Address to the Defence Audit and Program Evaluation Committee

Corporate Governance

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Pat Barrett
Auditor-General for Australia

Australian National
Audit Office

Corporate Governance

The major elements of corporate governance have been in place in the APS for most of the last decade or so. As the terminology suggests, the concept is basically about how we 'govern' our organisations to achieve required performance and satisfy our stakeholders. As Trevor Sykes of the Australian Financial Review stated in an interview with the Chartered Institute of Company Secretaries in Australia:

> *'Expressing the sentiments of corporate governance is dead easy … What is going to be harder is making it work, putting flesh on the bones'* (Australian Company Secretary, Vol.50, No.2, March 1998)

I therefore do not expect to be telling you something you do not already know but see this presentation as an opportunity to share and reinforce an understanding of a contemporary range of relevant issues to promote a more effective dialogue and exchange of views in the future.

The Defence mission and objectives make corporate governance in the Department a major and complex task, particularly given its size and its diverse nature and dispersed locations. I know that management of Defence's fourteen programs is shared by the Secretary and the Chief of the Defence Force. I am also aware of the establishment of the Defence Executive as Defence's highest-decision making body comprising all ten of the organisation's senior managers along with the Commander, Support Australia (COMSPTAS). These approaches are important elements of the governance framework and require clear understanding of the roles and responsibilities of those involved.

Effective public sector governance requires leadership from the executive management of agencies and a strong commitment to quality control and client service. Corporate governance is basically concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes. Major elements are business planning, risk management, performance monitoring and accountability. The framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outcomes.

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At the present time there would undoubtedly be questions about effectiveness of the various elements within and across agencies. In particular, there would be a general concern as to the extent to which such elements are effectively integrated into a coherent corporate approach by individual agencies and well understood and applied throughout those agencies. The issue is not simply about creation of appropriate committee structures or the way in which they work. The requirement is to promote understanding and commitment and more disciplined systems which assist better communication and provide greater confidence and assurance across the organisation.

You would be aware of the concerns and initiatives in the private sector about corporate governance. These have been reinforced by corporate failures and the requirement of the Australian Stock Exchange to report on corporate governance in corporate annual reports. While debates about corporate governance in the private sector have often been about power and who exercises it, there is a growing recognition that the concept is more about finding ways to ensure that decisions are made effectively in a 'governed' rather than 'managed' sense. In the words of one Harvard-based lecturer:

> *'Governed corporations have more robust, pluralistic and adaptable decision-making processes. There are more new ideas. The oversight process is less personalised; it focuses not on the competence of the CEO but on the effectiveness of the organisation. … The policies of the governed corporation make the organisation accountable to its markets'.* (John Pound, Harvard Business Review, March-April 1995)

In a paper entitled *'Applying Corporate Governance Principles and Practices to Budget Funded Public Sector Agencies'* the ANAO pointed to the advantages of the APS adopting or adapting these principles and practices for better management performance in the APS. The paper recognised the differences between the responsibilities of Chief Executive Officers (CEOs) in agencies covered by the *Financial Management and Accountability Act* (FMA) and those by Boards under the *Commonwealth Authorities and Corporations Act* (CAC). The latter, of course, have more in common with private sector corporations.

The ANAO is currently looking at preparing another paper on corporate governance for CAC bodies. This would build on the earlier paper prepared by the then Department of Finance entitled *'Governance Arrangements for Commonwealth Government Business Enterprises'*. Similar papers have been prepared by the New South Wales Audit Office covering public sector governing and advisory boards and by the New Zealand Audit Office and the Audit Commission in the United Kingdom. In the last year the ANAO has also produced two audit reports covering

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corporate governance in the Australian Tourist Commission (No.10 of 1997-98) and in the Australian Electoral Commission (No.1 of 1998-99).

There is no doubt that increased attention is being given to corporate governance as a result of the passage earlier this year of the FMA and CAC Acts. As well, the more principles-based legislation relating to workplace arrangements and the proposed new Public Service Act have also reinforced the need for such attention in a more devolved control (authority) environment. The emphasis is now very much on personal responsibility starting at the level of the CEO. Not surprisingly, this has focussed attention on personal sign-offs to the CEO, and so on to other organisation levels including in the normal hierarchical delegations for particular areas of responsibility by particular individuals, including for <u>financial</u> performance.

It is important to note that it is not the action of signing-off that creates the assurance. It is what underlines (or what underpins) the sign-off that is important, including endorsement of that underpinning and its acceptance by those who rely on it. Instructions, guidance and user-friendly information systems are essential in this respect and integral to good corporate governance. Therefore the exercise of responsibility and associated sign-offs are integral to the corporate structure with its agreed objectives, strategies and performance measures.

As you would know, there have been concerns expressed by Parliamentary Committees and by individual parliamentarians in debates about appropriate accountability mechanisms in an era of devolved authority. But this is not simply about administrative processes. It is primarily about attitudes of mind and a different public service culture. That is the underlying concern. It is necessary to ensure that the various elements of corporate governance can be drawn together in a way that the people involved understand and therefore support the need for a more cohesive approach to corporate governance. We are learning from experience as the earlier papers referred to indicate.

Corporate governance is largely about organisational performance. Importantly, it is about people taking individual and collective responsibility for that performance. It is also about identifying the various stakeholders involved and meeting their requirements. It is therefore not surprising that discussions about corporate governance focus on leadership, strategic direction, clients and reporting. From an internal point of view there has been international and national attention given by the private sector to issues of control structures, including the development of a robust control environment both for internal and external assurance. It is important to recognise that such control structures are the means of developing a more credible corporate governance framework and are not ends in themselves.

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The APS has developed reasonable control processes for its policies and procedures over many years. In particular, as public servants, we have been quite concerned to ensure that we have met the requirements of relevant legislation. However, we have not been as effective in constructing robust control structures aimed at assuring that we achieve defined outputs and outcomes, nor in providing efficient client-oriented services. The latter now involves addressing government programs/services to public sector clients, as citizens, and not the other way round. This focus is being reinforced by the requirement for Public Service Charters which should clearly signal to all concerned what our client groups can expect of an agency and its staff. While the program management and budgeting framework has required us to address such issues over the last decade or so, it is likely that the intended move to accrual-based budgeting for outputs and outcomes in 1999-2000 will be the catalyst that ensures we have the necessary links in place. And that is how we will be judged.

The changed budgeting arrangements will also put further pressure on managers to define more clearly measurable performance outputs and outcomes. This will require greater attention to costing and pricing methodologies including the rediscovery, for many of us, of management and cost accounting. Importantly, it will mean that managers generally at all levels will have to become familiar with such methods and techniques. As has already occurred, there will be a greater focus on financial reporting on an accrual basis and the links with the costing structures. The challenge is more for managers than accountants in coming to grips with this environment.

An important element of any control environment is robust monitoring and review. However, such an environment is directly dependent on the clear definition of performance measures and their acceptance by all those responsible for them. We will need to identify both the financial and non-financial drivers of agency business. This will involve the use of techniques such as the balanced scorecard approach promoted in the Management Advisory Board's (MAB) publication *'Beyond Bean Counting'* (December 1997). In MAB's words:

> *'The scorecard ….. complements the financial measures with operational measures on customer satisfaction, internal processes, and the organisation's innovation and improvement activities - these operational measures are drivers of future financial performance'.* (page 50)

The scorecard approach underlines the importance of the various linkages and their understanding and management such as between strategy and

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operations, budgets and performance. It also requires that attention be given to <u>measuring</u> performance where practicable and to articulating a credible basis for <u>assessing</u> qualitative or so-called 'soft' indicators of success. A parallel is the distinction between price and value for money. And they can be quite different as many Defence projects would indicate.

With the greater convergence of the public and private sectors there will be a need to focus more systematically on <u>risk management</u> practices in decision-making that will increasingly focus on cost, quality and financial performance. Similar pressures will come with the advent of the move to electronic commerce and the greater use of the internet for business purposes. In turn, these will put increasing pressure on management of our information systems and systems controls. Good corporate governance should ensure that not only are the needs of the individual managers for useful information met effectively, but also that timely and relevant corporate information is provided to allow an assessment as to whether the program/activity results are consistent with agreed corporate requirements and add to overall corporate performance.

And this brings us back to control structures both as an important accountability tool and as an aid to maximise our performance. Such structures should aim to achieve maximum integration of information technology based systems and be focussed on user needs at all levels of the agency. Robust audit trails are as important for management assurance and reliance as they are for external audit purposes in relation to fraud control and financial reporting. There will continue to be a requirement for evaluation, preferably involving independent assessment, as an effective means of assessing performance and providing required assurance to all stakeholders in a more devolved control environment. These will be important areas for executive management to review and promote, assisted by a proactive audit committee. The latter would benefit from a close relationship with both internal and external audit. The 'independence' factor is an important element of good corporate governance.

I have noted the formation of a new top management structure which will be called the Defence Executive which is to be Defence's highest decision-making body. Importantly, I also note the guiding principles which focus on professional excellence, ethics, integrity, fairness, accountability, openness, trust and loyalty. These are essential elements of a robust corporate governance framework. They also highlight areas of difference between the public and private sectors. It was very useful for the public service values to be included in regulations while the Public Service Bill is stalled in the Senate. Such values and their ethical consequences need to be embedded in the public sector culture. As well, the issues of openness and transparency have to be accepted as essential elements of public sector accountability. The APS has to act both in the public interest and avoid conflicts of interest. These will be particular challenges for agency

managers in establishing credible corporate governance frameworks within public sector agencies that are increasingly being asked to act in a more private-sector manner.

In summary, good corporate governance should result in good performance. Whatever framework we choose to put in place, we need to ensure that it will facilitate required outcomes no matter how they might be specified. Good processes are required to achieve good outcomes. They are not alternatives. And they do not occur by accident. In relation to a recent survey of the United States Government's *Performance and Results Act 1997*, the General Accounting Office (GAO) stated that:

> *'Significant performance improvements are possible when an agency adopted a disciplined approach to results-oriented goals, measuring its performance, and using performance information to improve effectiveness.'*

System and discipline are important means, as are understanding and commitment, to achieving required program outputs and outcomes. The latter are a significant challenge to managers at all levels of an agency, particularly as the APS moves into a more accrual-based accounting and budgetary environment. We need to be 'learning organisations' and ensure we have a culture of continuous improvement accepted and imbedded in our people. A robust corporate governance framework will provide the necessary structures to encourage and facilitate such a culture and promote the confidence, understanding and commitment of the whole organisation to what has to be done and how it will be done consistent with the public service values and ethical system.