DEALING WITH RISKS TO ENSURE GREATER EFFECTIVENESS

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1.   INTRODUCTION

As you are well aware, the theme of this conference is *'Managing Risks when Outsourcing in the Public Sector'*. The focus is on delivering 'cost effective and high quality services'. The latter is where I am directing attention to in this presentation. There is no doubt that outsourcing is a major challenge for most Chief Executive Officers (CEOs) and many managers at all levels of the public service. But outsourcing is basically a means to an end. And it is the ends that are of primary strategic and operational importance to those managers. This priority is reflected in the Government's public service reforms, particularly with the outputs/outcomes focus both on performance and for budgeting.

The question that has to be asked is what stands between managers and the achievement of required results. I contend there has been a growing realisation that a major impediment has been a failure to deal adequately with risk, including recognising risk as an opportunity and not simply something that has to be minimised or eliminated. In this connexion, I was interested to read Richard Humphry's comment to a recent hearing of the Senate Finance and Public Administration References Committee[1] on his independent review of information technology (IT)[2] outsourcing, as follows:

> *The report was produced, at the request of government, on future risk.[3]*

He went on later to observe that:

> *The key interest I have was in identifying risks.[4]*

As I read his report, his overriding concern was to make recommendations as to how best to manage those risks. And that is a concern I share.

My presentation is in four parts along the lines of the outline shown in the conference brochure. To a degree, it is intended to provide a context for the two day discussion with its emphasis on outsourcing as 'one of the fastest growing business solutions that governments around the world are implementing'. Consequently, I will start with a discussion of the changing nature of the 'bottom line' in the public sector with the greater emphasis on commercialisation and contestability, including competitive neutrality, and the greater involvement of the private sector in the delivery of public services. I will then address the issue of risk management within a corporate governance framework which reiterates the importance of taking an integrated approach to dealing with risk from an agency-wide perspective. The message is that risk has to be managed at all levels of an organisation. Ownership does not reside at the CEO, senior management and/or Board levels, even though they should set the 'tone' and overall approach to be taken.

The third part of the presentation takes a realistic look at elements of risk that we need to address in our changing environment. The most significant are project and contract management risks. However, we are also moving to more 'shared arrangements' which is being facilitated, or some might say driven, by the developments in electronic

communications and computing such as the Internet. As with all elements of management decision-making, we also need to think about the costs and benefits of our decisions.

Finally, in my concluding remarks, I will outline some of the important initiatives being taken to promote risk awareness and to develop our capacities and knowledge to deal more effectively with the various challenges it is posing to improve our 'bottom line', both as an opportunity and as an impediment. At the same time, we need to encourage 'ownership' of the aims of, and responses to, these challenges which will be supported by robust corporate governance measures which focus both on control and performance to achieve the required results. In these respects, it is not a case of 'one size fits all' but, rather, applying recognised principles and better practice to your particular situation.

2.   A DIFFERENT BOTTOM LINE - FOCUSING ON RESULTS

In Australia over the past decade, at both the Commonwealth and State level, governments have been confronted by a number of significant pressures affecting their roles and responsibilities. These include:

- globalisation—global pressures to cooperate and compete in new ways;

- technological innovation –new opportunities and risks for service delivery;

- budget restraint—the need to curtail expenditure and reduce deficits (preferably to create surpluses); and

- community dissatisfaction—increasing demands and rising expectations of citizens.

These pressures have meant that traditional forms of public provision have come under increased scrutiny. In response, Australian governments at both the Commonwealth and State levels have been focussing increasingly on achieving a better performing public sector and less costly, more tailored—or better directed—and higher quality services to citizens. A major imperative has been the successful management of change which has become more than a catchcry.

Governments have reacted to budgetary pressures on expenditure and, at the same time, strong demand from the community for the maintenance and even extension of government services, by seeking to make the administrative elements and structures that provide public services more efficient and effective. Accordingly, the Australian Public Service (APS) has been steadily evolving towards a more private sector orientation with a particular emphasis now on:

- the contestability of services;

- the outsourcing of functions which the private sector can undertake more efficiently;

- adapting or adopting private sector methods and techniques, including budgeting and reporting on an accrual accounting basis;

- an accent on continuous improvement to achieve better performance in an environment of devolved authority and greater management flexibility;

- ensuring a greater orientation towards outputs and outcomes, rather than just on process, and the notion of 'market pricing'; and

- direct participation by the private sector in providing public services, even so-called and traditionally regarded 'core services' such as policy advice and determination of citizen entitlements.

Such changes are often described as the 'privatisation' or 'commercialisation' of the public sector. These actions have been seen as addressing weaknesses in the more traditional, centralised and often compliance-based management systems. Nevertheless, there are also problems associated with devolved and decentralised systems, particularly where different organisations are involved in the use of public resources and the delivery of public policies. New frameworks are needed to guide behaviour as these changes do not rely on uniform rules for the management relationship or for ensuring proper accountability for results.

Bob Sendt, my counterpart in New South Wales, has remarked:

> *Governments in Australia have been privatising, corporatising, contracting out and engaging in various forms of partnership with the private sector.*
>
> *Such developments have been justified in many ways:*
>
> - *corporatisation is said to focus management's attention on acting commercially and efficiently and achieving appropriate 'bottom line' results and return on investment;*
>
> - *privatisation and contracting out are said to utilise the comparative advantages the private sector has in certain areas, to take advantage of innovation, to reduce risks to government and the taxpayer and to allow governments to focus on core public services.*
>
> *These arguments have a strong logic to them. However, these developments raise further important questions as to the continuing right of the public – and indeed Parliament – to know that their interests are being met and protected.*[5]

I suggest that for managers in contemporary Australian government, there is still a different, if not changing, bottom line. In other words, as well as their similarities, it is

important to recognise the basic differences between the administrative/management structures of private and public sector entities and between their respective accountability frameworks. The political environment, with its focus on checks and balances and value systems that emphasise issues of ethics and codes of conduct, implies quite different corporate governance frameworks from those of a commercially oriented private sector. It is equally important to recognise that the diversity of the public sector is also likely to result in different models of corporate governance. That is, one size does not fit all, even though there will be common elements of any such models.

The values, standards and practices that underpin corporate governance in public sector agencies flow from peak public service values, obligations and standards, which in turn are derived from legislation, policy and accepted public service conventions. Codes of conduct and ethical behaviour emanate from such sources. And they are an important element in the fight against fraud and corruption. These elements are constantly linked with the notion of the 'public interest'. The latter term has always been difficult to define or measure in any generally agreed fashion, except that it is very real to the Parliament and public servants, as well as to the ordinary citizen. In short, everyone seems to know when the public interest is not being followed, at least from his or her individual point of view. Section 37(2) of the *Auditor-General's Act 1997* sets out the reasons that disclosure of information would be contrary to the public interest and are instructive, in that sense, on this difficult concept.

The issues of openness and transparency have to be accepted as essential elements of public sector accountability. The public sector has both to act in the public interest and, in common with the private sector, 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. However, as with the latter sector, greater emphasis has to be placed on performance rather than mainly on conformance (process accountability), although the question is again one of balance according to the circumstances of the agency.

It has been increasingly recognised in both the private and public sectors that appropriate corporate governance arrangements are a key element in corporate success. They form the basis of a robust, credible and responsive framework necessary to deliver the required accountability and bottom line performance consistent with the organisation's objectives.[6] Attention to the principles of corporate governance requires those involved:

- to identify and articulate their responsibilities and their relationships;

- to consider who is responsible for what, to whom, and by when; and

- to acknowledge the relationship that exists between stakeholders and those who are entrusted to manage resources and deliver outcomes.

A major impetus for the changes we are seeing has been the fundamental questioning of what government does, or should do, allied with a perception of inefficient (costly) and ineffective (lacking client focus) delivery of public services owing to its monopoly provision and/or other constraints of public sector administration. It is no longer appropriate for the APS to have a monopoly in service delivery. It must prove that it can deliver government services as well as the private or non-profit sectors. Put simply, a common view is that public services would be provided more efficiently and effectively, with greater client satisfaction, in a more market oriented environment which provided greater flexibility for management decision-making and the discipline of competition.[7]

These developments have raised questions about just what constitutes 'core' public services as opposed to non-core ones. The short answer is that any definition of core government seems to be constantly changing with privatisation of many public services over recent years, including even those that would be considered to be traditional public services such as policy, including legal, advising, corporate management and delivery of welfare services.

The Minister Assisting the Prime Minister for the Public Service has stated that the Government's objective:

> *…has been to focus the APS on its core activities of policy development, legislative implementation and the contracting and oversight of service delivery.* [8]

That is, these are the functions that the Government considers can, and should, be performed and delivered only by government. The Prime Minister has offered the following list of those activities that he considers fall within this realm:

> *Defence, justice, a social security net, the monitoring of outcomes of, and alternatives to, existing policies—all these will require public service output. And there will also be a real need for high quality economic, constitutional and other policy advice.* [9]

Within such definitional bounds, just how small the core public sector can become without jeopardising the public interest is still open to debate. A broader question is what is the sustainable critical mass necessary to retain a credible and effective public sector as part of sound democratic governance in the longer term. If we talk in terms of the outright limits on the extent of the public sector, we should take note of the Prime Minister's observation that:

> *… no matter how radical anyone's view is about the role of government in the twenty-first century, I believe there will always be an irreducible minimum of public service functions.* [10]

The Auditor-General of Queensland, drawing on D.F Kettle, refers to six core characteristics of what he refers to as the global public sector.[11]

Productivity	*How can governments produce more services with less tax money?*
Marketisation	*How can governments use market style incentives to eradicate the pathologies of government bureacracy? Marketisation seeks to replace traditional bureacratic command-and-control mechanisms with market strategies, and then rely on these strategies to change the behaviour of program managers.*
Service orientation	*How can governments better connect with citizens? Reformers have tried to put citizens as service recipients first.*
Decentralisation	*How can governments make programs more responsive and effective? In many nations, the reform strategy has decentralised many programs to lower levels of government.*
Policy	*How can governments improve their capacity to devise and track policy?*
Accountability for results	*How can governments improve their ability to deliver what they promise? Governments have tried to replace top-down, rule –based accountability systems with bottom-up results-driven systems.*

Such characteristics of contemporary governance and public administration reflect the different demands that are being made on public sector managers, including on what they do and how they do it. They are also raising questions about accountability, not least about who is accountable for what, as I noted earlier, particularly in an outsourcing situation. While the often repeated Parliamentary view is that accountability cannot be outsourced, questions are being asked about the practability of that requirement where there is little or no public sector involvement in the activities and/or relevant expertise available in the agency concerned.

Triple bottom line

Within the foreseeable future we can expect to see an emergence and consolidation of new modalities of accountability. One example is the so-called *Triple Bottom Line*. A recent article suggested that the current socio-legal construction of accountability in the business world – and I would include government operations in this category – is on the threshold of a major paradigm shift [12]. Public and other stakeholder expectations in an increasingly globalised business and communications environment will, according to the article's author and other proponents of the Triple Bottom Line (TBL), provide the drivers for a shift away from traditional *input-output* based model of accountability towards a focus on *economic prosperity, environmental quality and social justice.*[13]

TBL goes beyond the current orthodox focus on financial performance (in the narrow sense of profit and loss), the utilisation of inputs and the disposition of outputs, and probity (expressed as conformance with applicable law and the minimisation of liability) to also take into account the environmental and social consequences of business activity. In part, this view is supported by the passage of 'right-to-know' legislation. As well, new corporate governance rules are challenging the traditional non-disclosure or low-disclosure policies of companies and are, consequently, giving rise to new expectations and standards of transparency. One could speculate about the effects of the greater spread of shareholding generally and the impact of large size Management and Superannuation Funds, particularly when their holdings are sufficient to gain a seat or seats on Corporate Boards.

TBL reporting could lead to changes to the manner in which public and private sector organisations report performance and discharge their accountability to their stakeholders. The concept of sustainability requires new definitions of performance and the re-articulation of organisational goals. In the private sector, this would involve some balancing of environmental and social considerations against profitability. The bottom line for the public sector is often diffuse with a range of sometimes apparently conflicting objectives and, consequently, balances have to be struck at points in time and over time. An important aspect for both sectors is management of reputation, which is an all-pervasive issue for performance assessment. A degree of 'trust and confidence' is essential for a sustainable future particularly where the general community is placing some value on corporations' meeting broader 'social' goals.

3.   ADDRESSING RISK MANAGEMENT IN A CORPORATE GOVERNANCE FRAMEWORK

The changing nature of governance

It is necessary to look at corporate governance frameworks in the public sector in the context of the changing nature of governance. The World Bank says simply:

> *Governance is the exercise of political power.* [14]

All those engaged in, or who deal with, government recognise the significance, and implications, of this observation. It is central to the differences between the public and private sectors of any economy, an important element of which is the philosophic/values-based judgements that are often made by government in dealing with citizens.

The World Bank goes on to note the characteristics of 'good governance' are an efficient public service; an independent judicial system and legal framework to enforce contracts; the accountable administration of public funds; an independent auditor, responsible to a representative legislature; respect for the rule of law and human rights at all levels of government; a pluralistic institutional structure; and a free press. Thus governance is a wider concept than government, particularly in many countries with the growing

involvement of the private sector in the activities of government, including service delivery and even policy advising.

Many countries in our region, and indeed most Western democracies, are witnessing significant changes in their governance arrangements as a result of globalisation; greater private sector involvement, both as supplier to the public sector and as a direct provider of public services; and the electronic, including communication, revolution. Comments have been made about 'declining' and 'virtual' government which raise questions about the nature, scope and contribution of public sector management or administration in the future.

One can observe some tensions in the developing systems of governance, as noted by the OECD last year as follows:

> *They are becoming more fragmented as the number and variety of actors increases. There is more interdependence between levels of government as the problems to be addressed become more complex and difficult to resolve unilaterally. Divisions of responsibility for the design, implementation and evaluation of programmes are changing; and the distinction between who finances, delivers and administers is increasingly unclear in many programmes. The search for greater flexibility in managing public programmes can blur lines of accountability. The overall effect is to make inter-governmental relations more complex; and sub-national government a more important partner in the broad patterns of governance.[15]*

The OECD goes on to point out the following set of trade-offs that are demanded in response to this situation:

> *encouraging more <u>autonomy</u> at lower levels of government, while providing overall <u>direction</u>;*
>
> *allowing for <u>differentiation</u> through flexibility yet ensuring some minimum degree of <u>uniformity</u>; and*
>
> *catering for more responsiveness to local needs, but not to the detriment of <u>efficiency</u> and <u>economy</u>. (OECD emphasis)[16]*

Within Australia, there has been a shift from central agency control to a framework of devolved authority with enhanced responsibility and accountability being demanded of public sector agencies and statutory bodies. The legislation, for example, the Financial Management and Accountability Act, the Commonwealth Authorities and Companies Act, the Public Service Act and the Workplace Relations Act, covering financial arrangements for government entities and government business enterprises (GBEs), codes of conduct and workplace relations now reflect this shift. The intention is to allow the APS to manage and respond better to new challenges brought about by the changing environment. This body of legislation, which is principles rather than process based,

provides opportunities for enhanced performance and accountability in the APS; but it can also involve greater management risks, particularly in an environment of devolved authority. It has also helped to heighten public service managers' awareness of the need for good corporate governance.

Australia is not alone in adopting this new policy direction. The changes which we are experiencing are consistent with an international move towards a smaller public sector, greater privatisation[17] and commercialisation of the public sector and an increasing involvement of the private sector in the provision of public services (sometimes in competition with the public sector). This move also involves the adoption, or at least the adaptation, of private sector concepts and approaches in the public sector, as noted earlier.

A major impetus for the changes we are seeing has been the fundamental questioning of what government does, or should do, allied with a perception of inefficient (costly) and ineffective (lacking client focus) delivery of public services due to its monopoly provision and/or other constraints of public sector administration. Implementation of the reform agenda has involved organisational restructuring, business re-engineering, outsourcing, commercialisation, privatisation and/or the transfer or abandonment of functions and services. These actions have been seen as addressing weaknesses in the more traditional, centralised and often compliance-based management systems.

Put simply, a common view is that public services would be provided more efficiently and effectively, with greater client satisfaction, in a more market-oriented environment that provided greater flexibility for management decision-making and the discipline of competition.[18] Indeed, history shows varying support for such a view but with reservations, for example, about market imperfections and public goods arguments – using economic terminology. Nevertheless, some have a quite pragmatic view about notions of clients and markets as the following quote from the OECD indicates:

> *The privileges of governance and the political consequences of disappointing sufficient citizens, therefore, require that governments be more than disinterested facilitators of market exchanges. ... the limits of a government's responsibilities to its citizens are far more extensive than that of delivery performance.[19]*

Such observations inevitably raise questions about the government's role and obligations to its population as citizens, not just as customers or clients of government services.

Devolution of authority has also increased the level of responsibility, and correspondingly the level of risk, exercised by public sector agencies, authorities and/or corporations, with less central control being provided by central agencies such as the Departments of the Treasury and/or Department of Finance and Administration (DOFA). This means that a variety of tasks with traditional corporate governance attributes which were previously undertaken by central agencies and particular specialist groups, are now the responsibility of individual entities.

Consequently, any coordination of activities or sharing of experiences are now matters for individual agencies to arrange between themselves. Reduced central oversight and coordination is problematical as agencies recognise that some interrelationships, such as shared outcomes, are indicative of the need for broader corporate governance arrangements across agencies. Realistically, such arrangements are likely to take some effort to accomplish within a reform environment of devolved authority and personal accountability. Lessons learned from the Council of Australian Governments (COAG) process may provide some guidance to agencies in their endeavours to establish appropriate shared governance frameworks.

The apparent convergence of the public and private sectors has also led to concerns about ethics, as well as issues such as probity, privacy, security, equity and transparency. In this regard, the New Zealand Auditor-General recently observed that:

> *There is a special relationship between the user of a public service and the provider of that service – dependency, the force of law, and a lack of choice are all factors that distinguish public from private services.*[20]

Such differences are important not only in considerations of private sector participation in public sector activities, which are impacting on governance arrangements, but also on the nature and systems of corporate governance. This applies both to individual public sector entities and to their relationships with the profit and not-for-profit private sector organisations that are involved. I should also reiterate the importance of public sector values and codes of conduct as our collective touchstone and one of the major factors distinguishing the two sectors. I will stress this point again in the context of the corporate governance framework.

For the public sector the specific problem for ethics management is:

> *…how to integrate results, risk-taking and managerial flexibility with the appropriate standards of public accountability and due process that are necessary to good government.*[21]

This has led to the question of whether public administration might need to consider a different set of principles reflecting so-called 'entrepreneurial values' in a more private sector oriented environment.[22] On the other hand, some have argued that such an environment makes it more vital to underpin public interest with enduring ethical standards grounded in law and constitutional democracy. [23] The tension is similar to that with the related question of any accountability trade-off, which, in my view is one primarily for the Parliament and/or the Government to resolve.

Achieving an integrated corporate governance framework

In the last decade, Government agencies have put in place many of the elements of good corporate governance. These include corporate objectives and strategies; corporate

business planning; audit committees; control structures, including risk management; agency values and codes of ethics; identification of stakeholders; performance information and standards; evaluation and review; and a focus on client service to name just a few. However, too often these elements are not linked or interrelated in such a way that people in the organisation can understand both their overall purpose and the various ways the various elements need to be coordinated in order to achieve better performance. This is also necessary to ensure that a mutually supportive framework is produced that identifies outcomes for identified stakeholders.

Therefore, the real challenge is not simply to define the elements of effective corporate governance but to ensure that all the elements of good corporate governance are effectively integrated into a coherent corporate approach by individual organisations and are well understood and applied throughout those organisations. If implemented effectively, such an approach should provide the integrated strategic management framework necessary to achieve the output and outcome performance required to fulfil organisational goals and objectives. That framework also assists agencies to discharge their accountability obligations with greater confidence and both internal and external credibility.

Effective public sector governance requires leadership from the Board (where applicable), the Chief Executive Officer (CEO) and executive management of organisations as well as a strong commitment to quality control and client service throughout the agency. Public sector executives leading by example is perhaps the most effective way to encourage accountability and improve performance. Corporate governance is largely about leadership, which is also not confined to the top of the organisation. However, the success of any governance framework does depend importantly on the 'tone at the top'. This has to start with elected officials as the following statement indicates:

> *… sound governance requires political bodies of a high calibre and sufficient integrity to give expression to a national vision.*[24]

Good corporate governance is based on a clear code of ethical behaviour and integrity that is binding on management and staff and communicated to stakeholders. Such a culture of integrity and disclosure (accountability) is also essential for the establishment of sound risk management approaches and the confidence it can give to stakeholders in both the organisation and in what it does. Moreover, there is a mutually supportive relationship between corporate governance, risk management and performance orientation. A robust accountability approach that encourages better performance through sound risk management is integral to any corporate governance framework. [25]

Concern has been expressed that there has been more emphasis on the form rather than the substance of good corporate governance. I want to stress that effective corporate governance is more than just putting in place structures, such as committees and reporting mechanisms, to achieve desired results. Such structures are only a means for

developing a more credible corporate governance framework and are not ends in themselves. As the chairman of three major Australian companies has recently put it:

> '… *there's been too much concentration in recent times on the conformance, the governance, the ticking of the boxes, who comes to meetings and I think it's far from clear that that adds value, improves the performance of companies, delivers benefits for shareholders.'*[26]

Defining individual roles and responsibilities in the corporate governance framework

One of the most important components of robust accountability is to ensure that there is a clear understanding and appreciation of the roles and responsibilities of the relevant participants in the governance framework. Furthermore, the absence of clearly designated roles weakens accountability and threatens the achievement of organisational objectives.

Any discussion of corporate governance within the private sector and, indeed, for public authorities and companies as well, usually begins with a discussion of the role of the Board of Directors, who have a central role in corporate governance. This was clearly indicated as follows by Sir Ronald Hampel's Committee on Corporate Governance (UK) which has been extensively quoted in governance papers and discussions:

> *It is the Board's responsibility to ensure good governance and to account to shareholders for their record in this regard.*[27]

In the private sector, there is a clearly defined relationship structure between the main parties. That is, the generic private sector governing structure consists of a board of directors, including the chairperson of the board, and a CEO responsible for the ongoing management of the agency.[28] However, this model is not readily transferable to the public sector, even with Government Business Enterprises (GBEs), because of the different roles and relationships between the responsible Minister(s), the CEO and (possibly) the Board. As well, citizens (stakeholders) have no choice as to their investment.

I should mention here another apparent difference between the public and private sectors which is reflected in a public sector organisation's relationship to its stakeholders. Private sector approaches tend to focus primarily on shareholders, while recognising other stakeholders such as employees, customers, suppliers, creditors and the community. This can be illustrated by the US Business Roundtable's view that:

> *…the paramount duty of management and of boards of directors is to the corporation's stockholders; the interests of other stakeholders are relevant as a <u>derivative</u>* [my underlining] *of the duty to stockholders.*[29]

While I agree that a Board's primary responsibility should be to its shareholders, I would suggest that concepts of greater social and community responsibility are increasingly being embraced by the private sector, as a matter of course. Boards are beginning to recognise that being seen as 'good corporate citizens' is integral to the long-term viability of an organisation and, therefore, in the interests of shareholders. I mentioned earlier the so-called triple bottom line financial accounting and reporting approach that takes account of the environmental and social consequences of business activity. In Australia, some private sector corporations, such as BP Australia, are leading the way in this kind of reporting.

In the public sector, although we can identify citizens in a similar role to shareholders, in practical terms boards, CEOs and management have to be very aware of their responsibilities to the government (as owners or custodians, and regulators), to the Parliament (as representatives of citizens, and legislators) and to citizens (as ultimate owners as well as in their <u>particular</u> roles as clients). It is important to recognise the distinction between agencies that are governed by a CEO, possibly with the assistance of a board of management in an advisory capacity, and those organisations that have a governing board to which the CEO should preferably be accountable, such as public sector statutory authorities and companies. The latter categories of agency, of course, have more in common with the private sector. They also have added complexities as a result of the additional party (the governing board) in the accountability chain. Organisations will need to tailor their governance practices to take account of such differences.

The ANAO in a discussion paper entitled *Corporate Governance in Commonwealth Authorities and Companies* [30] suggests, *inter alia*, that there may be opportunities to formalise relationships between the Board, the CEO, including management, and responsible Minister(s), perhaps through the development of a Board Charter. Alternatively, a written agreement or memorandum of understanding could be prepared outlining roles and responsibilities as is done, say, in New Zealand. Consideration also needs to be given to adequate training both of the Board Members and management to ensure that there is full understanding of the requirements and obligations, legal and otherwise.

In Government agencies where a Board is responsible for directing and controlling the organisation on behalf of the stakeholders and is ultimately accountable for its own performance as well as that of the organisation, it is important to note that maximising performance within an organisation requires an effective 'partnership' between the Board and management in guiding organisation strategy and performance. Similarly, CEOs of government departments and agencies will need to ensure effective partnerships with senior management if they are to govern their organisations effectively.

Thus, the threshold requirement of sound governance must be agreement between the key parties, whether this is the board and management (including the CEO) or the CEO and management, on the broader corporate objectives. These parties should jointly develop the corporate objectives that the CEO is responsible for achieving. Where there are

separate Boards, be they advisory, management or corporate, it is advisable for such Boards to have a clear Charter which sets out their roles and responsibilities. This is a benefit not only to Board Members but also for everyone concerned with the organisation as a stakeholder.

Managing risk as part of an integrated corporate governance framework

Corporate governance provides the integrated strategic management framework necessary to achieve the outputs and outcomes required to fulfil organisational goals and objectives. I have already shown that clearly defined roles and responsibilities are essential if realistically we are to be held accountable for our performance. Control structures, incorporating sound risk management, are also a particularly relevant element of an effective governance framework because of their importance in promoting effective performance and ensuring accountability obligations are appropriately discharged.

An effective corporate governance framework assists an organisation to identify and manage risks in a more systematic and effective manner. A corporate governance framework, incorporating sound values, cost structures and risk management processes can provide a solid foundation on which we can build a cost effective, transparent and accountable public sector. As one expert opinion puts it 'corporate governance is the organisation's strategic response to risk.'[31] Yet another professional suggests that:

> *An effective risk management program has to be integrated into the organisational structure, management process and culture throughout all levels of the organisation.* [32]

My view of risk management is that it is an essential element of corporate governance underlying many of the reforms that are currently taking place in the public sector. It is not a separate activity within management but an integral part of good management process, particularly as an adjunct to the control environment when we have limited resources and competing priorities. Risk management can only become more critical when considered against the background of the increasing use of a range of different service delivery arrangements; greater involvement of the private sector in the provision of public services; and with a more contestable/competitive market-oriented imperative.

The devolution of authority and accountability to agency heads, from various public sector reforms over the last fifteen years and particularly the recent changes to financial and industrial legislation, together with contracting out and contestability, have significantly increased the risk profile of agencies.

In the past, risk has often been related to the possible loss of assets or the emergence of a liability. As a result, risk management has focused on matters that can be covered as insurable losses. However the more contemporary definition of risk is far broader, reflecting the increasing complexity of our corporate and economic environment and incorporating corporate governance, operational and strategic objectives. Risk management can more properly be defined as:

... the term applied to a logical and systematic method of identifying, analysing, assessing, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable organisations to minimise losses and maximise opportunities. [33]

To be effective, the risk management process needs to be rigorous and systematic. [34] If organisations do not take a comprehensive approach to risk management then directors and managers may not adequately identify or analyse risks. Compounding the problem, inappropriate treatment regimes may be designed which do not appropriately mitigate the actual risks confronting their organisations and programs. Recent ANAO audits have highlighted the need for:

- a strategic direction in setting the risk management focus and practices;

- transparency in the process; and

- effective management information systems.

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

As a result of the greater interest in, and attention applied to, related issues, last year my Office prepared a *Business Continuity Management Guide*.[35] The Guide includes two major features: the first part deals with business continuity management concepts in a risk management context; the second part identifies the processes and procedures required to be undertaken to produce a business continuity plan. (An accompanying Workbook provides a number of pro-forma schedules, working papers and questionnaires to facilitate the business continuity implementation process within agencies).

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

The Guide ... recommends that the business continuity plan be developed in conjunction with the risk management plan for the organisation. There are no short cuts in this area and no substitutes for systematic risk identification, assessment, prioritisation, treatment, monitoring and review, including systems testing.[36]

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

Risk management and decision-making

An important principle underpinning an effective risk management framework is the transparency of decision-making processes. Transparency is achieved by ensuring that the decision-making process and the <u>reasons</u> for decisions made are adequately documented and communicated to stakeholders.

As Auditor-General, I see documentation of key risk management principles and management decisions as an essential element of the public sector accountability framework. But just as importantly, documenting and communicating key processes and decisions throughout an organisation:

- improves the transparency and consistency of decisions made by the agency over time;

- contributes to the cost-effective achievement of stated outcomes;

- promotes a shared ownership of decisions throughout the agency; and

- places the agency in a considerably stronger position to defend to the Parliament and clients any decisions made.

Risk management is primarily the responsibility of the CEO and/or board. Effective governance arrangements require senior managers and/or directors to identify business risks, as well as potential opportunities, and ensure the establishment, by management, of appropriate processes and practices to manage all risks associated with the organisation's operations.[37] As the National Manager of Comcover in Australia has observed that, while insurance products of his organisation are designed to reduce the exposure of the public sector to insurable risks:

> *The availability of this insurance does not remove the onus on agency management to properly manage risks.*[38]

He went on to say it has been estimated that uninsurable costs can represent between three and six times the insurable cost.

Management of risk in the public sector involves making decisions that accord with statutory requirements and are consistent with public service values and ethics. This means that more, rather than less, attention should be devoted to ensuring that the best decision is made. This will require placing emphasis on making the 'right rather than quick decisions'. That said, with the increased convergence between the public and private sectors, there will be a need to consider a private sector point of view where the focus on cost, quality and financial performance is an important aspect of competing effectively. In this respect, an observation by the United Kingdom Comptroller and Auditor General is instructive:

> *Understanding the differences between the private sector and public sector approaches to the same output specification lies at the heart of assessing value for money.*[39]

The key message from the above discussion is that CEOs and/or board should aim to ensure that decisions made using risk management are not based on 'risky' management practices. We need to be conscious that mistakes will be made and look to ensure that management learns from such mistakes and implements effective processes to minimise the impact of errors in the future as well as reducing the likelihood of their recurrence. The following observation is apt given the more contestable environment in which the public sector is operating:

> *Experimentation and innovation need to be encouraged and supported. It is important to accept that there can be no experimentation without risk. Ministers and senior officials must accept some of the uncertainty implicit in giving up a degree of control. Not every experiment will be a success. Some honest mistakes will be made. This needs to be understood and accepted. Our commitment should be to learn from these situations.*[40]

An effective risk management regime, then, is integral to corporate governance. For it to be effective it needs to address the whole business risk. This implies a systematic research and evaluation regime that is able to recognise emerging risks in the political, business and even the physical environment. It hardly needs to be stressed that the mix of these factors will be specific to each agency. It needs to monitor also the internal constitution of the organisation itself. Changes in skill sets or operating procedures can change the organisation's capability to perform its tasks properly. It must then be able to assess the impact of changes in the environment or the make up of the organisation on existing risks.

Implicit in this is the need to have clear definitions of what constitutes risk and what are the thresholds for acceptable risk. In the last analysis, these are decisions for the CEO or Board. However, the entire management team needs to take responsibility for risk management. At every level managers are called upon to manage their own sets of risks.

The top management must ensure that risk management polices are communicated effectively throughout their organisations. There must be a clear understanding and acceptance of the role that each takes in both the strategic and operational aspects of risk management. This includes the development of reporting and evaluation systems that have the capability to recognise risks that fall outside the normal criteria.

The consequences of the risk management approach are pervasive. People management must also abide by the rules. It would be ironic and counterproductive if subordinate managers were expected to manage their relationships with customers and the environment according to risk management principles, but were themselves subject to the rigidities of older bureaucratic templates. Risk management as a standard integrated approach needs to be communicated and encouraged throughout the organisation by example and not just by edict.

Control structures to manage risk

Complementary to a sound risk management approach is a robust system of administrative control. Control structures are particularly relevant elements of an effective governance framework because of their importance in promoting effective performance and in ensuring accountability obligations are appropriately discharged. Control can be broadly defined as 'a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency's objectives.' The emphasis should be on a more systematic approach to decision-making to manage, rather than avoid, risk.

Although reflecting the United Kingdom (UK) situation, the Internal Control Working Party (the Turnbull Committee), and its 1999 report *Internal Control—Guidance for Directors on the Combined Code*[41] has, in my view, provided an effective lead towards the introduction of internal control arrangements for the private sector—and, by extension, for commercial elements of the public sector:

> *The Turnbull Rules now require companies' boards to ensure that processes are in place to manage not just financial, but <u>all</u>* [my underlining] *the organisation's risks.*[42]

In effect the Turnbull Committee has sought to reflect some of the best practices available in designing and operating systems of control, and in incorporating a risk-based approach to corporate governance arrangements. I note in particular, and support, the Committee's comprehensive statement that:

> *An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company that, taken together:*
>
> - *facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial,*

compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed;

- *help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation; and*

- *help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.* [43]

Given the best practice nature of the Code and of the Turnbull Committee's report itself, I would suggest, as one source of implementation advice provided for UK private companies puts it, that:

Non-compliance with the Turnbull guidelines, given their wide support, is likely to be viewed unfavourably by the market. [44]

In the Australian public sector situation at least, I consider that we can learn from, and apply where applicable, the principles enunciated for private sector arrangements by key authorities such as the Turnbull Committee. It is axiomatic that effective control structures within a corporate governance framework are a vital part of providing assurance to clients and the Parliament that an agency is operating in the public interest, and that it has established clear lines of responsibility and accountability for its performance. This is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. In contrast, weak internal controls provide an environment that increases the risk of fraud. [45]

Fraud and corruption control as part of risk management

One area where agencies need to ensure robust processes relates to their fraud control systems. Notwithstanding the focus on outcomes and outputs it is important that agencies have in place appropriate frameworks to protect public funds from loss and fraudulent misappropriation.

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

In this particular context, I note that the requirements for management to establish and maintain policies and procedures that manage the risk of fraud, and on auditors to oversight such arrangements, are to be reinforced at the international level shortly. Action is underway through the International Federation of Accountants (IFAC) to tighten the International Standard of Auditing (ISA) 240 on fraud and error, with an expectation that draft guidelines, presently released for comment by accountants, auditors and managers, will be adopted as a global auditing standard by the end of this year. While the existing standard provides guidance to auditors as to how to treat fraud and error when they detect it, the revised standard will require auditors and, most importantly, management of entities, to take a more proactive role in both prevention and detection.

Specifically, under the proposed new standard:

- *... auditors will be required to quiz managers and boards of directors about what systems they have to detect fraud and glaring errors;*

- *auditors will also need to check whether incorrect statements in the company books, including omissions of amounts and disclosures, are simply honest mistakes;*
- *businesses will not only have to notify auditors, in writing of any fraud or suspicious activity; they will also be required to produce any financial statements that turn out to be incorrect and that management claimed were immaterial; and*

- *auditors will be required to pass these details on to those in charge of governance at the company that is being audited.[46]*

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

- *it is the responsibility of management to establish and maintain policies and procedures that would contribute to the orderly and efficient conduct of the entity's business;*

- *this responsibility includes implementing and ensuring the continued operation of accounting and internal control systems which are designed to prevent and detect fraud and error; and*

- *further, it is the responsibility of those charged with governance to ensure, through oversight of management, that these systems are in place.[47]*

It would seem appropriate to put the onus on managers and directors, including those in public sector agencies, to ensure that their organisations have internal controls to prevent

and detect fraudulent activity as well as any undue errors. My audits do not set out to detect fraud but do strenuously check all entity systems bearing on financial management and reporting.

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

An effective audit committee can improve communication and coordination between management and internal, as well as external, audit and strengthen internal control frameworks and structures to assist CEOs and Boards meet their statutory and fiduciary obligations. The committee's strength is its demonstrated independence (particularly with an independent Chair) and power to seek explanations and information, as well as its understanding of the various accountability relationships and their impacts, particularly on financial performance and reporting.

The ANAO has pointed out:

> *A constructive, open working relationship with external audit is important to the effective functioning of the committee... the attendance of external auditors at committee meetings and the review of external audit reports are the most obvious means by which the audit committee relates to external audit.*[48]

The CEO or the board of an organisation, together with senior management, is responsible for devising and maintaining the control structure. In carrying out this responsibility management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. The entity's executive board, audit committee and internal audit are fundamental to this exercise. Management's attitude towards risk and enforcement of control procedures strongly influences the control environment.

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

The key to developing an effective control framework lies in achieving the <u>right</u> balance so that the control environment is not unnecessarily restrictive nor encourages risk averse behaviour and indeed can promote sound risk management and the systematic approach that goes with it. It must be kept in mind though that controls provide reasonable assurance, not absolute assurance that organisational objectives are being achieved. Control is 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 has to be effected by staff at all levels if the agency is to provide both internal and external assurance and achieve its required outputs and outcomes.

The control structure should support the linkages between the agency's strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the organisation's objectives and which adds value by focusing control efforts on the 'big picture'. Public sector organisations will need to concentrate on the potential of an effective control framework to enhance their operations in the context of the more contestable environment that is being created as part of government reform policy.

In relation to corruption, the NSW Independent Commission Against Corruption, in a survey undertaken in 1994, found that:

> *It is clear that the level of agreement among respondents' perception of corruption differed amongst the scenarios* [The survey asked for evaluations of scenarios that could be described as more or less corrupt].[49]

This suggests that corruption may be a hidden risk for many organisations.

Allied concerns can also be expressed about protective security issues. Protective security is a central element of public sector focus and Parliamentary concern. It is now generally recognised as an important element of agency risk management. Agencies are operating in more complicated environments and the issues with which they have to deal seem to have become increasingly more complex. The nature and level of risks and security exposures reflect such an environment.

The ANAO sees protective security primarily as protection of assets in the form of people, physical assets and information against a specific kind of exposure – National Security. However, in a more contestable public sector environment, increasing attention is also being paid to intangible assets such as intellectual property, reputation and goodwill. The Protective Security Manual (PSM 2000) defines a security risk as 'the likelihood and consequences of compromise of official resources'[50]. The role the ANAO takes in relation to Protective Security can best be considered in terms of reviewing the management of policies and procedures, including information, personnel, physical and information technology and telecommunications (IT&T) operations. The ANAO is not resourced to be expert in the technical aspects of, say, data encryption and information

management, nor technical processes involved in securing physical assets. That is best left to specialist agencies and/or firms in the private sector.

The ANAO also has an educative role in raising awareness in agencies of the need to pay particular attention to security matters. This is largely addressed by carrying out audits of protective security issues across agencies and then reporting back to participants about the overall findings. Their involvement in the preparation of any Better Practice Guides is also a significant learning process. Hopefully, such activity will complement, if not enhance, the work being undertaken by internal audit and security advisers.

The PSM has been a constant source of guidance over many years. While the 2000 manual has only just been released, there are already plans in place to update parts of it to ensure it continues to meet the needs of agencies. However, as the Manual states, regardless of an agency's functions or security concerns, the central messages for managing security risks remain the same:

- security risk management is everyone's business;

- risk management, including security risk management is part of day-to-day business; and

- the process for managing security risk is logical and systematic, and should become a habit.[51]

The impact of information technology and the widespread availability of the Internet impose continuing challenges on agencies. The environment of devolved accountability and outsourcing simply adds to the task of ensuring agencies meet the protective security requirements. A particular problem is emerging with greater involvement of the private sector in public sector activities. The PSM's principles require each agency to ensure that the contracted service providers are fully aware of the agency's security policy and guidelines. Appropriate security procedures, based on the nature of the function, and the classification of the information, need to be negotiated with the contractor and settled before finalising the contract.[52] Contracts that involve access to security classified information must impose on the contractor and any sub-contractor an obligation to meet mandatory security requirements. Of particular note, is that:

> *Access must be permitted for a security risk review to evaluate the contractor's security procedures.*[53]

Relationships with stakeholders

The development of effective working relationships with stakeholders is an important element in a functioning corporate governance framework. Stakeholders for government agencies include particularly:

- the executive government – ministers, cabinet and other government institutions;

- the legislature or parliament – including its committees and investigative processes. and

- the public for whom government provides services, on whom it imposes its regulation, and from whom it raises its taxes.

The way in which these relationships are maintained has been changing significantly over recent years. We have seen a move from the secrecy or semi-secrecy of former years to the enactment of freedom of information legislation in many jurisdictions. The possibility of judicial challenge for administrative decisions and the requirement to provide reasons for administrative decisions has markedly changed the way in which public servants view their position. The effect of greater emphasis on corporate governance principles has inevitably led to a changed focus for them from one that is directed to conformance with legislation to one of customer service. Agencies, in many countries, now find it necessary to develop service charters. These charters serve the following purposes:

- they provide a written standard of performance against which agencies can be judged;

- they help to strike a balance between the demands of customers and a realistic assessment of what can be provided with the resources available; and

- they provide quantifiable performance targets for those engaged in the provision of services and set a platform for performance assessment at all levels within an organisation.

In Australia, the Government decided in March 1997 to introduce Service Charters in order to promote a more open and customer-focused Australian Public Service. All Australian departments, agencies and Government Business Enterprises that have an impact on the public must develop a Service Charter. These charters are to represent a public commitment by each agency to deliver high quality services to their customers. Where relevant, the charters have to guarantee specific standards for service delivery. The importance of such performance has been stressed by the Australian Senate Finance and Public Administration Legislation Committee, in the context of public sector entities' Annual Reports, as follows:

> *The Committee will continue to monitor the results of implementation of charters to ascertain the extent to which identified customer needs and quality of services are being met and that any problem areas are addressed.*[54]

Where service delivery has been outsourced, Service Charters will clearly have a direct impact on the private sector contractor. In particular, it is to be expected that outsourcing contracts will need to reflect the Service Charter commitments if the charters are to have any meaning. It will also be important to require, as part of the contractual arrangement,

the provider to supply outcome, output and input information against which the provider's performance can be assessed, including whether processes are efficient and the service quality is satisfactory. In this way, even if the client is one or more steps removed from the responsible department, it should still be possible to ensure clients are receiving the appropriate level and quality of service, consistent with the Service Charter. Such an approach may also be expected to reinforce the notion of both the private sector provider and the contracting agency being dependent on one-another for delivering a satisfactory level of performance and accounting for this performance.

These charters are an important element of agencies' accountability and a useful basis for the review of their performance.

Performance assessment

Performance information is a critical tool in the overall management of programs, organisations and work units. It is important not as an end in itself, but in the part it plays in managing effectively and has an expanded role in the new ways of delivering public services as a means of protecting public interests. It is therefore a key component of good corporate governance. Performance information fits within the wider management framework that includes objectives, strategies for achieving objectives and mechanisms for collecting and using such information. The latter is essential for assessing the impact of identified risks as well as to assist management to take timely action to deal pro-actively with identified risk whether by turning it to advantage or implementing credible preventative measures. In a recent report the Western Australian Auditor-General noted that:

> *In a rapidly changing environment, public sector managers will face challenges of simultaneously complying with policies designed to achieve fairness and value for money and providing effective performance.*[55]

Standards should be developed against which performance can be compared. Generally these standards will be written in terms of cost (or efficiency), scheduling and service quality. The standards may be expressed in absolute terms, or within a specified acceptable range, or by participants' rating service quality and expectations.

Having developed the mechanisms to allow the assessment of performance, it is important that public sector entities use performance information for ongoing monitoring as well as for 'point in time' assessment and reporting. Ongoing monitoring at different levels in any organisation assists to ensure that a program is achieving its objectives and that entities are using their resources so that they maximise outputs and related outcomes. Such checks also provide assurance to top management as well as allowing them to take timely, strategic action if performance is not satisfactory.

In reporting on outputs and outcomes, say to the CEO/Board or to the Parliament, performance reports should be balanced and candid accounts of both successes and shortcomings. They should have sufficient information to allow the Board or the

Parliament (and even the public) to make informed judgements on how well an organisation is achieving its objectives. Reports should include information on performance trends and comparisons over time rather than just a snapshot at a point in time, which may be misleading.

I see the move towards both accrual budgeting and reporting as an important element in assisting departments and agencies to develop useful performance information systems. It will help agencies to become more outcome-focussed in reporting, providing improved information to both agency management and the Parliament and encouraging an effective Corporate Governance framework.[56] This heralds the need for management to develop more sophisticated information systems that will incorporate improved forecasting and decision-support tools.

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

Australia is not alone in grappling with the development and use of sound performance information, particularly in the light of the rapidly changing operating environment. Many countries are now actively sharing experiences on deriving suitable performance information for accountability purposes. Moreover, we would do well to heed comments such as those made by the Clerk of the Privy Council and Secretary to Cabinet in her Annual Report to the Prime Minister on the Public Service of Canada:

> *Public servants want to meet citizens' expectations and are ready to remove barriers to more effective service delivery, but it must be done in a manner that is true to the roles and values of the public sector.*[57]

The focus of public sector reform is very much on results but it also matters how those results are achieved. A major challenge for the public sector in the future is performance management. If we are successful in achieving a credible, trusted performance management framework, we will earn the confidence and support of all our stakeholders, including those who work, and want to work, in the public sector. From an accountability viewpoint the following observation by the Comptroller General of the United States is apposite:

> *Performance management ensures accountability because it generates valid and reliable data on program impact on the allocation of resources and on the economy, efficiency, effectiveness and integrity with which the government's finances are run.*[58]

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 put demands on suitable 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 individual managers for useful information met effectively, but also that timely and relevant corporate information is provided to allow an assessment as to whether results are consistent with agreed corporate requirements and add to overall corporate performance.

4. ADDRESSING ELEMENTS OF RISK REALISTICALLY

What follows from all this is that organisations need to carry out their own risk assessments in a thorough and rigorous manner. These risks they face are both external and internal.

Changes in the stance of the public service so that it has become more focused on project and contract management mean that there is a range of issues that need to be incorporated into their risk assessments.

There has been a significant change in the role and authority of the so-called central agencies, that is, mainly the Treasury, Prime Minister and Cabinet, and Finance and Administration. These agencies now have quite limited involvement in the detailed business and operations of agencies. This has meant that agencies have had to establish their own effective corporate governance framework and that includes, as I mentioned earlier, risk management as one of its central pillars.

Over the last few years my Office has had a particular focus on risk management in its performance audit program. There are some common themes flowing from these audits.

First, the public service has not had a great deal of experience in risk management. To some extent, this reflects a traditional view of accountability that encourages approaches that limit risk taking. Parliamentary committees have shown little tolerance for approaches to program management that placed taxpayers' funds at any risk. But there are indications that this situation is changing. The Joint Committee for Public Accounts and Audit (JCPAA) now recognises that it is important that risks are assessed and managed[59]. The Committee wants to see that priorities are set; decisions are made rationally in the light of the risks involved; then monitored, reviewed and treated. And it also wants to see that any mistakes are identified and rectified. As well, it wants to be convinced that managers are not taking a laissez-faire attitude to risk-taking.

Moreover, the ethos of the public service is changing even if somewhat slowly. Many managers still appear to want to find a simple template that fits all circumstances and which minimises, if not eliminates, risk. This view finds its expression in two areas:

- the risk management framework; and

- the competence and attitudes of the managers in regard to risk.

Our audit examinations indicate that there are some good examples of comprehensive risk management frameworks in the public service. The Australian Tax Office (ATO) and the Australian Customs Service (ACS), for instance, have been very active in this respect, including gaining increasing commitment from staff at all levels of these organisations. The following comment by the ACS' Chief Finance Officer, is apposite:

> *All managers should understand the importance of managing risk. At Customs, it is fundamentally important that all staff understand this, too. Managing risk is integral to achieving key result areas in our corporate plan.*[60]

In other organisations the frameworks are still not in place. Many agencies still do not have comprehensive systematic collection of information about risks, risk evaluation methodologies, or appropriate mechanisms for ensuring that the whole organisation responds to the risks in a positive way both as an opportunity and a liability.

To be effective, the risk management process needs to be rigorous and systematic.[61] This applies to the identification, assessment, prioritisation and treatment of risks as well as to their monitoring and review. For example, inappropriate treatment regimes may be designed that do not appropriately mitigate the actual risks confronting public sector organisations and programs. Recent ANAO audits have highlighted the need for:

- a clear strategic direction in setting the risk management focus and practices;

- transparency in the process; and

- effective management information systems as an important tool.

Project and Contract Risks

The ANAO conducted an audit of the Implementation of the Whole of Government Information Technology Infrastructure and Outsourcing Initiative that called into question the benefits claimed for the Initiative.[62] As a response to the audit, the Government commissioned the recent review of IT outsourcing (referred to earlier) conducted by Richard Humphry, who remarked:

> *While it is always the prerogative of Government to set central policies, the responsibility for implementation and management lies with agency Chief Executives and Boards in accordance with the legislative requirements of the [relevant] Acts.*

A key response to the perceived unwillingness of agencies to implement the Initiative was the adoption of a compulsory, centralised approach under the direction of OASITO. It was felt that an agent of change... was needed, at the beginning, to help deliver the Initiative's goals.

Priority has been given to executing outsourced contracts without adequate regard to the highly sensitive risk and complex processes of transition and the ongoing management of the outsourced business arrangement.[63]

The review pointed out that there were several risk management lessons to be learned as follows:

- the most significant risk factors were the unwillingness to change and the failure to buy in the appropriate expertise;

- there was a lack of focus on the operational aspects of implementation;

- there was insufficient attention paid to the necessary process of understanding the agencies' business; and

- insufficient consultation with key stakeholders.[64]

Our audit of the Submarine Project[65] being undertaken by the Department of Defence highlighted a range of risk management problems with the project. However, it also gave hints of more significant risks that were not recognised. Defence project managers believed that they were managing the risk associated with managing the project. However, they failed to see the implications of the significant cost overruns for the strategic environment as a whole. The Government at that time had agreed to a strategic defence posture that required particular defence capabilities of which the submarines were a part. The diversion of the large sums of money necessary to ensure that the submarines achieved their operational capability meant that the capabilities of other elements of the Defence Force were compromised. Without the additional commitment that has come about as a result of the Defence White Paper, it is doubtful that Defence could have achieved the strategic capability required by the Government.

What is significant in this context is the relationship between operational risk management and strategic risk management. Changes to the risk profile at an operational level can also have ramifications at the strategic level. As the project management failed to meet sensible risk targets – nearly 90 per cent of the project cost had been paid before even one submarine had been delivered – the implications of this fact on the overall defence capability needed to be reviewed and the consequences evaluated. Changes in operational risks need to be monitored at the highest levels through a process of exception reporting.

What these and other examples point to is that the difficulties facing the full and effective implementation of risk management in the APS are both structural and attitudinal. Even

in agencies that have the broad structures in place there are gaps in the communication chains and reporting structures as well as the analytical capability. As a result the ability of the organisation to adjust to its changing environment is jeopardised. The more recent interest in knowledge management systems and the focus on our human capital are indications that we are realising the imperatives of the changing environment (including retention of corporate knowledge) and of having the necessary skills, experience and information to deal effectively with both the internal and external demands being made on agency management.

During recent years the management of contracts by public sector agencies has been of particular concern to my Office and I have tabled a number of audit reports which address this area. A common theme of these audit reports has been the deficiencies in the project management skills of agency decision-makers, which is of concern given that some of these projects involve substantial resources and complexity. As well, reports have flagged a need for care in assessing value for money and negotiating, preparing, administering and amending major contracts[66]. The Parliament and the media have also paid particular attention to these issues during recent years with several agencies receiving significant adverse comments and publicity. I am not alone therefore in stating that this situation has to be addressed as a matter of urgency. The various elements of the public sector that are involved in contract administration have to reverse such concerns to win back the confidence of all stakeholders. Future audit reports will closely examine relevant contracting issues and work with agencies in implementing identified better practice and in achieving their performance requirements.

Our experience highlights the importance of having a strong project and contract management skills base that can be drawn upon to make decisions and to achieve the required results. This does not necessitate a full time complement of skilled project and contract managers. Rather, agencies should ensure that, if the current decision-makers do not have the requisite skills, sufficient external expertise is obtained. Such external expertise may be required, for example, in relation to the financial, legal and technical aspects of contract management. The comments of the Humphry Report bear this out. One factor which experience shows can benefit <u>all</u> parties involved is to ensure at least some continuity between those involved in the tender stage, the contract negotiation stage and the actual contract management.[67]

The replacement of direct service delivery by government agencies by contracted services establishes a new locus of control for service delivery, as Linda Taylor has pointed out[68]. She then quotes Kettl as follows:

> *Officials cannot give orders to contractors. They can only shape the incentives to which contractors respond*[69].

Nevertheless, to get the most from a contract, the contract manager and provider need to foster a relationship, supporting the objectives of <u>both</u> parties and which focuses primarily on the results to be achieved.

Two particular issues have emerged which bear on the various relationships involved in outsourcing and contract management. They are access to information and private sector premises and commercial-in-confidence considerations. I will discuss each in turn.

One of the problems for both auditors and agency managers is having sufficient access to information that allows them to assess, and decide how to treat, risks and to ensure that they are in a position to be accountable for their functional (and statutory) responsibilities. A particular issue facing my Office and, I am sure, many others[70], is that of access to contractor records and other information relevant to public accountability. This matter is of concern not only to Auditors-General, but also to public agencies in their role as contract managers, to Ministers as decision-makers, and to the Parliament when scrutinising public sector activities.

My Office has experienced problems in accessing contractor information both through audited agencies and in direct approaches to private sector providers. Several audits and parliamentary inquiries[71] have focussed closely on what public accountability means in the context of contract management, third party service providers and commercially-based public activities.

As part of his/her statutory duty to the Parliament, the Auditor-General may require access to records and information relating to contractor performance. The Auditor-General's legislative information-gathering powers are set out in Part 5 of the *Auditor-General Act 1997*. These powers are broad but they do not include access to contractors' premises to obtain information.

In September 1997, my Office drafted model access clauses (reflecting the provisions of the *Auditor-General Act 1997)* which were circulated to agencies for the recommended insertion in appropriate contracts. These clauses give the agency and my Office access to contractors' premises and the right to inspect and copy documentation and records associated with the contract.

The primary responsibility for ensuring there is sufficient access to relevant records and information pertaining to a contract lies with agency heads. This responsibility is mandated in section 44 of the *Financial Management and Accountability Act 1997* which states clearly that a Chief Executive must manage the affairs of the Agency in a way that promotes proper use (meaning efficient, effective and ethical use) of the Commonwealth resources for which the Chief Executive is responsible.

For accountability measures to be effective, it is critical that agencies closely examine the nature and level of information to be supplied under the contract and the authority to access contractors' records and premises <u>as necessary</u> to monitor adequately the performance of the contract. I stress 'as necessary' because we are not advocating carte blanche access. Audit access to premises would not usually be necessary for 'products' or 'commodity type services' provided in the normal course of business.

The ANAO considers its own access to contract related records and information would generally be equivalent to that which should reasonably be specified by the contracting agency in order to fulfil its responsibility for competent performance management and administration of the contract. The inclusion of access provisions within the contract for performance and financial auditing is particularly important in maintaining the thread of accountability with Commonwealth agencies' growing reliance on partnering with the private sector and on contractors' quality assurance systems. In some cases, such accountability is necessary in relation to Commonwealth assets, including records, located on private sector premises.

The Joint Committee of Public Accounts and Audit (JCPAA) subsequently recommended that the Minister for Finance make <u>legislative</u> provision for such access.[72] The Government response to that report stated that:

> *its preferred approach is not to mandate obligations, through legislative or other means, to provide the Auditor-General and automatic right of access to contractors' premises.*

and that

> *the Government supports Commonwealth bodies including appropriate clauses in contracts as the best and most cost effective mechanism to facilitate access by the ANAO to a contractor's premises in appropriate circumstances.[73]*

The response also stated that:

> *the Commonwealth Procurement Guidelines would be amended to emphasise the importance of agencies ensuring they are able to satisfy all relevant accountability obligations, including ANAO access to records and premises.[74]*

While noting the Government's response, the ANAO continues to encourage the use of contractual provisions as the key mechanism for ensuring agency and ANAO access to contractor's records for accountability purposes. The ANAO is currently in discussions with the Department of Finance and Administration to review the content of the standard access clauses and intend to write again to agencies recommending the use of the clauses once this consultation process is complete.

Situations have arisen where performance data relevant to managing a contract is held exclusively by the private sector. Private sector providers have made, on many occasions, claims of commercial confidentiality that seek to limit or exclude data in agency hands from wider parliamentary scrutiny. Thus accountability can be impaired where outsourcing reduces openness and transparency in public administration.

The Australasian Council of Auditors-General has released a statement of Principles for Commercial Confidentiality and the Public Interest[75]. Of particular concern to Auditors-General has been the insertion of confidentiality clauses in agreements/contracts which can impact adversely on Parliament's 'right to know' even if they do not limit a legislatively protected capacity of an Auditor-General to report to Parliament. For example, the then Auditor-General of Victoria commented that:

> *… the issue of commercial confidentiality and sensitivity should not override the fundamental obligation of government to be fully accountable at all times for all financial arrangements involving public moneys.[76]*

This view has been echoed in almost every audit jurisdiction, for example, as the then Chairman of the Tasmanian Public Accounts Committee stated:

> *Maintaining secrecy by confidentiality clauses in contracts is adverse to the Parliament's right to know. Confidentiality clauses should not, therefore, be used in contracts unless there are specific approvals for them by the Parliament itself.[77]*

I am sensitive to the need to respect the confidentiality of genuine 'commercial-in-confidence' information. This requires an understanding of the commercial imperatives in a competitive market environment. In my own experience, I have found that, almost without exception, the relevant issues of principle can be explored in an audit report without the need to disclose the precise information that could be regarded as commercial-in-confidence. In this way, the Parliament can be confident it is informed of the substance of the issues that impact on public administration. It is then up to the Parliament to decide the extent to which it requires additional information for its own purposes. This view is supported by the Victorian Public Accounts and Estimates Committee in a landmark report last year, as follows:

> *'5.6 Commercial-in-Confidence should not prevent Auditor-General and Ombudsman from disclosing information where they assess its disclosure to be in the public interest'[78]*

The Chairman of that Committee recently reiterated that a variety of options exist for dealing with commercially sensitive material and that, where <u>genuine reasons exist</u>, it is possible to take a middle ground between unrestricted access or total confidentiality.[79] The Chairman went on to note that the only Committee recommendations rejected outright related to the disclosure of information contained in tenders (as opposed to contracts) and the conferral of the Ombudsman of an extended oversight role in relation to commercial in confidence claims[80].

Commercial confidentiality concerns have also been addressed by a number of Commonwealth Parliamentary inquiries.[81] Recently, the Senate Finance and Public Administration References Committee, in its *Inquiry into the Mechanism for Providing Accountability to the Senate in Relation to Government Contracts,* addressed a motion

that had been put before the Senate by Australian Democrat Senator Andrew Murray. Senator Murray's motion sought to achieve greater transparency of government contracting through passage of a Senate Order that would require:

- the posting on agency web sites of lists of contracts entered into, indicating whether they contain confidentiality clauses and, if so, the reason for them;

- the independent verification by the Auditor-General of those confidentiality claims; and

- the requirement for Ministers to table letters in the Senate chamber on a six-monthly basis indicating compliance with the Order.

The Committee's report noted that, at almost every estimates hearing, information is denied Senators on the grounds that it is commercially confidential. The Committee considered that this creates a situation where:

> *Without recourse to an independent arbiter acceptable to both sides, this results in an impasse unsatisfactory to all. In many cases the confidentiality claim may be correct but, without seeing the information, senators are unable to judge the veracity of the assertion of confidentiality. Nor are they able to assess the level of financial risk to which the Commonwealth may be exposed by the use of confidential clauses, if they are denied access to contracts.[82]*

Senator Murray's motion can be taken as a further indication of Parliament's frustration with insufficient accountability reporting associated with government contracting and a belief that commercial-in-confidence provisions are used excessively and unnecessarily in contracts.

During the ANAO's appearance at the Committee's public hearings on this Inquiry on 12 May 2000, the Deputy Auditor-General offered to conduct a performance audit on the use of confidential contract provisions. This offer was accepted by the Committee and, once the audit is completed, the Committee will report again on the Senate motion. I have commenced the audit and expect to table the report in Parliament in mid 2001. The audit is seeking to:

- assess the extent of guidance on the use of confidentiality clauses in the context of commercial contracts at a government wide level or within selected agencies;

- develop criteria that could be used to determine whether information in a commercial contract is confidential, and what limits on disclosure should apply; and

- assess the appropriateness of agencies' use of confidentiality clauses and the effectiveness of the existing accountability and disclosure arrangements for the transparency of contracts entered into by the Commonwealth.

The significance of agencies having a clear understanding of the legal imperatives associated with contracting was highlighted in a seminar on legal issues relating to the public sector that was conducted in 1999.[83] Participants discussed, among other things, the convergence of legal and commercial risks and the need for planning and sound systems for contract management, particularly over the whole life of the contract. With the strengthening of legislation relating to governance across our region generally, judicial decisions will also emphasise the importance of having a legally defensible tender process as an integral part of contracting out. It has always been important for the tender process to be commercially defensible. Moreover, it is apparent that meeting legal requirements and processes is in the commercial interest of those involved in contracting of services.

There is no doubt that the more 'market-oriented' environment being created is inherently more risky from both performance and accountability viewpoints. To good managers, it is an opportunity to perform better, particularly when the focus is more on outcomes and results and less on administrative processes and the inevitable frustration that comes from a narrow pre-occupation with the latter. Having said this, it is important for us all to remember that the Public Service is just as accountable to the Government and the Parliament for the processes it uses as it is for the outcomes it achieves. That is inevitable and proper. In my experience, however, some agencies, faced with the prospect of adverse comment in an audit report about the transparency and accountability of their risk management or other processes, have argued for a greater emphasis on the outcomes achieved by the agency. The following observation made by the then Chairman of the Australian Senate's Standing Committee on Finance and Public Administration, reflects well my response to such arguments:

> *[Risk management] does not mean that managers can expect to be judged only on the efficiency and effectiveness of their results and be able to claim that the mix of inputs chosen, how they are applied and the selection of who is to supply them is outside the reviewer's area of concern. The fundamental principles of accountability have not changed: information still needs to be readily available to allow reviewers to make their own assessments about the legal and proper use of inputs and the ethical behaviour of the people involved in the processes. Managers cannot simply claim that the ends justify the means.[84]*

What is particularly clear is that no two organisations face the same array of risks. In the first instance, it is important to establish the 'right' governance frameworks. These frameworks should be characterised by both intellectual rigour and operational flexibility. The costs involved in rectifying what were poorly designed approaches in the first place can be very high. In terms of performance or results, the opportunity costs can also be significant. Sound risk assessments and treatments, complemented by regular monitoring and review, are an essential element of those frameworks, as I noted earlier. The ANAO's Better Practice Guide on Contract Management notes that:

The difference beween a contract delivering benefits, and one that does not, can be often attributed to the way that the risks associated with the delivery of those services are managed.[85]

In particular, the design of risk treatments needs to consider what should be done in advance to minimise the consequences of a risk event and what should be done if, despite the organisation's best efforts in managing the risk, that event still occurs and has a detrimental impact.[86]

The consequences of excessive rigidity in the framework are that the organisations will not address emerging risks in an appropriate way. What this means, in effect, is that we must change the way we do business. Instead of looking to have a set of plans and procedures that are accepted as a set of words and to some extent influence action, we need to think of them as mechanisms for influencing attitudes. The frameworks need to be designed so that people can see the results and outcomes and relate them to different strategies. Of course this approach is not really discretionary. It is at least implied in the FMA Act. CEOs are responsible for achieving the Government's desired outcomes in the most efficient, effective, economical and ethical way.

Networked Risk Management – another layer of risk

An interesting outcome of recent public sector reform directions is that virtually all of the results most governments strive to achieve require the coordinated efforts of two or more agencies/parties/levels of government. Unfocussed and uncoordinated programs waste scarce resources, confuse and frustrate clients (citizens) and limit overall program effectiveness. An emerging issue is the need to identify and overcome fragmentation and overlaps in a number of government programs. Market mechanisms may actually create operational 'islands' within agencies, particularly where activities are more commercially based and make coordination of services to citizens in a seamless manner that much more difficult.

In an increasingly global environment, the question of competitiveness and/or contestability of the public sector against similar elements in the private sector would seem likely to focus greater attention on the need to be more outwardly than inwardly focused in the future at least. External pressures, including the growing strength of large multinational corporations, may require the development of 'real' partnerships between the public and private sectors in the interests of maintaining national sovereignty and global competitiveness. The imperative would then be to develop a highly performing public sector to complement the private sector rather than just compete with it. In this respect, it is interesting to consider the United Kingdom (UK) 'Modernising Government' approach which stresses 'partnership delivery' by all parts of government as well as with the private sector.[87] The UK National Audit Office subsequently reported on its response (and strategies) to that policy, including the notion of 'joined-up' government. [88]

In a similar context, an academic paper published in 1999 by Professor Mark Considine and Jenny Lewis of the Melbourne University in Victoria, Australia, noted the emerging image of 'network bureaucracy' stressing co-production of results as against 'market bureaucracy' with its emphasis on contracting-in and introduction of quasi-markets.[89]

The move to an output/outcomes framework for managing resources and measuring performance at the Australian National Government level has engendered discussion about 'shared outcomes' and the strategic and other relationships between outputs that contribute to those outcomes and those organisations responsible for both.

There are increasing indications of a re-emergence of interest in the concept of 'network bureaucracy' as a means of delivering more efficient, effective and responsive public services. For example, it has been commented that:

> *'While the market form of organisation is thought by its proponents to excel at certain types of cost containment, and is a favoured means for terminating old programs, it is less certain that it is able to build new systems of quality service delivery and to create effective institutional linkages within policy sectors. Network advocates have begun to suggest that the competitive market bureaucracy may not mobilise support, share information successfully, invest in new technologies, create common service standards, and focus upon the individual needs of suppliers and clients. Furthermore, it is suggested, markets may undervalue the rights of individual clients when the cost of difficult clients is higher than the benefit to be gained from "creaming" only the better priced customers.'[90]*

The network bureaucracy concept proposes interdependence as a binding characteristic where services are tailored to individual or small batch clients and costs are shared across an inter-organisational web of co-producers. Network agents are the local officials who take direct responsibility for establishing effective links between suppliers, co-producers and customers. In the United Kingdom (UK), it has been observed that a key difference between the Compulsory Competitive Tendering (CCT) regime and achieving best value for money, is the emphasis which the latter places on promoting partnership, particularly joint ventures between local authorities and the private sector.[91]

In Australia, there do appear to be indications that the network bureaucracy concept is gaining favour as a means of delivering more responsive public services to citizens. For example, one recent ANAO report[92] discussed how three welfare agencies were defining their particular outcomes and outputs and how the outputs of one of these agencies were directly related to the outcomes of the purchasing departments. These arrangements have subsequently expanded such that a particular agency, Centrelink, now delivers welfare services on behalf of five agencies under formal purchaser-provider arrangements.[93]

It has been recognised that more networked approaches to service delivery envisage more sophisticated and cooperative approaches to cross-cutting issues and, consequently, stress the importance of partnerships, coordination and joint working. This is increasingly

occurring at the inter-agency level. Therefore, networking can be expected to evolve to include strategic arrangements and structures between public organisations, private operators and voluntary associations as well as individual clients and the community generally. Such interaction should in turn generate new forms of service delivery and redefine the relationship between government and the community.

Realising the benefits of networking in a cross-cutting mode requires further cultural transformation in government agencies. For example, hierarchical management approaches may need to yield to more 'partnering-type' approaches. Process oriented ways of doing business will need to be supplanted by results-oriented ones. This is consistent with the Australian Government's outputs/outcomes approach to public administration and budgeting. Agencies in an environment of devolved authority can become virtual 'silos' in the delivery of public services. This can also mean overlapping functions and associated inefficiencies in their management and responsibilities. Consequently, there is a need for such agencies to become better integrated organisations as well as being more externally focussed if they are to meet the needs and expectations of their ultimate clients. This places considerable pressures on individuals and information systems to facilitate successful operations and outputs, as well as outcomes.

The aim should be to deliver services that appear seamless to the recipient.[94] In such arrangements, where there is joint responsibility for overseeing and implementing programs across a number of bodies, involving public and/or private sector organisations, a clear governance framework and accountability and reporting arrangements, which clearly define roles and responsibilities of the various participants, may be required. Increasingly, relevant governance arrangements will need to cross organisational boundaries to better align activities and reduce barriers to effective cooperation and coordination. Of note is the fact that globalisation has resulted in an increasing number of business networks operating across national borders. Networks do not necessarily require formal organisational, including corporate governance, structures. However, they do not simply occur and automatically perform. As a consequence, in my view, it does raise the notion of 'virtual' corporate governance to complement the more formal frameworks in the individual organisations involved.

Assessing Cost and Benefits

At a practical level, decision making based on sound risk management requires a system that makes it possible for alternative actions to be assessed in common terms, that is comparing like with like. As far as possible, it is desirable to make that assessment in quantifiable terms and take into account the implications for the full life of the project. It should be noted that the composition of cost and benefits will vary according to the nature and complexity of the goods and services being considered.

> *For example, the initial acquisition cost of capital equipment is often significantly less than 50% of the total acquisition cost (after taking into account maintenance, spares and servicing). With simple purchases, the initial price may represent almost all of the total cost of the item.[95]*

The Department of Finance and Administration points out that the total cost of an item includes more than just the initial price. Whole of life costing includes:

- the cost of the purchase or acquisition;

- a prediction of the useful life;

- training and other personnel costs;

- cost of consumables;

- maintenance costs; operational factors; and

- consideration of asset disposal or resale[96]

Although this list is directly relevant to the purchase of equipment, the same principles can be applied to most decision making situations.

The following comment on the experience in New Zealand is relevant:

> *The ability to assess legitimate costs of contracted services, then compare them with in house delivery costs, is a common problem for government that was highlighted in a 1997 report on government contracting practices commissioned by the Treasury which noted that ,*
>
> *…formal evaluation or benchmarking of contractors' ongoing performance was often lacking. This creates the risk that a department is not receiving value for money from contracting out and creates operational risks to the quality of service delivery. (page 6)*
>
> *Similar problems were experienced in the United Kingdom (Lewis, 1996) when it became apparent that establishing unit costs of many personal social services was often arbitrary at best.[97]*

From a theoretical viewpoint, cost- benefit analysis (CBA) is the centrepiece of economic evaluation. It is the most comprehensive of all the available techniques in that it can, in principle, determine whether a particular project or program is worthwhile in comparison with all alternative uses of the relevant resources, whether in the health services or not. To do this, it requires that all costs and all benefits be identified, wherever they fall and whether they are tangible or not. Both costs and benefits must then be expressed in the common metric of money. Because people attach more importance to both costs and benefits now than in the future, in programs which extend over time both must be adjusted by what is known as a social discount or 'time-preference' rate. This is similar to a pure interest rate (ie, excluding inflation) but taking the viewpoint of society rather than an individual. Opinions differ about whether the same rate should be applied to both

costs and benefits. Whichever figures are used, the technique reduces the flow of benefits and costs (including the annualised value of any establishment costs or capital investment) to give a net present value (NPV) – the sum of discounted benefits less discounted costs – over the life of the relevant project or program. Since costs reflect, in principle, the value of whatever benefits the relevant resources could yield in other uses, a positive NPV would then justify the program and, of course, the larger the NPV the more desirable it would be. Though CBA has been criticised, for example, for its omission of any criteria for the distribution of benefits, it has been quite widely used in public investment appraisal generally over many years.[98]

It should be noted also that Cost Benefit Analysis has certain weaknesses when applied to social issues, particularly in developing a methodology that properly reflects the economic value of human life.[99]

There are other methodologies for assessing the relative merits of alternatives, but CBA has the advantage of being the most comprehensive. For example, one could use cost effectiveness analysis or cost utility analysis. Each has is own strength and weakness[100] Whichever form of analysis is used, it is important to recognise that each gives rise to its own set of risks – in particular that relevant factors will not be adequately identified and/or given adequate weighting in the consideration.

Risk management is also important in the calculation of the discount factors involved in arriving at a NPV. The discount factor is in fact an allowance for the risks involved in following a specific option. In other words, the calculation of the discount factor should reflect the risks involved in pursuing that particular option. For example when comparing a tried and tested technology with one at the cutting edge, for example, the TGV versus a maglev train for Speedrail – the discount rates to be applied to the various costs and benefits must reflect the differential in risk.

The value of unquantifiable aspects of alternatives is also problematic. For this reason, the comments made previously about the need for performance assessment rather than performance measurement are particularly relevant.

Activity based costing

In several ANAO audits, it has been noted that agencies need to be able to monitor their costs through some form of activity based costing. Particularly in an environment where the emphasis is on contract and project management it is important to have a clear understanding of what the full range of resource costs in managing the projects is. In particular it is important to be able to allocate human resource costs to various projects, because, in many, if not most cases, they represent the single greatest element of project costs.

Activity based costing should also be directed to the risk management process itself. The research and analysis involved in risk management can be significant. We must recognise that risk management itself is not costless. 'Paralysis by analysis' is possible in a risk

management environment too. Activities involved in the continual monitoring of the environment, reporting and reassessment of the implications of changes in the risk profile, need to be identified separately so that those activities themselves can be subjected to an assessment of the impact on operations if they were not done or done at reduced levels.

What is implied in this is that there is a premium on getting the system right first time. We need systems that give early warning of changes in the risk environment. At the same time we need to see that that means that it is inevitable that changes will need to be made. It is important, therefore, that risk management systems are designed in such a way that the can accommodate change easily without need for frequent radical changes. They will then more easily give a valid and robust structure to risk assessment, decision making and ongoing review.

5.   CONCLUDING REMARKS

It is almost axiomatic that, for risk management approaches to be adopted in delivering outcomes more effectively, they must be seen to be relevant to the business operating environment. Any process of improvement must move from where we are now to where we want to be. This impies that we can articulate what the present situation is and what is a desirable and achievable outcome in the environment in which we have to operate. It also implies that, if all concerned are to move forward together, there must be a shared ownership of the aims and process involved.

Within the Australian private and public sector communities, much is being done to find out what the current status of risk management is. CPA Australia, through the Public Sector Centre of Excellence, commissioned PriceWaterhouseCoopers to assess and report on the extent to which public sector agencies within each level of government have; understood, considered, accepted and/or implemented the concept of risk management. This project is in response to the growing profile of risk management, which has resulted from several very public management disasters. These included the Kew Cottages tragedy, the explosion at Longford refinery, cryptosporidium in Sydney's water supply and outbreaks of legionnaires disease

The objective of the project is to develop a series of case studies based on leading practice pubic sector organisations to assist risk management practitioners, public sector managers and academics to understand the better practice risk management in the Australian public sector.

The study will look at the philosophy and operation model used, the form of risk management adopted and the types of risks identified. It will also evaluate how far the concept is built into an organisation's processes and accepted as part of general management practice. The analysis will also consider the extent of integration of risk management into business processes, business decision-making, control risk management and performance reporting. The framework being used is the Australian/New Zealand

Risk management Standard AS/NZS 4360 1999 and relevant public sector material issued by the Commonwealth, state or local governments. The existence of "local" regulation or policy, which requires organisations to adopt a risk management framework will also be taken into account.

Output of the CPA Australia project will include a report, case studies and the potential development of a better practice guide.

Comcover is also currently undertaking a risk management benchmarking project to address what it sees as a limited understanding on how advanced Commonwealth agencies were with risk management. It is also a means of drawing attention to the need for management to take risk management seriously. The project will address managers' need for tools to measure their risk management performance.

The project has been developed with Cogent Business Solutions and in collaboration with CPA Australia. The project is concentrating on the strategic level of risk management in Commonwealth public sector agencies. It is an attempt to actually measure and benchmark risk management performance and the project will look to measure the key principles of risk management that can be applied to all organisations.

Outcomes of the Comcover survey include: evolving a risk management culture; implementing a risk management system; continuously improving risk management practices; and audit and report on the results. Comcover intends to repeat the project annually.

Organisations such as the Association of Risk and Insurance Managers of Australasia (ARIMA), are active in the development of risk management standards and education through the sharing of information and experience in the field. These organisations thus provide a useful basis for developing a professional approach to risk management.

Standards Australia, in cooperation with Arthur Andersen, has recently published a new 'case study' handbook on risk management practices. It looks at the experience of leading Australian organisations - QANTAS, Telstra and AMP - with the objective of assisting 'organisations and individuals develop their own approaches to and capabilities for managing risk'[101]. The ANAO is represented on two Standards Australia working parties dealing with risk management, one looking at the quality of assurance processes and the other at the 'slow uptake' of good risk management practices in Australia. The latter is interested in how we might use a fresh approach to continue the dialogue and increase successful implementation in both the public and private sectors.

I spoke recently at the launch of the Australasian Risk Management Unit at Monash University. The Unit's charter is to establish the concept of risk within an academic context and to build bridges from the university to industry and ensure that risk management evolves as a formal discipline in the future. The training programs being offered will focus on the development of workplace competencies needed by people working on risk management. The competencies are aligned to national risk management

standards, Australian Standards and current acts, regulations and state and federal guidelines associated with risk management. The establishment of this unit and other educational initiatives indicates that risk management is becoming part of the management mainstream.

This gives rise to a series of questions.

Firstly, how do we establish relevance? How do we capture the experience in the public and private sectors? We need to find a successful balance between empirical research that draws upon the experience of the population that it is trying to serve and a rigorous theoretical base that provides a framework for interpreting it. There is a vast amount of knowledge and experience at work in Australia in dealing with the business risks and their particular manifestations in an Australian context. Tapping into the worldwide experience is also important so that we can learn from others in the increasingly global environment that we live and work in. Having distilled all that wisdom, how do we make it work for us and those we serve?

Then, how do we maintain that relevance in an ever-changing environment? Risk management itself is nothing new, although it has been the focus of explicit attention only in recent years. Intuitively, we all manage risks to some degree. What becomes difficult is to recognise how risks present themselves in different environments. Even by examining the environment and its risks, we change both to some extent. We have an extremely dynamic process with which we are constantly interacting. There is a constant interplay between risk management and the environment. We can direct our research and education at what we see as today's threats only to find that they are yesterday's problems. By the time we have researched them and can articulate them, they are already bringing about their consequences.

The next problem is how do we establish ownership? The understanding of the principles of risk management within many operational areas needs to be improved, in some cases markedly. What we see is a failure of traditional training methods to give people the necessary skills or engender the necessary attitudes to make risk management the natural way of working for many of our middle level managers. To some extent this arises from a lack of a vibrant theoretical base in our broader educational environment. One wonders what, if any, departmental training is given in the principles and practice of risk management as it applies to the varying environments that agencies face. Our audits show that risk management plans and frameworks are given little regard at the middle and lower management levels.

Clearly, leadership in the application of risk management must come from the top, as is the case for all aspects of governance. It is up to chief executives and Boards to set the tone as I indicated at the outset. But leadership is to be expected from managers at all levels. Exhortation on its own cannot work. We need to be active in fostering a risk management culture that starts by getting the principles and concepts right.

Effective public sector governance requires leadership from the Board (where applicable), the Chief Executive Officer (CEO) and executive management of organisations as well as a strong commitment to quality control and client service throughout the agency. Public sector executives leading by example is perhaps the most effective way to encourage accountability and improve performance. Corporate governance is largely about leadership, which is also not confined to the top of the organisation. It is encumbent on all managers to learn to be an effective leader in whatever positions they find themselves.

Risk management has to be part of the culture of an organisation which is reinforced by managers at all levels and actively pursued. While some risks can be transferred, usually at some cost, to the private sector in an outsourcing situation, experience shows that both purchasers and providers should assume responsibility for those risks that <u>each</u> is best equipped to manage at least cost. Neither party gains from any attempt to naively transfer risk. This is one of the more important lessons that public and private sector managers have learnt from the outsourcing experience. As the Comptroller and Auditor General for the United Kingdom has observed:

> *The public sector body should seek the optimum, not the maximum, transfer of risk.*[102]

I spoke earlier of the importance of business continuity as part of sound risk management and at the core of corporate governance. I will finish with some practical advice from our Better Practice Guide on Contract Management that it is important not to underestimate the planning and management effort required to ensure that there is a smooth transition from one contract to another. As I also noted, this comment also applies to the transition from in-house provision to the outsourcing provider. The uninterrupted delivery of goods and services (that is, business continuity) is key to any organisation's success and is one of the major risks that have to be well managed. That is why trust, confidence and a close working relationship between contracting parties are absolutely essential. Perhaps that is the biggest risk which, if well managed, could be an organisation's biggest opportunity.

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> It is essential that the private sector provides considering projects involving the storage, processing and security of government information and systems, be advised at an early stage of both government agency and Auditor-General rights in regard to access and audit. This matter requires due contractual and legal consideration by the Government and its agencies to ensure the adequacy of safeguards over the security, integrity and

control of government information and processes, and to accommodate the Auditor-General's statutory audit responsibilities.

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'***Recommendation 5:*** *The Committee recommends that the Minister for Finance make legislative provision, either through amendment of the Auditor-General Act or the Finance Minister's Orders, to enable the Auditor-General to access the premises of a contractor for the purpose of inspecting and copying documentation and records directly related to a Commonwealth contract, and to inspect any Commonwealth assets held on the premises of the contractor, where such access is, in the opinion of the Auditor-General, required to assist in the performance of an Auditor-General function. (paragraph 6.20).'*

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