

National Institute for Governance,
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**Better Practice Public Sector
Governance**

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BETTER PRACTICE PUBLIC SECTOR GOVERNANCE

Thank you for inviting me to present at your seminar on Better Practice Public Sector Governance.

I know you are all aware of the increased focus on corporate governance in the wake of corporate collapses, and the flow-on effect this has for the public sector governance.¹ As a corporate governance practitioner recently, and colourfully, stated: ‘The US war on corporate governance has begun in earnest and the UK and Australia have joined the coalition of the willing’.²

This terminology implies considerable challenges, and major changes, for corporate governance in the private sector. On the basis of audits undertaken by the Australian National Audit Office (ANAO), I would suggest that the challenges are similar but probably lesser for the Australian Public Service (APS), as there are probably fewer organisations with very poor governance standards. However, our audits have shown scope for improvement in governance practices for many APS organisations.

As I will explain shortly, one way the ANAO attempts to raise the standard of governance in the APS is through the publication and release of better practice guides. This address will focus on the *Better Practice Guide on Public Sector Governance* that the ANAO released last month.³ In doing so, it will: explain the ANAO’s role and rationale for providing such guidance; indicate how the guide may assist public sector organisations improve their governance; outline the methodology applied and the nature of the guide; and discuss some of the main issues covered by the guide. This paper is in five parts reflecting these topics.

PART 1: BACKGROUND TO THE GUIDE

1.1 ANAO role and rationale for providing guidance on public sector governance

The ANAO’s mission is to add value to public sector performance and accountability. Accordingly, the ANAO seeks two outcomes:

- improvement in public administration—the independent assessment of the performance of selected Commonwealth public sector activities including the scope for improving efficiency and administrative effectiveness; and
- assurance—the independent assurance of Commonwealth public sector financial reporting, administration, control and accountability.

To achieve these outcomes, and to assist the Parliament in its work, the ANAO delivers an integrated audit service. This service includes financial statement audits, performance audits, business support process audits, protective security audits and benchmarking studies.

In undertaking these audits, the ANAO builds considerable knowledge of better practice approaches taken by APS organisations to achieve high performance and effective accountability. To utilise this knowledge, and to assist APS organisations, the ANAO also produces better practice guides on important operations of APS organisations.

The ANAO has long recognised that governance practices often strongly influence the performance and accountability of APS agencies. It is also an area where many APS agencies are unsure about better practices and value assistance. For this reason, the ANAO has provided a series of better practice guides on public sector governance.

The first such guide was released in 1997 and promoted governance principles and better practices in budget-funded agencies.⁴ A complementary guide was released in 1999, examining governance in Commonwealth authorities and companies.⁵ The third and latest guide⁶ was released last month. It discusses better practice governance for all types of APS organisations.

The new guide is different in nature to the previous two, which had more specific purposes. The first guide dealt with the application of governance in public sector agencies and, in particular, made the case for the establishment of executive boards for agencies. It predated the *Financial Management and Accountability Act 1997* (FMA Act) and the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The ANAO issued the second guide as a discussion paper in 1999, which was designed to assist members of the boards and senior managers of CAC Act bodies to evaluate their governance frameworks and make them more effective.

With the publication of the third, and current, guide the scope has widened again. In essence, it provides more practical guidance. While the latest guide incorporates recent legislative changes and reflects current concerns, the previous two guides remain useful, as the practices and principles they endorse continue to provide the foundations of better practice public sector governance.

The ANAO has produced these guides on public sector governance as it is able to do so cost-effectively, to provide some clarity for organisations that may be audited, but also because there have been few alternative sources of better practice information on governance focussed on the public sector. While there has been quite a rapid increase in documented guidance on 'corporate governance', especially by legal firms, these remain mainly directed towards private sector needs and requirements.

For this reason, the ANAO is likely to continue to provide guidance on public sector governance in the future. One avenue will be by adding to the latest better practice guide, to provide guidance on major emerging governance issues. The ANAO is also participating in an Australian Research Council linkage grants project with the University of Canberra and other organisations, to examine governance on a multi-disciplinary basis, with the aim of producing an integrated cross-government governance framework.

1.2 How the guide may assist APS agencies

The purpose of the ANAO's recent better practice guide on public sector governance is to assist public sector organisations to improve their governance. This encourages performance improvement while satisfying control and compliance requirements. To do so, guidance is provided on governance frameworks, concepts, protocols and procedures for public sector organisations and individuals to consider. It is not a prescriptive guide, and has no legislative status. The guide clearly states that it is the responsibility of individual agencies to tailor governance arrangements to their particular circumstances.

The guide covers the full range of public sector-specific governance issues, at least in an over-arching manner: to suggest better practices in the main elements of governance; to indicate the linkages between them; and to suggest ways in which they could be integrated. The guide provides more detailed discussion of specific aspects of governance of particular concern to public sector organisations.

The guide aims to assist public sector personnel working at all levels of organisations to more fully comprehend the main elements of better public sector governance, and to understand how to apply them. Thus, the guide is not designed solely for the benefit of those working at the top of organisations, although most of the issues raised will concern them.

While the guide focuses on Commonwealth organisations, many of the governance issues it examines affect public sector entities outside the Commonwealth sector. It should, therefore, also assist such entities, especially those in Australia's state and local government sectors. In this respect, we have been learning from the work done in those areas, particularly by our audit colleagues.

1.3 Nature of the guide: methodology, format and main contents

Methodology for preparing the guide

In developing the guide, the ANAO, in conjunction with staff from the National Institute for Governance at the University of Canberra, interviewed organisation heads and board members of a range of FMA and CAC agencies. Their opinions about the important and emerging governance issues, and issues they required guidance on, strongly influenced the nature and contents of the guide. This process attempted to ensure the guide would focus on current issues of concern to the public sector.

In order to embrace recent practical and theoretical developments in public sector governance, the guide was developed with substantial external input, especially from the National Institute for Governance and Blake Dawson Waldron Lawyers. In drafting and finalising the guide, comments were received from a number of APS organisations, most particularly the Department of Finance and Administration. I should like to record my thanks to these organisations for their valuable contribution.

Format and contents of the guide

To achieve the ANAO's objectives to provide high-level guidance about public sector governance and also to focus on issues nominated as important to APS organisations, the guide is organised in two parts. The first deals with overall frameworks, processes and practices, while the second is in module format, and looks at specific issues in more detail. The guide is intended to function as a living document, with ongoing relevance to the national debate. Therefore, the Governance Guidance Papers in Volume 2 may be updated as other governance issues gain prominence and as judgements are made that organisations might benefit from ANAO guidance, and as governance arrangements change.

On the latter point, this guide has been released at a time of considerable governance oriented 'activity', and has taken into account recent corporate governance releases, such as the Australian Stock Exchange *Principles of Good Corporate Governance and Best Practice Recommendations* and the suite of Australian standards on corporate governance from Standards Australia International. However, the soon to be released Uhrig Committee *Review of Corporate Governance of Statutory Authorities and Office Holders* and the Commonwealth Government's *Corporate Law and Economic Reform Program* (CLERP 9) draft legislation will generate further developments in corporate governance, that may require the ANAO to update and extend its governance Guidance Papers.

As I just mentioned, Volume 1 of the guide focusses on framework, processes and practices for good public sector governance. In doing so, it also defines the term 'public sector governance', discusses the objectives and principles of public sector governance, and outlines the key elements of the Commonwealth's legal and policy arrangements relating to the governance of its various organisations.

Volume 2 of the guide comprises eight distinct Governance Guidance Papers. These cover: board and higher level governance issues, including monitoring board performance; governance responsibilities of individual officers; conflicts of interest; and cross-agency governance issues. Their format generally includes: protocols that organisations can use to ascertain whether they have systems in place and practices that support better practice; examples of better practice; and key references and organisations that can provide further information, guidance or support on each topic.

PART 2: ISSUES DISCUSSED IN VOLUME 1 OF THE GUIDE

On the basis of your invitation, my presentation will discuss some of the main messages emerging from the ANAO's recent better practice guide on public sector governance. Beginning with the issues discussed in Volume 1 of the guide, it will focus on the importance of understanding the main governance principles, which underpin the intent and spirit of the law, as well as the need to fulfil the requirements of the relevant legislation. I will then discuss better practice public sector governance frameworks and elements, in the context of the prevailing legislative and policy frameworks, as well as evolving stakeholder expectations.

This discussion emphasises that the key to better practice public sector governance lies in the effective integration of the main elements of 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 before many agencies are able to accept that risk may engender an opportunity as well as events to be minimised or avoided.

In discussing governance issues (covered in both Volume 1 and Volume 2), I will occasionally draw on broader material, not included in the guide.

2.1 Defining public sector governance

The guide uses the term ‘public sector governance’ or simply ‘governance’ when discussing the governance of public sector bodies. This expression was chosen for clarity, and especially to reduce any perceived ambiguity concerning the application of the term ‘corporate’ to non-corporate public sector organisations.

The definition provided in the previous ANAO Better Practice Guide⁷ remains valid, as it refers to the ‘processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organisation.’

The recent ANAO guide adds that:

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

I note that some commentators treat governance in quite a narrow and restrictive manner, often focussing almost entirely on the operations of a governing board and its relationship with the CEO and with Ministers. 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 help manage the formers’ obligations to stakeholders. For example CAC agencies are directed through legislation such as the CAC Act and the *Public Service Act 1999* (PS Act) and through more informal guidelines including Chief Executive’s Instructions (CEIs) and Department of Finance and Administration Directions.

2.2 Objectives of public sector governance

Fundamentally, good governance arrangements are essential for an organisation to be able to demonstrate to stakeholders that it can be trusted to do what it is set up to do. Such arrangements assist stakeholders to have confidence that APS organisations not only have the competence and expertise required, but that they have also established robust administrative arrangements that enable them to do so efficiently, effectively and ethically.

Good governance generally focuses on two main requirements of organisations:

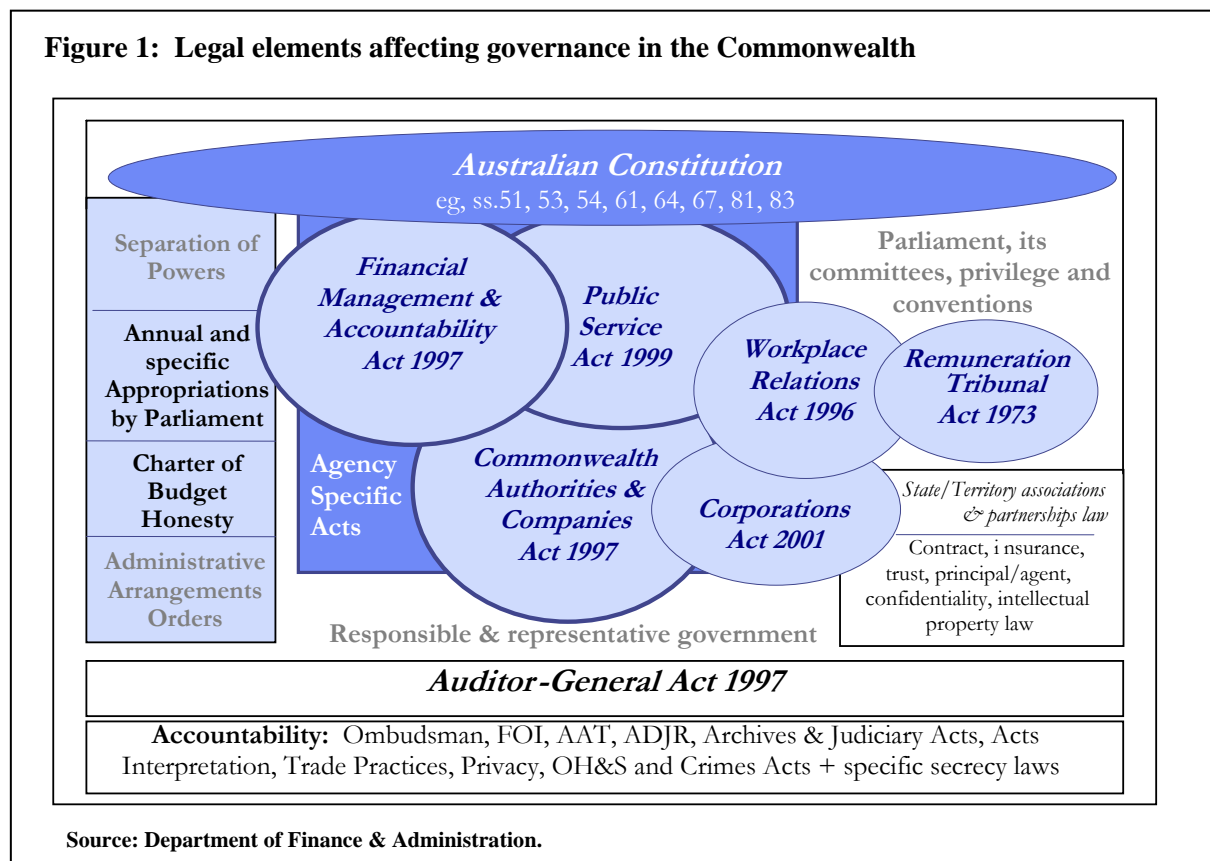
- **performance**, whereby the organisation uses its governance arrangements to contribute to its overall performance and the delivery of its goods, services or programs; and
- **conformance**, whereby the organisation uses its governance arrangements to ensure it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness.

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

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 discharged to impeccable standards, but in essence they are 'hygiene' issues. The real added value for boards, or equivalently chief executives of FMA agencies, is at the strategy level. This requires them to be forward looking, proactive, innovative, and not risk-averse.⁸ I would also add integrity as an essential element of 'tone at the top'.

2.3 Legal and policy framework

The Commonwealth public sector has an extensive legal and regulative framework that organisations must comply with (see Figure 1), and many policies they must conform to.



The major classes of organisation, and their major relevant legislation, are:

- Departments of State—these are part of the Crown and all subject to the FMA Act and the PS Act;
- Statutory Agencies—these are established by an enabling Act, are subject to the PS Act and may or may not be subject to the FMA Act;
- Commonwealth Authorities—these are established by an enabling Act, are subject to the CAC Act and may also be subject to the PS Act;
- Commonwealth companies—are subject to the *Corporations Act 2001* but generally not subject to the PS Act; and
- Government Business Enterprises (GBEs)—these are generally established under the *Corporations Act 2001* and are subject to the CAC Act.

These organisations, generally, must also comply with the other Acts outlined in Figure 1. Furthermore, all laws and actions of the Commonwealth must be in accord with the relevant provisions of the Constitution.

In addition to such legislation, Commonwealth government entities are subject to a variety of regulations and policies impacting on governance, such as the budget outcomes and outputs reporting regime, the growing emphasis on risk management, and the need for effective coordination of Whole-of-Government and inter-agency issues.

2.4 Principles of public sector governance

There is increasing evidence that behaviours consistent with good governance sustain improvements in organisational performance.⁹ This requires the application of effective governance principles by the management and staff within each organisation to implement the designated governance frameworks, controls and guidelines.

In the recent guide, the ANAO primarily used the group of principles first articulated by the Nolan Committee of the UK in 1995¹⁰, which have stood the test of time. They are:

- **accountability**: where public sector organisations and the individuals within them are responsible for their decisions and actions, and where they are subject to external scrutiny;
- **transparency**, or openness: is required to ensure that stakeholders have confidence in the decisions and actions of public sector organisations and the individuals within them;
- **integrity**: is based on honesty, objectivity, and high standards of propriety and probity in the stewardship of public funds and resources;
- **stewardship**: reflects the fact that public officials exercise their powers on behalf of the nation, and that the resources they use are held in trust and are not privately owned;
- **leadership**: is one of the more crucial principles. It sets the tone at the top of the organisation, and is absolutely critical to achieving an organisation-wide commitment to good governance; and

- **efficiency:** is about the best use of resources to achieve the goals of the organisation, and is also about being able to prove that the organisation has indeed made the best use of public resources.

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

However, these are not necessarily the only governance principles, with different authors selecting different, but generally related principles, as outlined in Figure 2.

Figure 2: Alternative ‘principles’ of governance

<i>ANAO</i>	<i>King (South Africa)</i>	<i>Standards Australia</i>	<i>OECD</i>
Accountability	Accountability	Goodwill	Accountability
Transparency	Transparency	Transparency	Transparency
Integrity	Independence	Honesty	Fairness
Stewardship	Discipline	Legal	Responsibility
Leadership	Fairness	Fairness and balance	
Efficiency	Responsibility	Dignity	
Social responsibility			

Source: ANAO, *Better Practice Guide on Public Sector Governance*, July 2003. King, Mervyn S.C. ‘*Report on Corporate Governance in South Africa, 2002*’. Standards Australia, *Australian Standard: Good Governance Principles*, 2003. OECD, *Corporate Governance Advisory Group*, 2002.

2.5 Public sector governance framework, processes and practices

The legislative requirements outlined in Figure 1, together with requirements for high organisational performance, demand that public sector entities’ establish and operate an extensive but integrated system of governance.

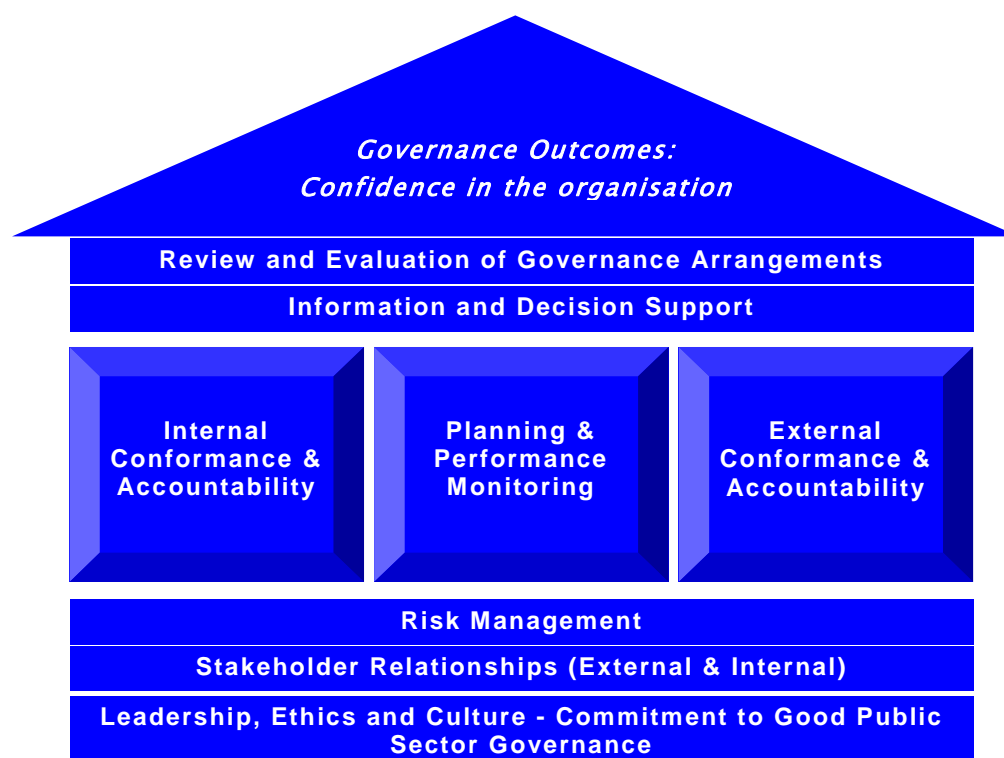
To illustrate the key generally accepted organisational and process elements of good public sector governance, the guide adapted a model developed by the Queensland Department of Transport—‘The House of Governance’ (Figure 3). This is a broad-based model that recognises the elements of good public sector governance need to be applied within government frameworks which may differ considerably according to the size, complexity, structure and legislative background of the organisations concerned.

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

Most public sector organisations have in place many of these desirable elements of good 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; and performance monitoring (including evaluation and review).

Figure 3: The House of Public Sector Governance



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

However, what many agencies seem to lack is a credible way to integrate those elements into a unified, mutually reinforcing complete structure. This involves a consistent, strategic approach to governance so that good governance practice is successfully integrated with, and supports, the way Commonwealth departments and agencies do business.¹¹ 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.

The guide discusses better practice in each of the elements of governance identified in Figure 3. For this address, I will focus on three of these elements: leadership, including ethics and culture; risk management; and performance monitoring. Selecting these issues does not imply that others, such as stakeholder management, are less important.

I would also like to emphasise that there are many ways to represent good governance in the public sector, other than those outlined in Figure 3. 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 public sector governance 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.

2.6 Leadership, ethics and culture

Legal responsibility varies according to the type of APS organisation, with chief executives legally responsible for FMA agencies and boards generally legally responsible for CAC agencies. As with others, I constantly emphasise the importance of leaders to set the ‘tone at the top’ of organisations, that is, to positively influence good governance.

The recent ANAO guide has clarified this tenet, identifying that leaders have dual responsibilities for governance:

- to ensure implementation, evaluation and improvement of good governance structures and processes; and
- to enact and influence good governance through their own performance and behaviours.

While rules, systems and structures are certainly important, they are the vehicles by which crucial values and behaviours are applied.¹² Good governance is, therefore, primarily a function of the behaviours and values of the organisation’s leaders and is a manifestation of the overall culture of the organisation.

In particular, it is important that leaders demonstrate an active commitment to the principles of good public sector governance outlined earlier (including accountability, openness, integrity, stewardship and efficiency). It is also vital that staff adopt good governance practices through their own behaviour and performance.

The recent Inquiry into the HIH collapse emphasises the importance of leadership, ethics and performance culture in determining good governance, as outlined below.¹³

[A] danger with an overly prescriptive approach to systems and structures is that it may unwittingly encourage a superficial or ‘tick the box’ approach to the achievement of governance objectives.

Systems and structures can provide an environment conducive to good corporate governance practices, but at the end of the day it is the acts or omissions of the people charged with relevant responsibilities that will determine whether governance objectives are in fact achieved.

Effective communication—both internally and externally—is therefore a primary function of leadership. It is through clear and consistent communication of the values and objectives of the organisation to staff, management and external stakeholders that an agency’s leadership most effectively supports good governance outcomes and contributes to stakeholder confidence in the organisation.

It is also through consistent communication and actions that leaders support ethical behaviour in the organisation, and influence the culture necessary to support the objectives of the organisation and achieve the required results.

2.7 Risk management and the control environment

Background to discussion of risk management in ANAO guide

The ANAO recognises that risk management is an integral component of good governance that underpins the organisation's approaches to achieving both performance and conformance objectives.

Given the importance of risk management to public sector governance and its operations, it was interesting that this topic was not one that was frequently cited by organisation heads and board members, interviewed as part of research for this guide, as requiring guidance. Conversely, it was an issue that many of the agencies that commented on drafts of the guide, considered to need increased emphasis. This apparent dichotomy of opinion may reflect:

- the high degree of knowledge about risk management processes throughout the public sector—resulting in some comfort by existing high-level leaders in its use; but also
- the reality that knowledge of the associated elements and processes does not guarantee good risk management. The latter depends on the application of public sector governance principles and their effective implementation—resulting in the emphasis placed by many governance practitioners on the link between effective risk management and good governance.

Risk management and public sector governance

Risk management involves the identification, analysis, treatment, monitoring and communicating of risks. In the public sector, risks are generally taken to represent threats rather than opportunities. That is, risks are identified as events that may prevent the achievement of business objectives much more frequently than events that may provide the opportunity to achieve additional benefits. Organisations in the public sector need to more frequently and comprehensively consider beneficial risks, as this would assist them to become less risk averse, and thereby enable them to more fully embrace the performance aspects of their conformance and performance objectives. A recent quote is apposite:

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.¹⁴

Governance is concerned with achieving results while taking account of risk, thus making formal risk management an essential element of sound governance and management practice. It is becoming even more important in the move to a more collaborative, networked, or joined-up, government. The bar is raised even further with similar arrangements involving the private sector.

The ultimate responsibility for an organisation's risk management sits with the head of that organisation. But all managers and staff have a responsibility to manage risk. Effective risk management requires a risk assessment culture, which supports a holistic approach to the identification and management of risk throughout an organisation. This means that risk management should be seamlessly integrated into the day-to-day

business of an organisation as well as being part of its higher-level strategy and planning processes.

This concept of risk management 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.

The control environment

Importantly, an integrated risk management system develops the control environment, which provides reasonable assurance that the organisation will achieve its objectives with an acceptable degree of residual risk. Taking this approach to risk management can ultimately mean that all major decisions are considered in terms of sound risk management principles.

In the ANAO's experience, it is difficult to over-emphasise the importance of integrating an organisation's approach to control with its overall risk management strategy 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 well 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/CEO for information and any guidance or direction, including considering whether controls are effective and if not, how they should be adjusted. An audit committee should have particular interests in these issues.

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 responsiveness¹⁵

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 largely 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 nor incidental. It is fundamental to accountability and performance. Indeed, it has been suggested that boards should formally accept their responsibility for reviewing the effectiveness of internal control.¹⁶

2.8 Performance monitoring and reporting

Background to discussion of performance monitoring in ANAO guide

Similar to risk management, performance management and reporting was not an issue that those in senior governance positions interviewed as part of research for the guide often cited as requiring guidance. Yet I would say that this is the single issue that comprises most ANAO performance audit recommendations and suggestions for improvement.

This audit attention occurs not just because of the difficulty of implementing a credible outputs and outcomes framework but because organisations are often loathe to commit to indicators that they believe they may not have full control over and that they think may reflect badly on them if they show a drop in performance at any time, or over time. Furthermore, while it is often difficult to design indicators that effectively measure outcomes, it is usually possible to establish second-level indicators (for example, intermediate outcomes) that provide a very useful start.

The ANAO recognises the imperfections of most performance indicators and the difficulty of ascribing causality. However, the benefits from developing relevant performance indicators, especially in relation to accountability and transparency, and their positive impact on policies, behaviours and ultimately performance, justify the effort to get them right. We will continue to work with agencies to achieve that outcome and to make recommendations accordingly.

Performance monitoring and public sector governance

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:

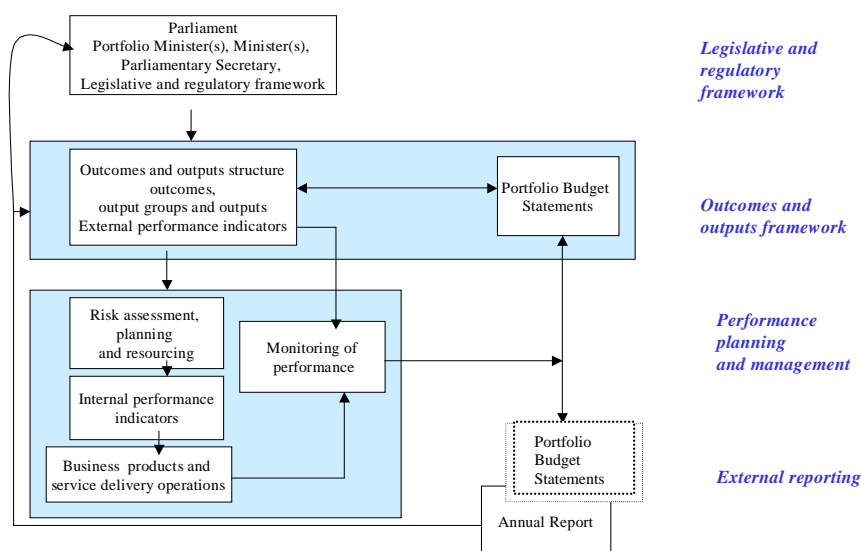
resource management with an emphasis on measuring performance, in terms of what is being produced, what is being achieved and what is the cost of individual goods and services...¹⁷

Recognising this focus by central government agencies, the recent guide also emphasises the need to integrate performance monitoring with business planning processes, as follows:

- effective corporate and business planning;
- a clear and robust budgeting and financial planning system;
- chief executive officer (or equivalent) and chief financial officer (or equivalent) sign-off to the board regarding financial reports;
- a structured and regular system of performance monitoring;
- consideration of Whole-of-Government and cross-agency issues in policy development and programme delivery; and
- a structured, detailed and integrated approach to risk management.

Figure 4 highlights the key role performance information plays in the governance framework.

Figure 4 – Agency planning, management and governance framework



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

Once the key elements of the governance framework have been settled, good scorekeeping systems (balanced scorecards and/or executive snapshots) can 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 as well as a useful basis for communicating with staff and other stakeholders on how the agency is performing against its targets. 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, ideally, 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, including that used in entity annual reports, are part of the same integrated framework.

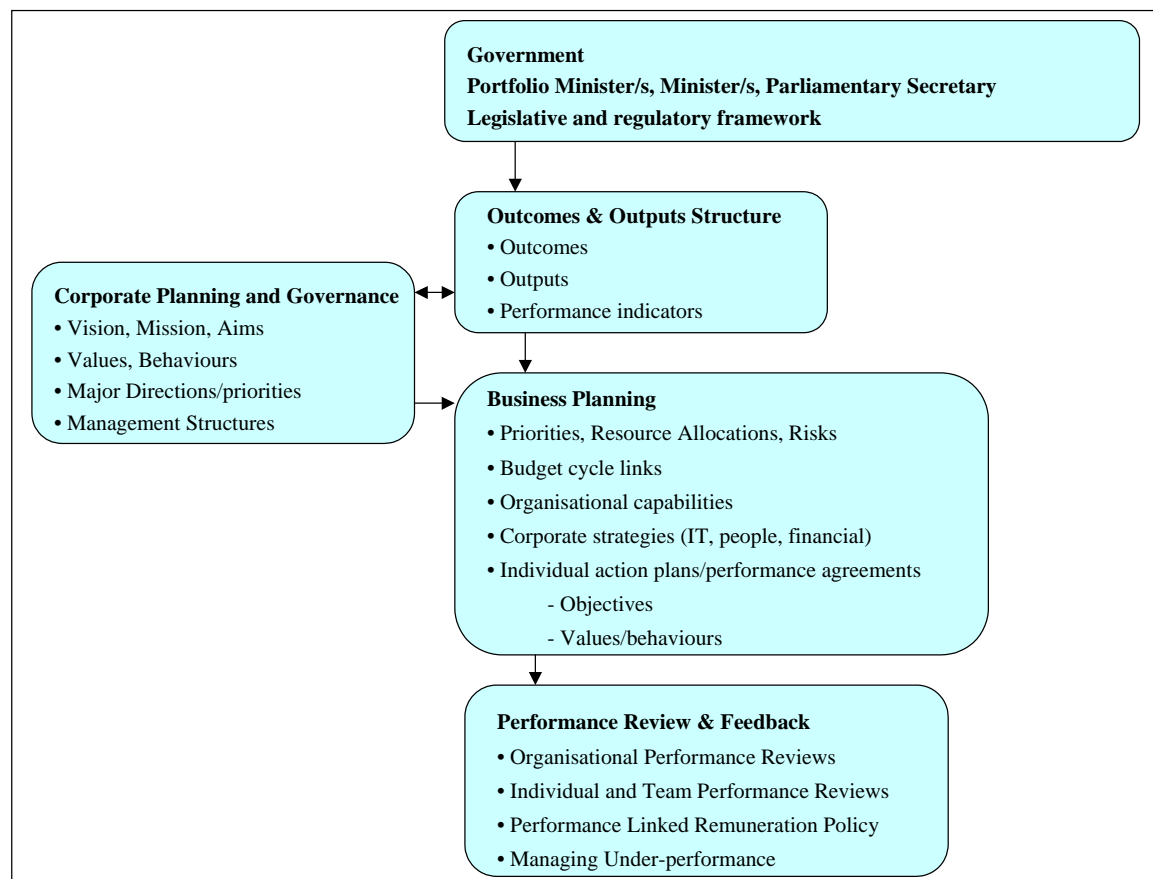
Boards and/or CEOs are responsible for determining the performance requirements of the organisation as well as reviewing performance information. CAC legislation refers to the requirement to collect and report both financial and non-financial performance information. The public sector is familiar with the requirements for public service obligations that 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 that go well beyond financial indicators. 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.¹⁸

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.¹⁹

Figure 5 – A Generalised Performance Management Framework



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

PART 3: SELECTED ISSUES DISCUSSED IN VOLUME 2 OF THE GUIDE

As I mentioned earlier, Volume 2 of the guide contains eight Governance Guidance Papers. The issues covered in these papers were identified by senior public sector managers and directors as being important, and potentially benefiting from guidance. I will briefly discuss issues discussed in five of these papers, namely:

- public sector governance and the individual officer;
- advisory boards in FMA agencies;
- monitoring the performance of boards;
- handling conflicts of interest; and
- joined-up governance.

I will not discuss issues surrounding the operations of CAC boards (that are covered in Governance Guidance Papers No. 2 and No.3), as I understand that other speakers are addressing this topic.

3.1 Public Sector governance and the individual officer

Two Governance Guidance Papers in the recent ANAO guide were dedicated to assisting individual APS officers understand their governance responsibilities. Guidance Paper No.1 provides Commonwealth departments and agencies with guidance on how public sector governance issues affect the responsibility of the individual officer. Guidance Paper No.8 is a quick reference guide that summarises legal requirements that may be applicable to CAC and FMA bodies.

General guidance for individual APS officers

The emphasis on this issue is based on the view that good governance is enacted through the behaviour of staff at all levels of an organisation, as they personally contribute to the efficient, effective and ethical delivery of their organisation's goals. Having sound frameworks in place will not achieve good governance without the personal attention, commitment and contribution of individuals.

Every public official is the custodian of a certain measure of public power and resources, which are entrusted to him or her under the Australian system of Government. With this trust comes the responsibility for each individual to perform his or her duties according to the generally accepted principles of sound public sector governance.

The accountability of every officer of the public service must not only be clear, it must be well understood. For individuals, the type of organisation in which they work, as well as the position that he or she occupies, will determine the applicable legislative and policy regime.

According to that regime, the duties, responsibilities and powers of individual officers must be clearly spelt out, for example in a position statement or performance contract. In addition, each and every officer needs to understand the legislation, delegations, and performance standards relevant to his or her duties. This applies, in particular, to the Values and Code of Conduct included in the PS Act.

Each APS staff member also needs to understand clearly how their individual governance behaviour can be exposed under Freedom of Information Act requirements, and the investigations of organisations such as the Ombudsman, the Auditor-General, the Privacy Commissioner and the Administrative Appeals Tribunal. In this regard, good record-keeping and good audit trails are not ‘bureaucratic’ in a pejorative sense. To the contrary, they are valuable management assets. They are evidence of sound governance processes and practices, and demonstrate transparency and accountability to our stakeholders.

Flowing from all this, each staff member needs to know how his or her personal contribution promotes good governance and, ultimately, the achievement of corporate goals and objectives. Achieving this understanding takes time and effort for both the organisation and the individual. However, in the guide, we have outlined some useful procedures that organisations may take (see Figure 6).

Figure 6: Procedures to support staff to contribute to good public sector governance

Agencies should engage their staff and managers in the development, evaluation, monitoring and receipt of the following key documents:

- a clear statement of the values, practices and behaviours expected of the organisation’s employees;
- a clear statement of the organisation’s human resource policy, including the rights and obligations it places upon supervisors and subordinates;
- concise, up-to-date and consistent information on the organisation’s governance arrangements, including the applicable legislative and policy framework, boards and committees, their charters, membership and relationships with other governance bodies, audit and fraud control arrangements, and whistleblower mechanism;
- a clear statement of the organisation’s corporate goals, key performance indicators and business plans; and
- a clear set of personal duties, delegations and performance targets related to the organisation’s corporate and business plans.

Agency leaders should provide to their staff and managers:

- regular information on the deliberations and decisions of the key board(s) or committee(s) governing the organisation;
- regular reports on the organisation’s performance against its key indicators, with analysis that will assist the organisation to learn from experience;
- encouragement at all levels to contribute to good governance, with exemplary leadership from senior management. This needs to be written into individual performance contracts and should be appropriately resourced and recognised; and
- Chief Executive Instructions, that provide guidance on matters necessary or convenient for carrying out or giving effect to the FMA Act or the FMA Regulations.

Source: ANAO, *Better Practice Guide on Public Sector Governance*, July 2003.

While such information and protocols strongly support individual staff members, it remains difficult for these staff members to implement good public sector governance if the culture of the organisation works against them. Leadership provided by agency heads and other senior staff plays a critical role in determining how effective an agency will be in encouraging behaviour that supports good governance throughout the organisation.

Legal requirements that may be applicable to APS officers

The guide also provides a summary of legal requirements that may be applicable to CAC and FMA bodies. The guide considers over 25 potential governance requirements, such as annual reporting to stakeholders and disclosing directors interests, and indicates which officers are responsible, by type of body (eg CAC authority or FMA agency).

3.2 Advisory boards in FMA agencies

Overview of types of public sector boards

Boards within the Australian public sector can be grouped into three broad categories, based on their legal responsibilities and operational arrangements:

- **management boards** associated with those agencies subject to the CAC Act, and particularly of GBEs;
- **advisory boards** of agencies under the FMA Act; and
- **committees or boards** which oversight governance arrangements where two or more agencies have responsibility for the co-ordinated delivery of particular services to users.

Volume 2 of the guide contains Guidance Papers that discuss management boards in CAC bodies (No. 3) and also tensions in higher-level governance arrangements involving these bodies (No. 2). However, as I mentioned previously, I will not discuss these papers here as I understand that the other speakers will address these topics. Instead, I will discuss advisory boards in FMA agencies, and cross-agency governance arrangements.

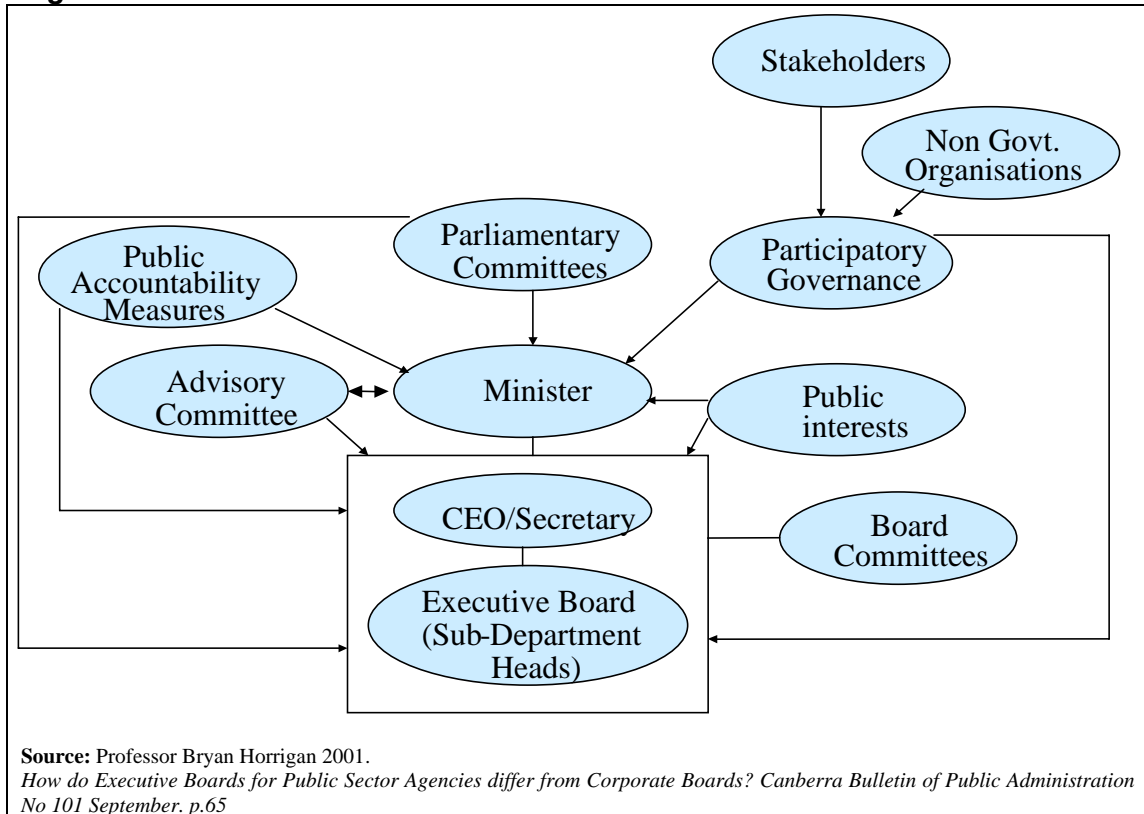
Legal responsibility of advisory boards

The FMA Act confers legislative responsibility 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. Therefore, apart from the CEO, who may chair the meetings, no individual on such a board has legal accountability for the decisions the board may take. While the ‘executive board’ is an ‘advisory committee’ to the CEO, some CEOs may choose to be bound by its advice, accepting personal risk in so doing but no doubt assisted in their governance task.

Roles of advisory boards

To illustrate the role of executive or advisory boards in public sector agencies, Figure 7 draws on an article by Professor Bryan Horrigan,²⁰ of the University of Canberra.

Figure 7: Boards – A Public Sector Model



Source: Professor Bryan Horrigan 2001.

How do Executive Boards for Public Sector Agencies differ from Corporate Boards? Canberra Bulletin of Public Administration No 101 September. p.65

Where executive or advisory boards exist, they should be concerned about both performance and conformance issues and about securing an appropriate balance between them, as I observed earlier, with the caveat noted. If such boards are to add value, they must involve themselves actively and regularly in the functions of strategic planning and risk management. The guide identifies a number of ways in which executive boards can be used to assist the CEO and the organisation.

These include:

- **strategy formulation:** members can assist in the development of major strategy (utilising the agency's specified risk management framework and approach), and performance measurement;
- **as a forum for reporting on cross-divisional responsibilities:** executive directors are often assigned responsibility for outcomes that cut across divisional boundaries. Progress against these targets can be discussed with colleagues and senior management;
- **providing advice:** board members can provide advice on the basis of more detailed understanding of the issues;
- **stakeholder liaison:** members can be assigned the task of liaison with groups of outside stakeholders, reporting their views on current or proposed policy;
- **communication:** members can convey information back to their own areas of the agency, engage in dialogue with and provide feedback to and from a wide range of staff;

- **performance monitoring and evaluation:** members can analyse regular reports against major indicators and develop necessary modifications to business plans;
- **learning:** members can provide experience-based feedback from successes and failures that can assist the organisation to learn; and
- **committees:** under the FMA Act, the CEO must set up an Audit Committee (compliance). In addition to Audit, there could be committees on Governance, Ethics, Human Resources, Performance, Strategy, Information (including Information, Technology and Communications) or Cross-divisional outcomes. A committee comprising a cross-section of staff from different levels and parts of the organisations could be used to provide a participatory governance mechanism.

The role and specific responsibilities of advisory boards are very much at the prerogative of the CEO. However, the ANAO considers that such boards should follow the traditional audit view and not be involved in operational, or day-to-day, management, but rather 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. Together with the CEO, the executive board should set the tone for the corporate culture. In this way it fulfils a stewardship and strategic leadership role, rather than a management role, focussed on implementing organisation culture and strategic direction.

Executive boards should also include structures, procedures and mechanisms to direct, guide or monitor the ethical enhancement of performance and conformance with legal obligations. These elements are based on, and embody, principles of public sector governance, including transparency, integrity, accountability, efficiency, and stewardship.

Protocols for advisory boards

The guide suggests a number of protocols that FMA agencies should consider to assess whether current executive board arrangements can be improved. Each agency is encouraged to develop its own tailored arrangements and to review their effectiveness regularly (see Figure 8).

Figure 8: Better practice protocols for FMA agency boards

	Procedures or protocols:	Assessment
1	A clear board charter, setting out its role, powers and responsibilities in relation to the chief executive and the Minister, its operating rules, performance criteria and mechanisms for assessing performance.	1 ف 2 ف 3 ف 4 ف
2	A mechanism for handling conflict of interest and conflict of role.	1 ف 2 ف 3 ف 4 ف
3	Board committees to meet the needs of the organisation. In addition to Audit, these could be Governance, Ethics, Human Resources, Performance, Strategy or Cross-divisional committees.	1 ف 2 ف 3 ف 4 ف

Code: 1 Not addressed; 2 Developing; 3 Better practice; 4 Time for review.

Source: ANAO, *Better Practice Guide on Public Sector Governance*.

The protocols are based around clarifying the roles, responsibilities and behaviours of each board member and determining the contribution of board committees. They should also include better practice approaches to handling conflicts of interest.

Board charters

It is a well-established part of good governance in the private sector that boards have a charter that clarifies the roles, responsibilities and behaviours of each board member. I advocate that public sector boards, covered by both the FMA and CAC Acts, should also have such a charter.

However, the content of the charter should be tailored to the circumstances of the organisation. Typically, a small organisation with a relatively narrow range of policy or operational concerns and little exposure to risks of conflicts of interest will have less need for a detailed board charter than a larger organisation with greater risk exposure. The former might also require less frequent and/or less intensive reviews of board performance than would be appropriate in larger, more complex organisations.

According to the recent guide, all boards or executive committees should have a charter or some other form of documentation that specifies such matters as:

- the functions, powers, membership of the board or committee;
- the role and responsibilities of members—for example, due diligence and good faith, commitment to acting in the best interests of the organisation as a whole, attendance, participation in discussions, to read and understand papers, to raise concerns, to deal with other members and staff with courtesy and respect, access to information, outside advice, confidentiality;
- the role of the chair—including: promoting full participation by all members; constructive questioning; strategic thinking; risk management; consideration of the right issues; decision-making and follow-up; adequate reporting; and relations with the organisation head, Minister and key stakeholders;
- processes for identifying and measuring conflict of interest;
- basic meeting procedures—for example, agenda, papers, minutes, declarations of interests and how these are to be handled, powers of the chair, voting procedures;
- policies on member remuneration (where relevant); and
- policies on board performance review.

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. These rules should encourage vigorous debate, but with expressions of dissent undertaken in a harmonious and collegiate fashion.

3.3 Monitoring the performance of boards

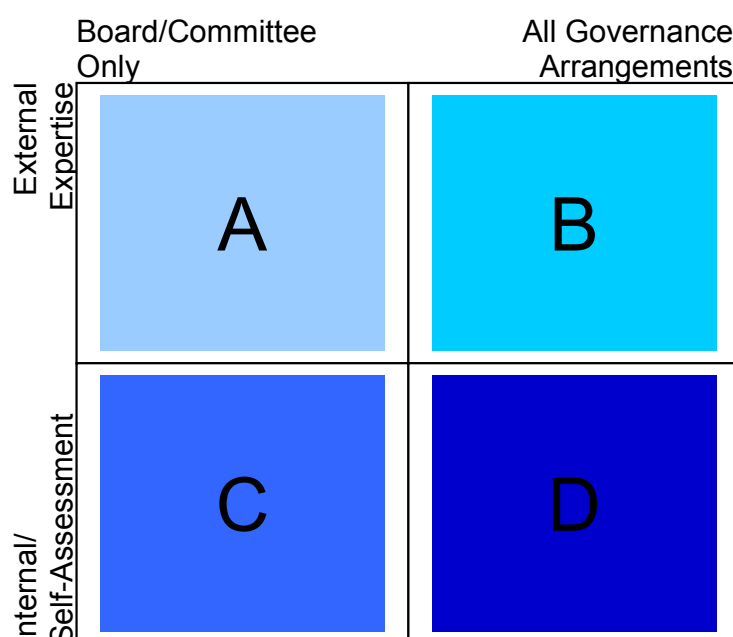
Performance reviews of boards and individual directors (including chairs) are also more effective if roles, responsibilities and capabilities have been clearly specified in a board charter or equivalent document. This enables assessment criteria to match these

specifications, in a similar way to those applied routinely to management positions. The same comment applies to board committees.

However, there is no general legal requirement that Commonwealth boards must work to an established charter, or review their performance against that charter. This applies to both FMA and CAC agencies.

As shown at Figure 9, there are four main types of governance review. The first (Box A) involves using an external, independent person or group to assess the performance of the governing board or committee. Such a review allows for an outside perspective that can reflect on some of the more subtle but crucial issues such as relationships between board members, balance in the board make-up, any tendencies towards group-think, or an unwillingness to question more powerful individuals.

Figure 9: Reviewing governance arrangements



Source: ANAO, *Better Practice Guide on Public Sector Governance*, July 2003. 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.

Which form of review or evaluation is best in a given circumstance is a matter for judgement. Externally facilitated reviews every three years can establish a benchmark for more frequent (annual) internal assessments.

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.²¹ Not surprisingly, to date in Australia, overall board performance assessments are more common than individual director assessments.

3.4 Handling conflicts of interest

Coverage of conflicts on interest in the ANAO guide

Research undertaken in preparation for the guide identified that management of conflicts of interest is an issue of significant and ongoing concern to public service organisations – from the board and agency head downwards. For this reason, the guide included a Governance Guidance Paper on better practice approaches to conflicts of interest and conflicts of role.

Given the breadth of public sector stakeholders, and the need to properly consider the interests of many of these stakeholders, there are many situations where conflicts of interest may arise. In the APS, these commonly include:

- 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.

These, and all other, conflicts should be carefully assessed—as many can be quite severe. The fundamental message is to manage conflicts of interest proactively, rather than wait for problems to emerge.

The principles that apply here are the same ones that go to the heart of good governance. Conflicts of interest and role need to be considered within an ethical framework that requires people to act with integrity, with impartiality, in good faith, and in the best interests of the organisation they serve. Transparency is fundamental—and officials must be responsible for disclosing any personal interests that could constitute a real or perceived conflict of interest. From the organisation’s point of view, adherence to disclosure requirements must be monitored and enforced. This necessitates good record-keeping. Consistently requiring conflicts to be identified and dealt with properly is an essential part of building an ethical organisational culture.

The guide suggested some procedures to help organisations and individuals cope with possible conflicts of interest, as outlined in Figure 10.

These procedures are based around a formal protocol that grades conflicts of interest and recommends different policies depending on the severity of the grading. Important elements of the procedures also include those to review, evaluate and consider complaints.

The guide also discusses the issue of ‘nominee’ or ‘representative’ board members. It supports the view that appointments to boards should be made on the basis of the best person to contribute to their operations, rather than on the basis of representation. The guide adds that Commonwealth organisations should review policies and legislation that require supplier or client representatives on boards, with a view to advising reconsideration of the requirement if potential or perceived conflicts of interest are evident.

Figure 10: Procedures to manage conflicts of interest and conflicts of role

	Procedures or protocols to:	Assessment
1	Determine which decision-makers need to make a statement of personal interest and/or may be subject to conflicts of role.	1 2 3 4
2	Obtain assurance from decision-makers that they have made relevant disclosures, and that these are up-to-date.	1 2 3 4
3	Monitor adherence to the required legislation and standards, and ensure accountability.	1 2 3 4
4	Grade the severity of conflicts of personal interest and determine how to manage each level, based on the requisite 'threshold of materiality'.	1 2 3 4
5	Adapt the above grading system to cater for some conflicts of role.	1 2 3 4
6	Cover special conflicts of role, such as a portfolio secretary sitting on a statutory board.	1 2 3 4
7	Train officers to be able to recognise conflicts of personal interest and to understand their obligations in terms of the legislation and policy relevant to their position.	1 2 3 4
8	Identify and regularly review decisions that could be affected by conflict of personal interest and/or role.	1 2 3 4
9	Regularly review procedures for handling conflicts, involving internal and external stakeholders.	1 2 3 4
10	Manage a complaints mechanism.	1 2 3 4
11	Maintain register of senior executive's statements of private interest.	1 2 3 4

Code: 1 Not addressed; 2 Developing; 3 Better practice; 4 Time for review.

Source: ANAO, *Better Practice Guide on Public Sector Governance*, Vol 2, Guidance Paper No.6, July 2003.

Examples of ANAO audits that address conflicts of interest

Two recent audits tabled by the ANAO addressed this particular issue. The audit of Defence Housing and Relocation Services released last month recognised that the Defence Housing Authority (DHA) is a commercial body and that the Department of Defence is in most respects its client. Yet Defence had many representatives on the DHA board. The ANAO, therefore, recommended that:

Defence consider reviewing, and providing advice to the Government on, the provision in the *Defence Housing Authority Act 1987* for Defence officers to be appointed to the DHA board, in view of the potential conflict of interest that such appointments create for those officers.

The Department of Defence accepted this recommendation.

The ANAO's report on Magnetic Resonance Imaging Services²² examined 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.²³

OECD guidelines for managing conflicts of interest

An Organisation for Economic Co-operation and Development (OECD) report released in June 2003 provided guidelines for managing conflicts of interest in the public sector.²⁴ It noted that such conflicts of interest have become a major matter of public concern world-wide. This is especially due to the existence of new forms of relationship that have developed between the public sector and the business and non-profit sectors, that give rise to increasingly close forms of collaboration. These include public/private partnerships, self-regulation, interchanges of personnel, and sponsorships.

The OECD also noted that the objective of an effective Conflict of Interest policy should be 'to maintain the integrity of official policy and administrative decisions, and of public management generally, recognising that an unresolved conflict of interest may result in abuse of public office'.²⁵ To do so, it must:

seek to strike a balance, by identifying risks to the integrity of public organisations and public officials, prohibiting unacceptable forms of conflict, managing conflict situations appropriately, making public organisations and individual officials aware of the incidence of such conflicts, ensuring effective procedures are deployed for the identification, disclosure, management, and promotion of the appropriate resolution of conflict of interest situations.²⁶

The OECD identified four core principles that public officials should observe when dealing with conflict of interest matters, in order to promote integrity in the performance of official duties. These were:

- serving the public interest;
- supporting transparency and scrutiny;
- promoting individual responsibility and personal example; and
- engendering an organisational culture which is intolerant of conflicts of interest.

These principles for managing conflicts of interest are consistent with, and supplement those principles discussed earlier that support good governance more broadly and are articulated in the guide.

The OECD then outlines a policy approach to dealing with conflict of interest. Figure 11 lists the key functions of this approach.

Figure 11: OECD guidelines for public sector entities to develop policies to deal with conflicts of interest

- Definition of the general features of conflict of interest situations which have potential to put organisational and individual integrity at risk.
- Identification of specific occurrences of unacceptable conflict of interest situations.
- Leadership and commitment to implementation of the Conflict of Interest policy.
- Awareness that assists compliance, and anticipation of at-risk areas for prevention.
- Appropriate disclosure of adequate information, and effective management of conflicts.
- Partnerships with other stakeholders, including contractors, clients, sponsors and the community.
- Assessment and evaluation of a Conflict of Interest policy in the light of experience.
- Redevelopment and adjustment of policy and procedures as necessary to meet evolving situations.

Source: OECD, *Guidelines for Managing Conflict of Interest in the Public Service*, June 2003.

As with the ANAO guide, the OECD guidelines do not attempt to cover every possible situation in which a conflict of interest might arise, but instead are designed as ‘a general policy and practice reference that is relevant to a rapidly changing social context. The proposed measures are intended to reinforce each other to provide a coherent and consistent approach to managing conflict of interest situations.’²⁷

3.5 Cross-agency governance arrangements

Background

Cross-agency governance arrangements are becoming more common as public sector organisations and governments seek to address increasingly complex and/or wide-ranging policy and operational issues. Such arrangements are also facilitated by the application of new information and communication technologies that enable the rapid formation of virtual organisations to perform specific policy or operational tasks. Delivering the right mix of outputs to contribute to cross-agency outcomes can therefore require levels of organisation and governance that go beyond traditional forms of coordination and collaboration and which extend into the creation of separate actual or virtual organisations focussed on the joint objectives.²⁸

There is no documented general legal or policy framework for cross-agency governance arrangements in the Commonwealth. However, any such arrangement should meet accepted standards of good governance, including those discussed in the ANAO guide.

Elements of better practice

All cross-agency arrangements should have clear lines of accountability and the responsibilities of the parties should be well identified and understood—responsibility for outcomes should be apparent and unambiguous. It is also important that risks and opportunities are identified and shared in accordance with each agency’s contribution and level of responsibility. Governance arrangements should be initiated as soon as cross-agency issues are identified.

Cross-agency governance arrangements need to match the scale, nature and complexity of the task or activity (see Figure 12). A key determinant is the extent to which the activity falls primarily within the province of one agency or falls more or less evenly across two or more agencies.

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

Figure 12: Forms of cross-agency governance

Types of Activity	Main Types of Cross-Agency Governance Arrangements		
	<p>Lead Agency Single agency leading the project with other partner(s) fulfilling specific, subsidiary roles.</p>	<p>Partnership Equal responsibility and level of involvement for partners, without a separate entity being created.</p>	<p>Joint Venture Creation of a separate entity with detailed terms of reference.</p>
<p>Policy Development Formulation of major new policy position. Cross-agency governance appropriate where policy risks are high.</p>	<p>Appropriate where the policy issues are centred in one agency, with some involvement of others. Especially appropriate where delivery agencies are to be involved in policy development phase.</p>	<p>Appropriate where the core policy issues extend across two or more agencies. May also be useful where different agencies' perspectives need to be resolved.</p>	<p>Generally not necessary unless it is anticipated that the policy development process will lead to the establishment of a separate, ongoing entity with programme design and/or implementation responsibilities.</p>
<p>Programme Design Detailed design phase after principal policy decisions have been taken. Cross-agency governance appropriate where the design phase is lengthy and detailed.</p>	<p>Appropriate where the programme is primarily the concern of a single agency. Can be fairly informal.</p>	<p>Appropriate where the programme is evenly shared across two or more agencies.</p>	<p>Generally not necessary.</p>
<p>Programme Delivery Policy implementation, including direct delivery and/or contract management. Cross-agency governance appropriate where multiple policy objectives involved and/or major resource costs are involved.</p>	<p>Appropriate where one agency has prime carriage of most of the programme. May also be appropriate in a purchaser/provider environment where the lead agency (usually the policy department) purchases implementation services from other agencies.</p>	<p>Appropriate where the programme is evenly shared across two or more agencies. May involve partnership agreements sharing resources, responsibilities and risks.</p>	<p>Appropriate when involving a major new initiative that requires a separate entity for implementation. Can be governed by board with representatives of relevant agencies.</p>

Source: ANAO, *Better Practice Guide on Public Sector Governance*, July 2003.

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

- the objectives of the arrangement, including desired outcomes, and timeframes;
- the roles and responsibilities of the parties, including their capacity to contribute, and positions on governing boards or committees;

- the details of the activity, including specifications of services or projects to be undertaken;
- resources to be applied by the parties and related budgetary issues;
- the approach to identifying and sharing the risks and opportunities involved;
- agreed modes of review and evaluation; and
- agreed dispute resolution arrangements.

It is important to realise that practice in this area of public administration is still developing, and to some extent the application of better practice is a matter of trying out innovative and flexible arrangements that address the specific policy or operational circumstances.²⁹

Examples of APS cross-agency governance arrangements

FACS/Centrelink Business Partnership Agreement (BPA): Centrelink is the primary agency delivering FACS' income support and related services. In 2001–02, Centrelink delivered pensions, benefits and other services totalling \$56 billion, at a cost to FACS of \$1.7 billion. The relationship between FACS and Centrelink is governed by a BPA, which acknowledges joint responsibility for performance. The BPA outlines the roles and responsibilities of the two parties. FACS is responsible for providing Centrelink with appropriate policy advice, direction and funds to enable effective service delivery, and Centrelink is responsible for implementing strategies for payment control as part of its approach to service delivery.

A recent ANAO audit report examined 'The Strategic Partnership Agreement between the Department of Health and Ageing and the Health Insurance Commission (HIC)³⁰. This is a cross-agency governance arrangement in which a joint Senior Management Committee oversees the 'Agreement'. 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.³¹

PART 4: COMMENT ON ISSUES AFFECTING THE GUIDE

This Part is a brief discussion of:

- major recent Australian public sector governance developments and, moreover, some imminent developments that the ANAO guide has not been able to incorporate; and
- the way the ANAO may use the guide (and other resources) to audit public sector governance.

4.1 Recent and imminent developments affecting public sector governance

As I mentioned earlier, the guide has been released at a time of considerable activity, in terms of the number of reviews of governance in Australia, as well as the preparation of relevant guidelines and legislation. To incorporate such developments, the ANAO will update Guidance Papers in Volume 2 of the guide.

The ANAO guide has been able to take account of recent governance releases, such as the Australian Stock Exchange *Principles of Good Corporate Governance and Best Practice Recommendations* and the suite of Australian standards on corporate governance from Standards Australia International.

However, we decided not to delay the release of the guide to incorporate the forthcoming release of the Uhrig Committee *Review of corporate governance of Statutory Authorities and Office Holders* and the Commonwealth Government's *Corporate Law and Economic Reform Program (CLERP 9)* legislation because of the uncertainty of the timing of final Government/Parliamentary decisions on those matters. It also precedes the international harmonisation (adoption) of accounting and auditing standards.

Review of governance of statutory authorities and office holders

On 14 November 2002, the Prime Minister announced a review into the governance of Commonwealth statutory authorities and office holders in order to improve their accountability frameworks and overall performance.³² The review was undertaken by Mr John Uhrig AC, and reported to the government in July 2003. The government is expected to release the report, and to provide an initial response to it, in the near future.

The Uhrig review focussed on select group of agencies that have significant impacts on the business community. These include: the Australian Taxation Office; the Australian Competition and Consumer Competition; the Australian Prudential Regulation Authority; the Reserve Bank of Australia; the Australian Securities and Investments Commission; the Health Insurance Commission and Centrelink.

It addressed the following issues:

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

In addition to analysing existing governance arrangements, the review also addressed the selection process for board members and office holders, the mix of experience and skills required by boards, their development requirements, and their relationship to Government.

An expected outcome of the review is the development of a broad template of governance principles for statutory bodies. The Federal Government may consider extending these principles to other public sector bodies than those originally scheduled for review. It may also decide to develop best practice governance structures, including

formal accountability and risk management requirements. However, this is only conjecture on my part.

As a second stage to the process, and following the review, the Government is expected to assess statutory authorities and office holders against these principles. Reforms are likely to be undertaken on a whole-of-government basis.

Corporate Law Economic Reform Program 9 (CLERP 9)

Late last year, the Treasurer and the Parliamentary Secretary to the Treasurer released a policy paper aimed at seeking stakeholder comment on Government proposals aimed at achieving further improvement in audit regulation and the wider corporate disclosure framework (Corporate Disclosure – Strengthening the Financial Reporting Framework—CLERP 9).

The Government is expected to issue draft legislation shortly, based on this paper and associated stakeholder comment. The draft legislation is likely to also take into account relevant recommendations of the HIH Royal Commission, the work undertaken by the Joint Committee of Public Accounts and Audit (JCPAA), and developments overseas.

Consideration will need to be given to updating the guide to include the intention of this legislation and its impact. However, the ANAO recognises that this will be only be one further step in the development of governance legislation in Australia, as the Parliamentary Secretary concluded his address to the ASIC Summer School in March 2003 by stating that:

‘.. CLERP 9 won’t be the end of corporate law reform in Australia. I have already started work with Treasury officers and other stakeholders in developing a further number of chapters in the CLERP program. There is still a lot of work to be done to ensure that we keep improving Australia’s corporate regulatory environment with a view to making this a world-renowned place to do business with, a well informed market place with high levels of participation and a place that is very welcoming to international capital’.³³

Based on the Government’s policy paper (which reflected its response to the Ramsay report on the Independence of Australian Company Auditors), CLERP 9 may reform corporate laws affecting the following seven areas:

- the effectiveness of accounting standards and a proposal that Australia adopt international accounting standards by 2005;
- the regulation of accounting standards and practices;
- the audit function in Australia, including:
 - the market for audit and non-audit services;
 - the institutional framework for setting auditing standards and whether they should be given the force of law;
 - the rules and practices governing the audit engagement including appointment and removal of auditors and related governance arrangements;
 - auditor independence issues canvassed in the Ramsay report;

- the structures for oversight of the profession, including disciplinary powers, ethical rules, external quality assurance, educational requirements, professional development, competency standards etc; and
- liability issues, drawing on current work in the context of public liability and medical indemnity insurance, including the question of incorporation of auditors;
- the present continuous disclosure regime;
- conflicts of interest in relation to the provision of financial product advice;
- the current disclosure requirements for shares and debentures; and
- ways to encourage investors to become more active in the companies they invest in.³⁴

The Treasury received around sixty submissions on the policy paper. The April edition of CA Charter³⁵ gave a snap shot of the key issues arising from those submissions it had access to, as follows:

An Expanded Financial Reporting Council (FRC)

The proposed expansion of the responsibilities of the FRC drew the widest range of comments and while most agreed with the principle of some form of audit oversight there was a consistent theme regarding the need to improve the transparency and accountability of the FRC, particularly if it is to have an expanded role. Also the proposal to bring the Auditing and Assurance Standards Board (AuASB) under the auspices of the FRC caused concern given the AuASB's role in providing guidance in areas other than the auditing of general purpose financial statements. In addition, a concern emerged that the nature of auditing standards as a principle-based guidance did not lend itself to regulation by 'black letter law'.

Audit Quality

Many submissions stressed that the proposals should only apply to listed companies and their auditors, not to all audits required under the Corporations Act. An annual declaration of auditor independence was supported, as was the enhanced disclosure of non-audit services fees, including a statement in the annual report covering the impact of specified non-audit services on audit independence. There was unanimous support for compulsory audit committees for the top 500 listed companies. However, there was only limited support for the rotation of audit partners and review partners after 5 years.

Auditor Liability

Submissions generally expressed support for the incorporation of audit firms and for the adoption of proportionate liability.

Enforcement

While there was support for extending the matters on which that auditors are required to report to ASIC, many submissions questioned the likely effectiveness of the requirement. As regards the institutional arrangements for the Companies Auditor Liquidators Disciplinary Board, most submissions agreed with the proposals but rejected

the notion that the Board consist of a majority of non-accountants given the technical nature of the issues raised.

International Harmonisation of Accounting and Auditing Standards

Another issue affecting public sector governance in Australia is the harmonisation (or adoption) of international accounting standards. This issue was not covered in the recent ANAO guide, but may be covered in future updates.

Company boards and audit committees should be well aware of the decision announced by the FRC in July 2002 to work towards implementing the International Financial Reporting Standards (IFRS) in Australia for the financial years commencing on, or after, 1 January 2005³⁶. The FRC is established under the *Australian Securities and Investments Commission Act 2001* and is the peak body responsible for the broad oversight of Australia's accounting standard setting process for the private, public and not-for-profit sectors.

The FRC supports the Australian Accounting Standards Board (AASB) and the AASB's work towards harmonising its standards with those of the International Accounting Standards Board (IASB). The FRC recently required the AASB to refer to the adoption of international standards. Following the announcement by the FRC, the AASB announced its convergence (now adoption) strategy, which includes the decision to continue to issue one series of sector-neutral Standards applicable to both for-profit and not-for-profit entities, including the public sector³⁷. No one pretends that the transition will be easy. Some critics have raised issues about the costs involved, as well as the resulting quality of accounting information and its contribution to good governance.^{38 39}

From a private sector viewpoint, a single set of high quality accounting standards which are accepted across major international capital markets would greatly facilitate cross-border comparisons by investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas. From a public sector perspective, it would aid transparency and accountability. In particular, over time, such standards would facilitate an improved comparison between the operations of the public sector and private enterprise for those functions and services that could be provided by either group, whether in partnership or separately. A single set of high quality auditing standards would also enhance the reputation and credibility of the auditing profession and help restore public confidence in it.

There is no room for complacency in meeting the timetable for the adoption of international accounting standards by 1 January 2005. For accounting purposes (to have at least one year of comparative information), this effectively means that most organisations will have had to make the shift to the new framework by 1 July 2004. Indeed, the former Chairman of the Australian Accounting Standards Board has expressed the view that boards and audit committees should have a standing agenda item dealing with the transition, especially given the proposed requirement for comparative figures for the first reporting period.⁴⁰

This is a major issue for the public sector. It will be a significant challenge for agencies to meet these tight timeframes. Indeed, their ability to do so will depend in large part on the extent to which agency audit committees have come to terms with the implications of the revised standards for governance and reporting. At the Federal Government level, the onus is particularly on the Department of Finance and Administration, in conjunction

with the ANAO, to provide suitable guidance material, as well as organise timely awareness-raising web-based and face-to-face information sessions, such as implementation workshops.

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

‘The Board should pursue as an urgent priority the harmonisation of Government GFS and GAAP reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements’.⁴¹

Turning briefly to the area of auditing standards, under the CLERP 9 proposals the Government is seeking to expand the responsibilities of the FRC to oversee auditor independence requirements in Australia, including auditing standard-setting arrangements. The latter will be achieved by reconstituting the existing Australian Auditing and Assurance Standards Board (AuASB) with a government appointed Chairman under the auspices of the FRC. Auditing standards will have the force of law on the same basis as accounting standards.⁴² The Professional bodies have some difficulties with these latter proposals, noting that auditing standards already have the force of law through the Companies Auditors Liquidators Disciplinary Board (CALBD) under the Corporations law. As well, ‘Australianising’ auditing standards having specific Corporations Act backing would undermine the aim of harmonisation with International Auditing Standards.⁴³

4.2 Using the guide to audit governance of APS organisations

Role of audit in improving governance

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

The main roles for the ANAO in the governance framework are to provide assurance about conformance and performance and advice on change and its impacts across the

public sector. This advice draws on a broad range of audit experiences, which increasingly involve activities undertaken by both the public and private sectors. The statutory independence of the Auditor-General, as well as access to expertise across all Commonwealth departments and agencies, gives public audit a unique position within the accountability framework. In this regard, the ability of my office to investigate and report, freely and fearlessly, is crucial.

The ANAO provides this assurance and advice through the suite of audit products outlined earlier—namely financial statement audits, performance audits, business support process audits, protective security audits and benchmarking studies.

Approaches to auditing public sector governance

The ANAO typically audits public sector governance by assessing how governance structures and practices influence the ability of organisations to achieve their stated objectives. In this way, the achievement of objectives is the main focus of audits, not the adequacy of governance processes and practices, *per se*.⁴⁴

As a result, virtually all ANAO audits examine some aspects of public sector governance, most particularly performance monitoring, risk management and system control. However, few ANAO audits cover the entire range of governance arrangements in APS organisations. The main reason is that not all elements of governance contribute substantially to the objectives being examined in audits. Consequently, some elements may be excluded from the audit criteria and evidence collection process.

ANAO performance audits are typically quite comprehensive, collecting a wide range of information and undertaking extensive analysis to support findings and recommendations. To make audit examinations and reporting timely and manageable, audit topics usually focus on quite specific elements of an organisation's operations. Particularly for larger APS organisations, it is not feasible for the ANAO to undertake audits that would examine all aspects of their governance. For example, an audit of 'the effectiveness of all elements of Centrelink's governance framework in enabling it to achieve its stated outcomes and outputs' would be an enormous undertaking. The ANAO considers that better value is achieved by targeting specific topics of apparent concern or importance to the agency and its stakeholders. As necessary, the wider picture can be built up with a series of audits over time.

The ANAO constantly seeks to enhance its audit coverage of public sector governance. In the future, it is likely that we will increase our audit focus on higher level governance arrangements, including examining board charters and the relationships between boards, management and possibly Ministers. The ANAO may also examine the general implementation of governance principles across a number of APS organisations, especially of accountability, transparency and ethical behaviour.

The implications of current developments in governance, especially the Uhrig review and CLERP 9 legislation, are likely to have an impact on the ANAO's forward performance audit work program. This may involve some audits of internal audit performance, including the independence issues. In that respect, I should note that the ANAO is undertaking a follow-up of its 1997 audit of Internal Audit expected to commence in the near future, with completion in this financial year.

Example of ANAO ‘governance’ audit: *Corporate Governance in the Australian Broadcasting Corporation (ABC)*

The best recent example of a holistic governance audit undertaken by the ANAO, was the performance audit on Corporate Governance in the Australian Broadcasting Corporation.⁴⁵ I will briefly outline some of the major observations of that audit.

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

- 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 were better defined, giving rise to a common understanding of the roles and responsibilities of the various parties;⁴⁶
- 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;⁴⁷
- 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;⁴⁸
- 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;⁴⁹ and
- suggested the Board consider developing a written statement of its own governance principles and how these principles might be monitored.⁵⁰

Other relevant comments are as follows:

Accountability: requires a full, transparent account of performance, particularly in relation to the functions, powers, duties, privileges and resources approved by the 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.⁵¹

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.⁵²

Internal Control: the internal control and accountability arrangements have been strengthened as part of the planning framework, and a new internal budget setting process that better aligns with Corporate Plan objectives and strategies enables the Board and the Managing Director to take strategic and informed decisions on the allocation of resources against defined priorities and performance standards.⁵³

PART 5: CONCLUDING REMARKS

This year is shaping up to be one of the busiest on record for providing guidance on corporate governance and public sector governance. Not only has the ANAO released our latest better practice guide, but also within Australia the Australian Stock Exchange, the Australian Chamber of Commerce and Industry, Standards Australia and the HIH Royal Commission have also provided guidance. Importantly, we are also awaiting the release of the Uhrig Review and CLERP 9 draft legislation.

These guides, and legislation, can be used by individual public sector agencies to tailor and refine their governance practices. They will also influence the ANAO's future audit work program and audit approach. However, despite the importance of these developments, they are not likely to alter the key determinants of better practice in this area.

As I have been emphasising in recent years, the APS generally has in place appropriate governance frameworks, their elements and relevant policies. However, effective implementation is the ultimate key to success. Effective implementation requires the robust application of governance principles and behaviours. In particular, openness, integrity and effective communication are vital pre-requisites of good 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 goals and objectives and required performance levels.

Importantly, such behaviours, and the standard of governance itself, are strongly affected by the leadership of an agency—its tone at the top. This responsibility to behave in a manner that supports good governance outcomes falls to both CEOs and boards and, preferably, seamlessly to staff and other stakeholders. Nevertheless, all officers need to contribute to governance outcomes—relating to both conformance and performance. To do so effectively, they must be aware of their legal and other corporate responsibilities. As in all aspects of organisation management, good communication is an essential ingredient for success.

While these broad statements tend to simplify the governance task, we know that many complexities arise in practice. These often involve managing relationships between the various major stakeholders, be they directors, senior executives and Ministers, or with other government agencies, clients or the general community. In many cases, appropriate protocols can assist public sector governance by clearly specifying roles, responsibilities and policies and by providing effective review and complaint mechanisms.

This approach forms the basis for the ANAO's Better Practice Guide on Public Sector governance which we have just released. This was a collaborative project which owed its success to a wide range of interested participants to whom we are most grateful. Particular thanks are due to my own people who have been very professional in their approach and committed to a useful outcome. As well, it has been a learning process for all concerned. This has made the project all that more rewarding.

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