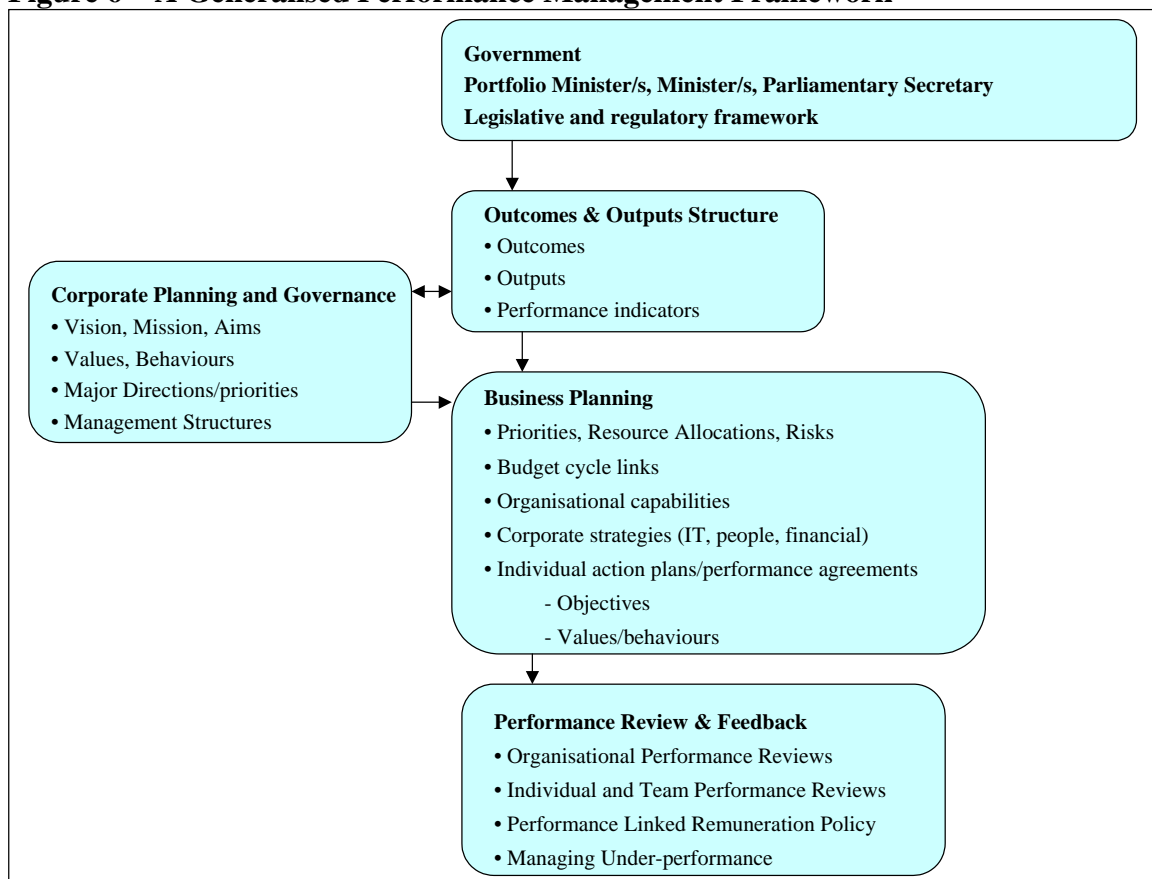
**Source :** Better Practice Guide, *Performance Information in Portfolio Budget Statements*, May 2002

Boards are responsible for determining the performance requirements of the organisation as well as reviewing performance information. CAC legislation refers to both financial and non-financial performance information. The public sector is familiar with the requirements for public service obligations which need to be met by particular organisations. However, there are increasingly greater numbers of performance measures that relate to social, as well as environmental, obligations which go well beyond financial measures. That said, there are also important obligations that go with performance management. The Management Advisory Committee has indicated that:

*Performance management is an essential component of a corporate governance framework, allowing boards, Ministers and committees to lead, monitor and respond to how an organisation delivers against its goals, mission and the outcomes required of it by the government.*<sup>89</sup>

The following figure reflects a generalised framework that shows not only the relationship with corporate planning and governance, but also with other major elements of the framework, including performance review and feedback. Importantly, an effective approach to performance management enables organisation employees to understand the goals of the organisation and how individual and team outputs contribute to the achievement of organisational objectives and values. Integrating people, planning and performance with organisation objectives develops individual and organisational capability and leads to higher performance.<sup>90</sup>

**Figure 6 – A Generalised Performance Management Framework**



**Source:** Management Advisory Committee, 2001 *Performance Management in the Australian Public Service – A Strategic Framework*, Canberra, p.16.

## 4. Concluding remarks

I would like to emphasise again the importance of the principles and behaviours that underpin better practice corporate governance. In particular, openness, integrity and effective communication are vital pre-requisites of good corporate governance. These qualities contribute to, and are implicitly linked with, other principles such as disclosure, commitment and integration, to ensure accountability in the use of public (and private)



assets in the quest to achieve stated objectives and required performance levels. Importantly, these behaviours, and the standard of corporate governance itself, are strongly affected by the leadership of an agency – its tone at the top. This responsibility falls to both CEOs and boards and, preferably, seamlessly to staff and other stakeholders.

While the ANAO has not undertaken a performance audit of the ACA, it is clear that, like virtually all APS agencies, it has in place the main elements of corporate governance - for example, risk management, financial controls, performance monitoring and audit. These are supported by business systems; staff skills and knowledge; and management, including suitable information governance arrangements.

Some of the governance arrangements for the ACA do in fact differ from the structures I would generally recommend as better practice. This mainly stems from the involvement of the senior board members, including the chair and deputy chair, in the day-to-day management of the authority. In theory, this weakens the separation of powers between the board and management and could potentially compromise the performance and conformance oversight function of the board. It also potentially weakens the internal audit function, as the audit committee reports to management rather than to the board.

However, the ANAO has not undertaken a performance audit of the ACA and, for this reason, I cannot provide an opinion of the effectiveness of the ACA's corporate governance. I note that the academic literature also does not clearly link governance structures to performance and typically emphasises: the importance of the governance culture (its behaviours and principles); as well as the competence and commitment of management; and systems that are in place. My invitation to speak about corporate governance today reflects well on the governance culture and leadership of the ACA. Governance structures do vary. It is not a case of one size fits all. However, we can all learn from other's experiences, positive and negative.

In this regard, I can provide the following pointers from a recent performance audit on Corporate Governance in the Australian Broadcasting Corporation.<sup>91</sup>

Board Practices – while the audit found board practices were generally in accord with better practice, the report:

- a) Observed that the delineation of responsibilities for strategic direction setting and policy development between the Board and the Managing Director could be more clearly articulated and the working relationships better defined, giving rise to a common understanding of the roles and responsibilities of the various parties.<sup>92</sup>
- b) Suggested that the Board issue guidelines regarding the format and structure of Board submissions to better enable the Board to review a range of solutions to problems for cost effectiveness and value for money.<sup>93</sup>
- c) Acknowledged the shift in reporting to the board from a mainly *ex post* perspective to one focusing more on identifying strategic issues or areas of

potential risk, and in future, the board will also be provided with reports against the Corporate Plan and the Corporate Performance Indicators.<sup>94</sup>

- d) Makes the point that induction and ongoing training for board members is a matter for the board and the report calls for a more formal training approach. The report also suggests that the Board regularly evaluate its effectiveness in discharging its obligations as a Board.<sup>95</sup>
- e) Suggested the Board consider developing a written statement of its own governance principles and how these principles might be monitored.<sup>96</sup>

Accountability – requires a full, transparent account of performance, particularly in relation to the functions, powers, duties, privileges and resources approved by Parliament. The audit report observed that a number of the senior executive of the ABC are new to the public sector and there was scope for a better appreciation of the specific features of the Commonwealth’s accountability framework and a fuller understanding of the board’s statutory obligations which they must support.<sup>97</sup>

Measuring and Reporting Performance – there was scope for the ABC to improve its strategic planning and measurement so that it can demonstrate how well it is performing against its Charter. The performance information used by management and published in key accountability documents had significant gaps and the data could be used more strategically. For the new planning and reporting framework to be fully effective, work is required to collect and integrate valid and reliable performance information that is aligned with the Corporate Plan.<sup>98</sup>

Internal Control – the internal control and accountability arrangements have been strengthened as part of a the planning framework and a new internal budget setting process that better aligns with Corporate Plan objectives and strategies enabling the Board and the Managing Director to take strategic and informed decisions on the allocation of resources against defined priorities and performance standards.

In conclusion, I draw your attention to the many recent and imminent guides being released on corporate governance in Australia, by, for example, Standards Australia, the Australian Stock Exchange, the Australian Chamber of Commerce and Industry, and the University of Canberra. I should also mention again the forthcoming better practice guide on public sector governance to be published shortly by the ANAO. These guides can be used by individual public sector agencies to tailor and refine their governance practices. Importantly, the findings and recommendations of the Uhrig review of corporate governance of statutory authorities and office holders, due in mid-2003, will probably provide further impetus for corporate governance reforms that will affect CAC agencies such as the ACA.

I do not think that it requires ‘the passion of a regulation tragic to go through all of the reforms proposed by these bodies.’ By now, many boards are aware of their strengths and areas which might need improvement. Attention can be focussed on the latter to achieve timely results. However, I suggest it is often useful for the board to be assured that its approach does constitute better practice. Some assurance also helps in achieving

the 'right balance' between conformance and performance in a robust corporate governance framework.

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- <sup>4</sup> Bird, F., 2001. *Good governance: A Philosophical discussion of the responsibilities and practices of organisational governors*, Canadian Journal of Administrative Studies, December, pp: 298-312.
- <sup>5</sup> Heracleous, Loizos 2001, 'What is the impact of corporate governance on organizational performance?', *Corporate Governance: An International Review*, 9(3), pp. 165-73.
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- <sup>7</sup> According to Section 12(1) of the *Australian Communications Authority Act 1997*, the Minister may give written directions to the ACA in relation to the performance of its functions and the exercise of its powers. However, apart from such notification (and the impact of other Acts), the ACA is not subject to direction by or on behalf of the Commonwealth Government.
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- <sup>21</sup> Independent Commission Against Corruption, *An Ethical Approach to Corporate Governance in the Public Sector*. Address by Poulton Grant 2002 to the IIR Conference on Corporate Governance in the Public Sector, Canberra. 13 August.
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