

Laboratory for Politicians and Top  
Managers from Different Public  
Institutions in Europe

**Implementing Adequate  
Supervision – What Kind and  
How Much**

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## IMPLEMENTING ADEQUATE SUPERVISION – OF WHAT KIND AND HOW MUCH

**SUPERVISE:** Oversee, superintend execution or performance of (thing) or actions or work of (person)  
Hence- Supervision

SOURCE: THE CONCISE OXFORD DICTIONARY OF CURRENT ENGLISH, 1982

### I. INTRODUCTION

I have been asked to speak about the adequacy of supervision in the public sector in a more devolved and decentralised environment of public administration. I will endeavour to place my remarks in a more global context but they will largely reflect the experiences at the Federal Government level in Australia in recent times. Perhaps not surprisingly, they are based on an audit perspective which is concerned both with performance and accountability for performance.

Simply put, devolution of authority is intended to provide public sector managers with greater flexibility in decision-making to achieve required results. Complementary to such devolution is the greater decentralisation of government activity to more directly meet the needs of individual citizens and, in some countries, to encourage and facilitate their greater involvement in such activity. In the past, there has been considerable reliance on central control and only limited scope for active citizen participation in government decision-making.

In many countries, there has been considerable emphasis on the rule of law, limited discretion and apparent encouragement of a risk averse attitude among civil servants. It has been observed that such an environment has largely focussed bureaucratic attention on process rather than on achieving the stated objectives of governments. It is also said that there needs to be a cultural change in the public sector if civil servants are to focus more on achieving required results and to be accountable for their performance including management, rather than avoidance, of risks.

It is not my intention to canvass different models of public administration. However, inevitably one is caught up in some of the debate when discussing the changing world in which we live, particularly the growing focus on globalisation and apparent convergence of the public and private sectors of many economies. While the latter is partly a reflection of views about what government should or should not do, and issues of privatisation and private sector participation in public service, there is also an underlying recognition that globalisation does pose significant challenges for governments in terms of governance and international competitiveness.

For a traditionally resources-based economy like Australia's, with a relatively small population and being geographically distant, issues such as economic sustainability and competitiveness place great pressures on all sectors of the economy. That is, all sectors need to be highly performing which means that all should be supportive of each other where the measures of performance are increasingly international, not national, benchmarks. This realisation has also directed attention to notions of team-work, partnership, and networks which have been resurrected as part of recent developments in public administration, for example, as a contributor to 'joined-up' government in the United Kingdom and reinforced by the greater use of information technology and communications (ITC), notably the Internet, for service delivery. More widely, the development of so-called 'one-stop' or 'no-stop' shops for improved interaction with citizens as part of a more responsive public sector, are likewise a product of such thinking.

Bearing these issues and developments in mind, it seemed to me to be useful to discuss first the apparent convergence of the public and private sectors and some of the implications of such convergence including the use of contractual arrangements and differences between the rhetoric and reality. Second, there needs to be a recognition of the supervisory roles in relation to performance and performance management and the associated cultural change necessary to focus more on results than on administrative processes. Third, it is suggested that the development and use of a sound corporate governance framework would provide the means for ensuring appropriate accountability for both performance and use of resources. This is necessary for the confidence and assurance of both internal and external stakeholders.

The discussion of corporate governance will cover the assurance provided by a sound internal control framework and the development of credible risk management approaches and plans. Finally, I will raise some issues of supervision arising out of any move from a more market-oriented approach to greater collaboration, networking and use of partnerships in the delivery of public services. In particular, there are questions about appropriate accountability from a management and supervisory viewpoint. It has been observed that:

*How to balance accountability in a way that allows for flexibility of action is the ongoing challenge of public policy in Australia.<sup>1</sup>*

I will also make some concluding remarks on specific points that are presenting challenges to the public sector now and in the future.

## **II. CONVERGENCE OF THE PUBLIC AND PRIVATE SECTORS**

### **AN OVERVIEW**

Much of the recent literature on public administration is focussed on the so-called New Public Management (NPM). The following observation is apposite:

*The central tenets emphasize management skills, quantified performance targets, devolution, the separation of policy, commercial and noncommercial functions, the use of private sector practices such as*

*corporate plans and short-term contracts, monetary incentives, and cost-cutting. Importantly, the new public management also emphasizes a preference for private ownership, and the use of contracting out and contestability in the provision of public services.*<sup>2</sup>

The author also notes that Public Choice theory and its ideas have been ‘exceedingly influential in supplying supporting frameworks to legitimize and provide an intellectual underpinning to political reforms’.<sup>3</sup>

However, questions have been raised by many academics as to whether there is an inevitable and global convergence towards such a particular style of public management.<sup>4</sup> Nevertheless, there are observable elements of NPM in most western democracies that clearly demonstrate sectoral convergence. That is not to say that there does not continue to be national differences in the approaches taken.

At least nominally, re-inventing government can range from the adoption of an entrepreneurial culture and practices involving ‘marketisation’ of bureaucracy to the implementation of more commercial approaches to those government activities that could be undertaken by the private sector solely or in competition with the public sector. It is not necessarily an all or nothing choice. Nor is it simply a useful ‘convergence myth’ to gain political and/or bureaucratic support and acclamation. We all recognise that ‘action speaks louder than words’. And it is action that I am mainly addressing here.

The nature and level of supervision will vary with the degree of convergence. Outright privatisation may mean the end of any government interest in the activity or may be accompanied by the establishment or strengthening of the regulatory framework. The latter will be likely where there are monopolistic characteristics and/or major public infrastructure requirements such as the provision of water, gas or electricity. Corporatisation in Australia will invite the attention of corporate watchdogs such as the Australian Competition and Consumer Commission, the Australian Securities and Investments Commission, and the Australian Prudential Regulatory Authority. Parliament will have various interests depending on whether the organisation is classified under the *Financial Management and Accountability (FMA) Act 1997* or the *Commonwealth Authorities and Companies (CAC) Act 1997*. Likewise will the Government and relevant Ministers.

In short, the supervision will vary depending on whether the organisation is classified as an FMA Act agency or as a CAC Act body. Broadly speaking, the distinction is whether the organisation is part of ‘core’ government or ‘non-core’ government. The latter comprises the more commercial activities, including government business enterprises, and is closest in relation to the private sector. A major difference is that such organisations derive their own revenues in contrast to receiving Parliamentary appropriations. Ownership and/or control are also factors which determine the attention of supervisory agencies such as the Australian National Audit Office (ANAO) and, to an extent, of the Ombudsman, Privacy Commissioner and the Administrative Review Council.

In the past, the nature and level of supervision of core and non-core government activities were reasonably clear. As well, there was a degree of stability of organisations in their categorisation in those two areas. However, with increasing levels of privatisation and involvement of the private sector in government activities, including service delivery,

different bodies are involved in the two areas as well as some agencies moving from one category to the other. Not only has considerable adjustment occurred, but questions are being raised about supervisory coverage and the nature of supervision required. The most dramatic expression of this uncertainty is the ongoing question of 'who is accountable for what'. This is a question I will be pursuing later in this address. The following observation reflects what, in a practical sense, is a difficulty facing public sector managers in the more complex environment that is being generated:

*Responsibility is a slippery and ambiguous concept, and accountability is scarcely less so.*<sup>5</sup>

In Australia, all major legislation covering the administration of the public sector is now principles-based. That is, the legislation is largely in the form of concepts and guidance. Nevertheless, the FMA Act includes a clear legal requirement for Chief Executive Officers (CEOs) to be accountable for the efficient, effective and ethical use of their agency's resources. In short, it provides the legislative framework for financial administration. Accountability requirements are specified in what are known as Chief Executive's Instructions (CEIs). While there was a suggested model for such CEIs, the content and requirements are largely determined by each CEO. These can include specific directions and requirements as well as indicating the extent of discretion available. An important complement is the Chief Executive's delegations.

Concerns about the nature and extent of government and its cost have also extended to the assessment of its impact in terms of regulation. The issue is generally about securing the 'right' balance between protecting the citizen on the one hand and ensuring the impact on those being regulated is not disproportionate, excessively bureaucratic or counterproductive. This balance is achieved in large part by having a requirement for regulatory impact assessments 'which should help establish accountability for the regulatory process'.<sup>6</sup> There is a recognition that simply passing legislation does not automatically result in compliance. As well, it is accepted that 'Good process is the key to good regulation'.<sup>7</sup>

Policy makers need to consider what encourages and discourages compliance and assess the costs and benefits involved. Of course, the degree of compliance affects the balance between actual costs and assessed benefits which needs to be taken into account to ensure a realistic view is taken of the regulatory impact. In Australia, Regulatory Impact Statements have been required since 1997 and have to be made public. Assessments of Compliance by agencies are undertaken by a central organisation known as the Office of Regulation Review. At least for relatively minor proposals, it has been suggested that a self-regulatory approach be undertaken with that Office later auditing the agency's Impact Statement.

While governments may now be more concerned with the commercial impact of regulation on the private sector, there are clearly more wide-ranging issues that need to be taken into account when assessing the impact on citizens, such as transparency, equity, probity and ethics. The latter reflect only some of the tensions that convergence of the public and private sectors may need to address. To the extent that there is greater privatisation of government activities, those tensions are only likely to be more apparent for the remainder of the government sector.

As an aside, I can well recall the observation by the well-known author and academic Peter Hennessy:

*Pieces of paper are one thing, real belief systems quite another. It is very hard to export the public service ethic into the private contractor hinterland. Commercial contracts are not susceptible to a foolproof, public service ethical override.*<sup>8</sup>

In a similar view, there have been concerns expressed about the condition of democracy in a number of countries and the extent to which any modelling of the public sector based on the private sector may aggravate that condition. But most would probably agree that:

*Today, it is difficult to predict how the globalization of economies and the expansion of market concepts into the public sector will affect democracy and public service, or to foresee the nature of the current and forward accommodation*<sup>9</sup>.

The same authors observed that:

*While it may be too early to assess the long-term impact of NPM in countries such as New Zealand and Australia, the evidence supporting democratic accountability and citizen engagement is not encouraging*<sup>10</sup>.

I intend to provide some comments which bear on such an assessment in relation to Australia on both issues, particularly the question of accountability for performance in the changing environment of public administration involving greater private sector participation and notions of partnership and networking. That is the reality many of us are addressing. However, I am very well aware that:

*by using the language of management, we are relegated to using technique to represent the democratic pole of the tension between bureaucracy and democracy*<sup>11</sup>.

Nevertheless, in describing supervision, it is difficult to avoid management language. However, I will continue to stress the values, concepts and culture of public administration and the involvement of, and responsiveness to, citizens as opposed to notions of marketisation and clients and/or customers. As a long time public servant, I frequently stress the importance of understanding the political environment in which we work. To people who have operated in the government arena for any reasonable period, this is a self-evident truth. Unfortunately, many in the private sector have little or no appreciation of the various pressures and demands of public life, or of the public interest. Some simply consider this of limited relevance to them as they are expected to act commercially and in the interests of their owners/shareholders.

Equally unfortunately has been the tendency of many public servants to misunderstand what is required of them when urged to be more entrepreneurial in their approach, to be more competitive under some kind of output budget pricing regime, and to focus on results. Addressing one element of this development relevant to the subject of this presentation, Professor David Good of the University of Victoria in Canada observed:

*Even if managers and employees only believed half of what they read, there was little doubt that emphasis would now be placed on achieving agreed results with a de-emphasis on administrative processes and procedures.<sup>12</sup>*

The enduring requirement is to translate political objectives and strategies into delivered performance within an accepted set of public values that is cognisant of a public duty to citizens as such whether or not they are direct recipients of public services.

The points made in this overview demonstrate the need to understand both the nature of modern public service as well as the changing public sector environment. Notions of partnership, networking and joined-up government are increasingly important elements of that environment. Consequently, those elements rate separate comment which I will provide later in the presentation, including addressing the resulting issues that are important from both the accountability and supervision perspectives.

## **THE CHANGING PUBLIC SECTOR ENVIRONMENT**

Governments, particularly in Europe, in North America, in Australia and in New Zealand, are now focussing on making the public sector less costly, better tailored to meet public needs and providing improved services to citizens. The premise that there are some activities which the private sector does best and others where the public sector has more to offer, has meant: orienting public sector more toward outcomes rather than processes (similar to private sector entities); a new emphasis on the contestability of services; outsourcing functions which the private sector can undertake more efficiently; and emphasising continuous improvement to achieve better performance in an environment of devolved authority and greater management flexibility.

The major impetus for these changes has been the questioning of what government does, or should do. This arose from the public's perception of inefficient (costly) and ineffective (lacking client focus) delivery of public services. The policy response was to create a more market oriented environment for public services, one providing greater flexibility for management decision-making and subject to the discipline of competition, in an endeavour to provide public services more efficiently and effectively and with greater client satisfaction.<sup>13</sup>

Providing a more market oriented environment for the delivery of public services must be balanced by the continuing requirement to properly account for public assets and to exercise prudent stewardship of public resources, requirements that are fundamental to a democratic system of government.<sup>14</sup> Clearly, the privatisation of the public sector does not obviate or limit the need for accountability to stakeholders. Instead, introducing a new player in the chain of accountability (the private sector service provider) together with greater flexibility in decision-making only strengthen the need for accountability.

This more business-like approach (of the public sector) has been generally welcomed, while recognising that the provision of public services involves a broader accounting than simply achieving the lowest price or a notional profit or return to shareholders. Public service agencies must simultaneously account for (among other things) client satisfaction, the public interest, fair play, honesty, justice and equity while striving to maximise overall

‘value for money’ for citizens. These additional requirements of public sector agencies and their managers derive, ultimately, from the political judgement passed (at intervals, through the electoral process) on the stewardship of public resources. The range and relative importance of these additional requirements vary and they remain the distinguishing feature of public sector accountability compared to private sector accountability; for example:

*‘Ethical behaviour is one of the principal means by which accountability is maintained in the public sector. Indeed, political and administrative accountability depend on the observance of ethical standards and ethical relations between individuals or between institutions.’<sup>15</sup>*

The public sector operates first and foremost in a political climate in which values and public interest are central. While ‘public interest’ has always been difficult to define or measure in any generally agreed fashion, it is very real to the Parliament, to public servants and to the ordinary citizen. In particular, everyone seems to know when public interest is not satisfied. Associated with this focus is an increasing emphasis on public sector values. With sectoral convergence this aspect cannot be over emphasised.

The current scope and range of private sector delivery of public services poses public sector managers, at all levels, risks and challenges different in nature and degree than in the past. The new risks arise from (for instance) separating responsibility for service delivery from responsibility for policy advice, less direct control over the delivery of services, and finding and retaining staff skilled in managing new sorts of contractual arrangements in a public sector environment. The risks must be managed in a public service that has, traditionally, been seen as risk averse and must now balance the trade-offs between, on the one hand, the nature and level of public sector accountability and, on the other hand, private sector cost efficiency. In particular:

*‘Contracting out inevitably involves some reduction in accountability... Accountability is also likely to be reduced through the reduced availability of citizen redress... At the same time, accountability may on occasion be increased through improved departmental and Ministerial control following from greater clarification of objectives and specification of standards. Providers may also become more responsive to public needs through the forces of market competition. Potential losses (and gains) in accountability need to be balanced against potential efficiency gains in each case.’<sup>16</sup>*

The move to commercialisation can strain the thread of accountability between executive government and the elected representatives of the people in parliament. The essential issue, as so often reflected in public administration, is to achieve an appropriate balance, one which can vary in differing circumstances and can derive the benefits of commercialisation and privatisation while properly accounting for the use of public assets, for public resources and for the quality of public services.

Achieving appropriate balance is even more of an imperative as many private and public sector interests gradually converge. The more closely the sectors interact, the more evident their similarities (for instance, management issues and responses) and the more stark their differences (mainly the nature and extent of accountability). Public servants, at least, must understand the pervasive and often decisive influence on public policy and on administration of ‘politics’ as distinct from the imperatives of ‘markets’.<sup>17</sup>



In Australia, public servants now work within a legislative and administrative framework that combines the advantages of a fuller accounting regime with the flexibility to engage directly with the private sector. Where before public sector accountability operated under fairly strict separation from private sector endeavour. Australian public servants are now required, for example:

- to take a much broader view of policy and administrative issues and possible solutions (*Public Service Act 1999*);<sup>18</sup>
- to work more flexibly with more attention to the efficient and effective use of human resources (*Workplace Relations Act 1996*);
- to assume greater responsibility and accountability for public resources (*Financial Management Act 1997*);
- to focus on outcomes through the accrual budgeting framework; and
- to emphasise strategies, such as customer charters, which help balance complex political, social and economic objectives.

Government and parliament ultimately decide on trade-offs between public sector accountability and private sector cost efficiency. They do so on the basis of information and advice from both the public and private sectors. It is proper that public servants, and Supreme Auditing Institutions (SAIs) / Auditors General in particular, ensure such advice is not, by omission or default, left solely to the private sector where the public interest may not be recognised or fully understood.

It has been said that the roles and responsibilities of the public and private sectors may converge to the point where, perhaps, the differences between the two become more apparent than real. As the British Prime Minister, Tony Blair, has observed:

*'Distinctions between services delivered by the public and private sectors are breaking down in many areas, opening the way to new ideas, partnerships and opportunities for devising and delivering what the public wants'.<sup>19</sup>*

and

*'People want effective government.'<sup>20</sup>*

This begs the question of what defines 'core' public sector activities: which functions can, and should, only, be performed and delivered by government? Outsourcing and privatising areas traditionally considered public sector activities indicates that size of the core is shrinking. A broader issue is whether, over the longer term, the public sector might diminish to a point at which it no longer constitutes a credible, effective or viable arm of sound democratic governance.

*It is always a worthy pursuit to aim for a government that is modest in size. However, the appropriate size of the public service will always be relative, not absolute.<sup>21</sup>*

As governments move down the NPM route what are the audit/supervision issues? I will address the following issues that I see as the more important.

### **GOVERNMENTS AS MINORITY SHAREHOLDERS**

In a number of countries, governments have taken out minority shareholdings in private companies for the purpose of delivering public services as a strategic stakeholder, or as a step on the way to a more privately centred delivery pattern. However, from studies by an international Working Group of Supreme Auditing Institutions on the Audit of Privatisation it seems that, in developed economies, this arrangement is likely to represent a small proportion of economic activity. The working group commented:

*There is widespread recognition of the exposure of the state to risk as a result of these holdings (eg of exposure to demand for financial support if the business gets into difficulty, or of criticism from wholly owned or non-subsidised private sector competitors about unfair competition). It is also clear that the state does not have any more legal rights and protection than those offered to other minority shareholders, even though it may in practice if not in law be more exposed to demands for support from the private business than private shareholders (eg indemnities, explicit or implicit).<sup>22</sup>*

Accordingly, the Working Group pointed to the need for more guidance on issues such as:

- ❑ *what are the risks to which the state is exposed where it is a minority shareholder and how these can best be managed;*
- ❑ *what steps the state needs to take to ensure that its interests are protected (eg by stating its objectives for its investment, ascertaining and securing its legal rights, valuing its contribution, securing a reasonable return, minimising moral hazard);*
- ❑ *the skills needed by public bodies required to monitor minority shareholdings or seeking to acquire such holdings;*
- ❑ *incentives for public bodies and their staff to protect the state's interests; and*
- ❑ *how to carry out constructive examinations where they have access rights to the public body responsible for the state's minority shareholding but not to the private business itself.<sup>23</sup>*

I would have to observe, based on my experience, that the issues are no less complex and pressing where government is a majority shareholder. In some ways, the potential conflicts of interest and financial and other exposures for government, boards and auditors can be more challenging and demanding.

### **PARTIAL PRIVATISATION**

The partial privatisation, or phased approach to full privatisation, gives rise to a different set of audit risks than full privatisation in a one step or 'clean break' approach. Chief among these is the question of whether the audit of partially privatised entities should be

part of the core business of SAIs. From the Australian perspective, this is not core business, though the ANAO still carries the full audit risks, including accountability, to both non-government shareholders and to the Parliament, including the Executive Government. The issue becomes how to handle the potential, if not likely, conflicts of interest.

There have been a number of instances of partial or phased privatisation in Australia, these include:

- The Commonwealth Bank of Australia was sold in three tranches between 1991 and 1996.
- 25 per cent of the national carrier Qantas Airways was sold to British Airways by way of trade sale in 1993 and the remaining 75 per cent was sold by way of a public share offer in 1995.
- One-third of the shares in Telstra Corporation were sold by public share offer in 1997 a further 16 per cent of these shares were sold to reduce the Australian Government to a 50.1 per cent shareholder. There has been some discussion about the possible sale of the remainder of the Commonwealth's Telstra shares, but no government decision has been taken and that would require further legislative amendment.

Government activities that have been partially privatised have somewhat different imperatives and require other forms of control or oversight in terms of how they are to be held accountable. It is important to recognise that the partial privatisation of a government business represents a marked change in the operating environment of an entity. In this context, SAIs need to consider what is the appropriate manner for them to discharge their mandate responsibilities. However, of critical importance is that, whatever delivery method is used I, as Auditor-General, have and will continue to have, the ultimate responsibility for the conduct of financial statement audits even if they are performed under contract by a private sector auditor.

Continuing this theme, private sector involvement in public audits can add value. The ANAO has been using private sector firms for a number of years as agents in conducting financial audits. This does not abrogate my responsibility for the opinion given on those financial statements nor from the responsibility to be satisfied that the work of our agents is not just "adequate" but is based on demonstrated good professional practice and in accordance with audit standards set by the Auditor-General. Therefore ANAO retains strong project management and oversight of such audits both for assurance and for understanding of the issues, including the professional development of ANAO staff.

Using the private sector in this way does, moreover, provides the ANAO with the opportunity to concentrate resources on core business (mainly entities wholly or largely budget funded). Here ANAO has specialist skills, knowledge, understanding and experience of public sector functions and activities. At the same time, ANAO provides a better service with private sector firms to the more specialised entities, often with limited or no additional budget funding, than could be provided solely from ANAO's resources. Such a strategic approach ensures the ability to provide the Federal Parliament with the required assurance about overall public service accountability and the necessary degree of

involvement to do so credibly. The issue is basically about achieving the right balance of such involvement to be effective.

## **PRIVATE FINANCING OF GOVERNMENT ACTIVITIES**

In the current budgetary environment, governments in many countries have often found it difficult to provide dedicated funding for large projects out of annual budgets. The encouragement of private sector investment in public infrastructure by governments is one response to fiscal pressures. This gives rise to additional challenges and demands for public accountability and transparency because the parameters of risk are far different to those involved in traditional approaches to funding public infrastructure. Indeed, the potential liabilities accruing to governments may be significant.

Extensive use has been made of private financing, for example in the United Kingdom (UK). The Private Finance Initiative (PFI) was introduced in 1992 to harness private sector management and expertise in the delivery of public services.<sup>24</sup> Up to the present, contracts for about 400 PFI projects have been signed by central and local government for procurement of services across a wide range of sectors, including roads, rail, hospitals, prisons, office accommodation and IT systems. The aggregate capital value of these projects is estimated to be some £Stg 20 billion. Total government payments commitment under these contracts is about £Stg 100 billion over the next 25 years.<sup>25</sup>

The UK National Audit Office (NAO) has noted that the private finance approach is both new and more complicated than traditional methods of funding public infrastructure.<sup>26</sup> It brings new risks to value for money and requires new skills on the part of the public sector.

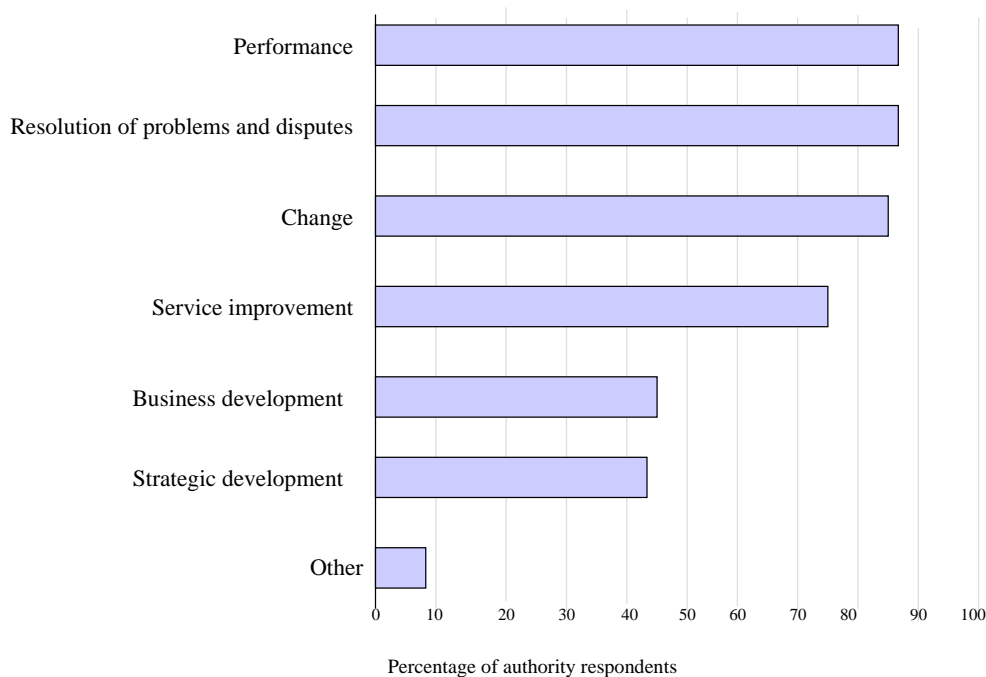
Since 1997, the NAO has published twenty-four reports on such projects. The ongoing message is that, for privately financed projects to represent value for money, the price must be in line with the market, the contract must provide a suitable framework for delivering the service or goods specified, and the cost of the privately financed option (taking into account risk) should be no more than that of a publicly funded alternative.<sup>27</sup> In financial terms, it has been recognised that it is difficult for the private sector to borrow as cheaply as governments can. Accordingly, delivering financial benefits from private financing requires cost savings in other aspects of the project and/or the effective transfer of risk. The NAO has identified three key stages critical to the long term success of a PFI project, as follows:

- a partnership approach is required supported by the right contractual framework;
- authorities need the right skills mix at the right time; and
- the partnership framework must be made to work in practice.

Governance procedures can be used to deal with a range of issues as the following figure shows:

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### Governance arrangements cover many events



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SOURCE: UK National Audit Office survey of authorities

It is apparent that the PFI in the UK is being driven heavily by the objective to transfer risk.<sup>28</sup> For example, in contracting the funding, design and management of IT and infrastructure projects to the private sector, the associated transfer of risk to private sector managers is being justified on the basis that they are better able to manage the risks involved. However, a report commissioned by the UK Treasury indicated that some invitations by public sector bodies to negotiate contract provisions included risks that could not realistically be best managed by the contractor.<sup>29</sup> The report went on to advocate an approach involving the ‘optimum’ transfer of risk, which simply means allocating individual risks to those best placed to manage them. As usual, the devil is in the detail but experience is indicating some useful means of deciding on an appropriate allocation of such risks. There would be general agreement that the issue is more about risk allocation than risk transfer. Nevertheless, there is always concern that the ultimate risk often rests with the public sector.

In Australia, most of the activity in private financing initiatives has occurred at the State Government level, particularly in relation to infrastructure projects such as roads. Prominent examples include the Sydney Harbour Tunnel, the M2 Motorway in Sydney<sup>30</sup> and the City Link project in Melbourne. Of note is that these high profile projects have been the subject of external scrutiny that has raised concerns about the exact distribution of risk and financial benefits between the public and private sectors.<sup>31 32</sup>

Equally significant, have been the concerns raised about public accountability for privately financed projects. These have stemmed from difficulties Parliaments have experienced in gaining access to contract documents. For example, in relation to the aforementioned M2 Motorway in New South Wales, the NSW Parliament was denied access to the contract deed between the public sector roads authority and the private sector counterpart.<sup>33</sup> These

experiences reinforce the need to have such contractual arrangements clearly specified and agreed at the outset rather than when difficulties arise and funding commitments have clearly been made. Both New South Wales<sup>34</sup> and Victorian Governments<sup>35</sup> have now issued extensive guidance on the use of private finance, which address many of the foregoing and other relevant issues.

At the national level in Australia, there has been increasing interest in private financing initiatives, although to date there has been limited actual adoption, notably in the property and defence projects areas. The clear intention on the part of Defence in widening the use of private financing (reportedly for as much as 25 to 35 per cent of all future acquisition projects<sup>36</sup>) is to achieve the best affordable operational capability.

As an aside, I note that, in rebutting some criticism that PFI in the Defence context has been seen as ‘simply putting Defence capital expenditure on the plastic’, the Under Secretary of the Defence Materiel Organisation has made the point that PFI will link the provision of the capital item or capacity with its life-cycle cost, and hence provide Defence with one *payment for availability*.<sup>37</sup>

Of course, any substantial move towards private financing of Defence activities would need to consider what core business the Department needs to maintain in order to manage effectively the longer-term risks that are involved in any outsourcing. With this in mind, the Department has indicated in a Discussion Paper that private financing is to be considered for all capability proposals and tested as an acquisition method unless the capability:

- involves the direct delivery of lethal force (core Defence business); or
- is demonstrably inappropriate and uneconomic (that is, does not reflect best value for money).<sup>38</sup>

In Australia the growing interest in, and use of, private financing initiatives and the important financial, risk transfer and accountability issues raised presents a challenge for agencies to determine just what is meant by ‘value for money’ in terms of the government purchasing policy of the day.

In testing value for money, specific attention, including considerations of accountability, will need to be given by agencies to ensuring that an adequate assessment (pricing) of risk to be transferred between the public and private sectors occurs before such transfer takes place. Unless risk is substantially transferred to the private sector, private financing may achieve little other than to provide the private sector with the benefit of a very secure income stream, similar to a government debt security, but with the private sector able to earn returns above those available from investing in government debt securities. However, the transfer of risk to the private sector is only really cost-effective where the private sector is better able to manage and price these risks.

Even where a risk has been transferred, as part of the allocation process, there can remain a residual risk that the public sector may have to step-in where the private sector contractor experiences difficulties in meeting its obligations. This is because, where the provision of public services or goods is involved, private financing does not equate to contracting out ultimate responsibility and accountability for the outputs and/or outcomes concerned. A good example was the United Kingdom Royal Armouries deal, where the armouries had to

take back certain risks previously allocated to the private sector supplier in a revised deal in July 1999.<sup>39</sup> This arrangement also illustrated that it is not always desirable to transfer demand risk since the level of usage required of an asset or service under PFI deals is usually not within the private sector's control. In this context, I welcome the following requirement in Australia's Commonwealth Policy Principles:

*Included in all private financing arrangements should be standard best practice clauses on audit access, security, privacy and parliamentary access.<sup>40</sup>*

Under PFI the shared responsibility, if not accountability, between the two sectors has implications for government governance arrangements, a theme I will pick up on later in the discussion of corporate governance issues. The key message I wish to leave here is the need for public sector managers to fully appreciate the nature of the commercial arrangements and attendant risks involved in private financing initiatives.

*Agencies are responsible for the delivery of their outputs even through the use of private financing. Agencies are not able to transfer accountability to a private sector entity, irrespective of the procurement method.<sup>41</sup>*

With the growing international importance of PFI, the contiguous audit /supervision issues have been recognised and a working group of Heads of Audit Offices from a range of countries, under the Chairmanship of the Comptroller and Auditor General of the United Kingdom, has recently published Guidelines on Best Practice for the Audit of Public/Private Finance and Concessions.<sup>42</sup>

## **PRIVATE SECTOR DELIVERY OF PUBLIC SERVICES**

Managing the risks associated with the increased involvement of the private sector in the delivery of government services, particularly through contract arrangements, has required the development and/or enhancement of a range of commercial, negotiating, project and contract management skills across the public sector.

Hence, outsourcing represents a fundamental change to an agency's operating environment. It brings with it new opportunities as well as risks, requiring managers to develop new approaches and skills. Managing the risks associated with the increased involvement of the private sector in the delivery of government services, in particular the delivery of services through contract arrangements, requires the development and/or enhancement of a range of skills across the public sector and will be a key accountability requirement of public sector managers. In particular, outsourcing places considerable focus and emphasis on project and contract management, including management of the underlying risks involved. The thrust of this change is reflected in the Australian Senate's Finance and Public Administration Committee's second report on Contracting Out of Government Services released in 1998:

*'Despite the volumes of advice on best practice which emphasise the need to approach contracting out cautiously, to invest heavily in all aspects of the process and to prepare carefully for the actual implementation, and the substantial body of comment in reports from the Auditor-General indicating*

*that Commonwealth agencies have a very mixed record as project and contract managers, the prevailing ethos still seems to promote contracting out as a management option that will yield inevitable benefits. Resources must be made available to ensure that contract managers have the skills to carry out the task.*<sup>43</sup>

In this context, public sector managers and auditors need to be cognisant of the potential risks that might arise from project management arrangements with private sector investors, such as:

- ❑ short term flexibility may be compromised by unforeseen ‘downstream’ costs or liabilities which erode or offset early gains;
- ❑ there may be a tendency for government to bear a disproportionate share of the risks, such as through the offer of guarantees or indemnities;
- ❑ the failure of private sector service providers may jeopardise the delivery of the project, with the result that the government may need to assume the costs of completion plus the costs of any legal action for any contractual breaches;
- ❑ drafting inadequacies in contracts or heads-of-agreement with partners could expose governments to unexpected risks or limit the discretion of future governments by imposing onerous penalty or default clauses;
- ❑ inadequacies in the modelling and projection of costs, risks and returns may, under some conditions, result in an obligation by governments to compensate private sector providers for actual losses or failure to achieve expected earnings;
- ❑ there may be some loss of transparency and accountability for disclosure as a result of private sector provider claiming commercial confidentiality with respect to the terms of their investment; and
- ❑ the level of private sector investment and the amount of risk private sector providers are willing to bear may be inversely proportionate to the conditions placed on them by governments to determine pricing, delivery of community service obligations, or transfer or sell interest in the project.

In the Australian context , over recent years, there has been considerable attention through the audits of the ANAO on the necessity of having in place the ‘right’ contract, as well as appropriate contract management arrangements, to assist in meeting government objectives and strategies. This reflects the greater involvement of the private sector in providing a wide range of public services. One important lesson we have learnt, and that is being reinforced constantly, is that:

*... clear identification and articulation of contract requirements at the outset can save considerable time, cost and effort later in contract management.*<sup>44</sup>

A common theme of these audit reports has been deficiencies in project management skills of agency decision-makers. As well, reports have highlighted a need for care in assessing value for money and negotiating, preparing, administering and amending major contracts.



Outsourcing has been a key feature of the changing Australian public sector environment and has raised important questions of accountability. The lessons learned from the outsourcing of information technology (IT) illustrate the challenges facing public sector managers charged with outsourcing functions which, it was judged, the private sector could deliver more efficiently.

The outsourcing of IT in the Commonwealth sphere in Australia arose from a government decision known as the IT Initiative, which was to transfer around \$A4 billion of IT provision in Federal agencies to the private sector. The then Office of Asset Sales and Information Technology Outsourcing (OASITO) managed the Initiative centrally for the government through a series of tenders dealing with groupings of agencies (clusters). These clusters were, in effect, mandated as opposed to agencies being allowed voluntary participation in groupings with accepted synergy and shared purpose. The scope of services that were to be included in each outsourcing tender was also mandated.

The arrangement posed significant problems of corporate governance for those agencies where the IT requirement was predominantly scientific or otherwise related to the core activities of a particular agency (for example, the payment of pensions). The approach taken by OASITO was designed to implement the Government's policy agenda under centralised direction (and control) despite the perceived reluctance (buy-in) of some of the agency heads because they did not have the degree of control necessary to best manage transition risks, and because they were ultimately responsible for the agency outputs and outcomes and the budgets involved.<sup>45</sup> There was no evidence to indicate that public servants were not endeavouring to implement the Government's outsourcing policy. The question was more to find the best way of meeting all the Government's requirements, including legislative imperatives.

The Australian Government, in response, commissioned a review of IT outsourcing that was conducted by Richard Humphry (Managing Director, Australian Stock Exchange). The independent review recognised the implicit management dilemma and recommended that, because Chief Executive Officers (CEOs) of agencies had the statutory responsibility, they should be responsible for the outsourcing decisions. In particular, decisions that impacted upon the core business of the agency needed to be taken at agency level. Mr Humphry remarked:

*'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.'*<sup>46</sup>

The Government agreed with the ten recommendations made by the review, some with qualification.<sup>47</sup> This agreement included that responsibility for implementation of the IT Initiative be devolved to Commonwealth agencies in accordance with the culture of performance and accountability incorporated in the relevant financial management legislation. Agencies are required to obtain value for money (including savings) and maximise Australian industry development outcomes. Agency heads will be held directly accountable for achieving these objectives within a reasonable timeframe, as well as grouping with other agencies at their discretion, wherever possible, to establish the economies of scale required to maximise outcomes.

Advocates of outsourcing point to the opportunities offered in terms of increased flexibility in service delivery; greater focus on outputs and outcomes rather than inputs; freeing public sector management to focus on higher priorities; encouraging suppliers to provide innovative solutions; and cost savings in providing services.<sup>48</sup> However, outsourcing also brings risks to an organisation which cannot be ignored. The experience of the ANAO has been that a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and considerable public concern<sup>49</sup>.

The main message from this experience is that savings and other benefits do not flow automatically from outsourcing. Indeed, like any other element of the business function, outsourcing must be well managed and analysed within an overall business case including an assessment of its effect on other elements of the business. The latter can be positive or negative. In the case of Finance's outsourcing of all its human resource management functions, it was assessed as positive for its core business. That arrangement subsequently won a worldwide outsourcing achievement award.<sup>50</sup>

### **THE ACCOUNTABILITY TRADE OFF**

All public sector organisations (whether statutory authorities, government agencies, corporations or local authorities) are required to be transparent, responsive and accountable for their activities. Citizens are entitled to know whether public resources are being properly used and what is being achieved with them. Such transparency is essential to help ensure that public bodies are fully accountable and is therefore central to good governance overall.

In a more privatised public sector, the question often becomes what is a reasonable trade-off when, inevitably in a public sector environment, the perceived needs for accountability can impact adversely on economy and efficiency. A similar observation extends to the notion of effectiveness, particularly where that concept does not embrace accountability concerns such as transparency, equity of treatment and probity in the use of public resources, including the application of public service values and codes of conduct.

The apparent trade-off has been extensively commented on by, for example, Professor Richard Mulgan of the Australian National University, in many articles and presentations in recent years. The following is indicative:

*Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out because the main increases in efficiency come from the greater freedom allowed to contracting providers.<sup>51</sup>*

A practical comment on the perceived trade-off has been provided by the former Canadian Auditor General, as follows:

*The emphasis should not be solely on greater efficiency or on meeting accountability requirements.<sup>52</sup>*

An appropriate balance has to be struck, which may involve re-consideration by the Government and the Parliament as to the appropriate nature and level of accountability of both public and private organisations where there is shared responsibility, and even accountability for the delivery of public services to the citizen. I am personally inclined to support the observation of Professor John Uhr, also of the Australian National University, that:

*Accountability and responsibility are two parts of a larger whole: whoever is 'responsible for' a policy or program is also 'accountable to' some authority for their performance within their sphere of responsibility.*<sup>53</sup>

When commenting on the need to maintain scrutiny of government operations, Senator Hogg (a Member of the Australian Parliament's Joint Committee of Public Accounts and Audit (JCPAA)), for instance, has noted that:

*Public funds are not for the private purse of the government nor the bureaucrats to do what they like with. They are public funds for public purposes and should stand the test of public scrutiny by the Parliament.*<sup>54</sup>

I take the view that accountability of public sector operations depends to a great extent on providing full information on the operations of agencies and other bodies. In some situations, because of the nature and complexity of public sector administration in an environment of ongoing reform:

*Additional transparency provisions may be a cost that we have to meet to ensure an acceptable level of accountability.*<sup>55</sup>

In the Australian context, there is no suggestion on the part of the Government or Parliament that accountability expectations will be downgraded; if anything, the reforms suggest that additional authority and flexibility require enhanced accountabilities even where there may be an additional cost involved. Parliament's confidence in the accountability of public sector organisations is an on-going challenge to our corporate governance frameworks. Nevertheless, in the words of a long time academic reviewer of the changing nature of governance in Australia:

*With the advent of entrepreneurial government and the enterprising state, expressed most obviously in extensive forms of contracting-out, (these) organizational boundaries and identities are less able to contain or limit the accountability issue. Recent changes have stretched the elasticity of our received notions of accountability to the breaking point.*<sup>56</sup>

## **THE PRIVACY AND SECURITY / OPENNESS AND TRANSPARENCY REQUIREMENTS**

The increased involvement of the private sector in the provision of public services also raises concerns about the security of agency data and records, particularly in electronic form. Previously, in Australia, the obligations that apply to Commonwealth agencies under the Privacy Act did not apply to private sector organisations. However, the Privacy Amendment (Private Sector) Act 2000 aims to provide privacy protection for personal records across the private sector, including those organisations providing outsourced services to the public sector. The Act enables a contract between a

Commonwealth agency and the private sector supplier to be the primary source of the contractors' privacy obligations regarding personal records. The Act:

*aims to control the way information is used and stored, and bring to justice those who abuse private information for their own ends. Placed in the insecure context of e-commerce and e-mail transmission of personal details, issues of privacy have become more significant.*<sup>57</sup>

A key provision of the Act is the inclusion of ten 'National Privacy Principles for the Fair Handling of Personal Information'. These Principles set standards about how business should collect, secure, store, use and disclose personal information. The Act makes a distinction between 'personal' and 'sensitive' information<sup>58</sup>. The latter includes information on a person's religious and political beliefs and health, where the private sector is more strictly limited in its collection and handling. This legislation is likely to have a marked impact on that sector's involvement in the delivery of public services.<sup>59</sup>

Section 95B of the *Privacy Amendment (Private Sector) Act 2000* requires agencies to consider their own obligations under the Act when entering into contracts and obliges them to take contractual measures to ensure that a contracted service provider does not do an act, or engage in a practice, that would breach an Information Privacy Principle if done by the agency. The obligation on the agency extends to ensuring that such an act or practice is not authorised by a subcontract.

Under the Privacy Act as currently constituted, privacy monitoring of outsourcing arrangements falls into two stages:

- assessing the privacy control environment, particularly by ensuring that outsourcing arrangements are governed by contracts that contain appropriate privacy clauses; and
- monitoring the actual implementation of the controls, particularly by monitoring compliance with the contractual clauses.<sup>60</sup>

In practice, to date, feedback from outsourcing agencies and contractors suggests that few, if any, complaints have arisen in relation to privacy breaches associated with outsourcing contracts.<sup>61</sup> The recent State of the Service Report indicates that:

*The Privacy Commissioner remains apprehensive about the handling of personal information by outsourced providers and stresses that, with an increase in outsourcing across a range of services, APS employees must be confident that service providers are complying with the Information Privacy Principles (IPPs) and the Privacy Act 2000.*<sup>62</sup>

Clearly, contracts for outsourcing service delivery need to ensure that prospective service providers are aware of the standard of protection that comes from dealing with people on behalf of the government and that the mechanisms in place do provide effective privacy protection. A watchful citizenry will want to be certain that agencies and their contractors cannot evade their obligations.

To fully address such concerns, a Better Practice Guide, recently prepared by the ANAO,<sup>63</sup> suggests that agency Internet websites should incorporate a prominently displayed Privacy

Statement that states what information is collected, for what purpose, and how this information is used, if it is disclosed and to whom. It should also address any other privacy issues.<sup>64</sup> According to Privacy Compliance Audits conducted by the Privacy Commissioner, of Commonwealth Government web sites in 2000 and 2001, about 20 per cent of larger agencies, and 38 per cent of smaller agencies, still need to include a privacy statement on their web sites.<sup>65</sup>

## ACCESS TO INFORMATION

The current trend towards increased contracting with the private sector for the provision of government services provides a challenge, not only for agencies' accountability, but also for an SAI's actual ability to access the relevant records.

Accountability can be markedly impaired where outsourcing reduces openness and transparency in public administration for whatever reason. It has been said that 'information is the lifeblood of accountability'.<sup>66</sup>

*Put simply there can be no accountability if there is no information.*  
(Senate Finance and Public Administration Reference Committee 2000)<sup>67</sup>

On the other hand, an alternative view is

*I think that the sanctity of a contract...[is] a fundamental pillar of our legal system, and if private business enter into contracts with governments that specify confidentiality, then that ought to be respected.*<sup>68</sup>

Access issues are not new. However, the current concerns reflect the increasing involvement of the private sector. This has raised questions about 'new frameworks of accountability'.<sup>69</sup>

*The test case is the accountability challenge posed by alternative service providers and their claims that their contracts with government lessen their liabilities of public accountability because of the 'commercial in confidence' nature of their performance information*<sup>70</sup>

My Office has experienced some problems in accessing contractor information both through audited agencies and in direct approaches to private sector providers. This matter should be of concern to public agencies in their role as contract managers, to executive government as decision-makers, and to the Parliament when scrutinising public sector activities. In particular, public service managers need to have a level of access sufficient to ensure they can meet their own accountability obligations. In general, the ANAO would not have any different requirements.

In this context, I noted with some interest in a recent United Kingdom (UK) National Audit Office Report<sup>71</sup> that a public authority had faced great difficulty in getting timely information on the true extent of the private sector provider's financial difficulties. This was because, under the contract, it had no access to the contractor's underlying financial records.<sup>72</sup> However, the Report also noted that, with appropriate subsequent action, 'greater rights of access to the private sector party's financial records are now standard in that country'.<sup>73</sup>

As part of performing a statutory duty to the Parliament, my Office may require access to records and information relating to contractor performance. My statutory information-gathering powers<sup>74</sup> are broad but they do not include a right of access to contractors' premises to obtain information. As early as September 1997, my Office circulated draft model access clauses to agencies and recommended their insertion in appropriate contracts. These clauses give the agency and the ANAO access to contractors' premises and the right to inspect and copy documentation and records associated with the contract. Clearly, the primary responsibility for ensuring there is sufficient access to relevant records and information pertaining to a contract lies with agency heads.

For accountability measures to be effective, it is critical the nature and level of information to be supplied under the contract and the authority to access contractors' records and premises is sufficient to adequately monitor the performance of the contract. I am not however advocating carte blanche access, I consider that access be equivalent to that which should reasonably be specified by the contracting agency in order to fulfil its responsibilities for competent performance management and administration of the contract.

Including access provisions within the contract, for performance and financial auditing, is important in maintaining the thread of accountability, particularly with government agencies' growing reliance on the private sector. I stress again that this is important both for agency management and audit assurance to other stakeholders, including the Government and the Parliament. There is ample support, for example:

*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.*<sup>75</sup>

and

*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.*<sup>76</sup>

The ANAO believes that the use of contractual provisions is the key mechanism for ensuring agency and ANAO access to contractor's records for accountability purposes. Following the work undertaken by the ANAO and the Department of Finance and Administration, the Minister for Finance and Administration subsequently approved standard clauses for inclusion in relevant government contracts.<sup>77</sup> These are included in the updated Australian Government 'Procurement Guidelines'.<sup>78</sup>

## **COMMERCIAL CONFIDENTIALITY**

Following on from the general issue of access, commercial confidentiality in contracts is one area that has been the subject of considerable parliamentary concern and comment in many constituencies both in Australia and overseas and is central to the issue of adequate supervision.

The debate has not just been limited to Parliamentarians and Parliamentary Committees, SAIs, and academics. For example, an editorial in an Australian newspaper commenting on the Australian High Court's judgement in relation to the tabling of documents before an Australian State Parliament stated that:

*'This defence (that papers were commercially sensitive and should not be released) is over-used by governments trying to avoid scrutiny and embarrassment and often represents arrogance of the first order; a democracy elects its representatives to act on behalf of the electorate as a whole, not of vested interests. The system requires the utmost transparency and direct accountability from its Parliamentary representatives. Lack of transparency and limiting the capacity of Parliament to review government decisions weakens our democracy.'*<sup>79</sup>

However, in the Australian context, I consider that we have made some useful headway on the issue, albeit that some commentators are not so sure.<sup>80</sup>

*'CIC [commercial-in-confidence] has been interpreted as the first skirmish in the deeply controversial paradigm shift from the government- as-service to government- as-contractor. Commerce, with heavily rationalised moral conditions, will be the winner, accountability and democracy the loser – unless the looming fight over CIC is finalised in the public interest.'*<sup>81</sup>

In Australia, three initiatives have contributed to improved accountability in this area. First, the Australasian Council of Auditors-General has released a statement of Principles for Commercial Confidentiality and the Public Interest<sup>82</sup>. Of particular concern to Council members has been the insertion of confidentiality clauses in agreements/contracts that can impact adversely on Parliament's 'right to know', even if they do not limit a legislatively protected capacity of an SAI to report to Parliament. As an example, one of the Principles concludes that:

*'Some private and public sector bodies are instinctively apprehensive and protective about the disclosure of any commercial information. But such views often overstate the implied risks to an entity that might be occasioned by the release of commercial data. After-the-event commercial information has significantly less value than commercial information concerning events that have yet to occur. But even where commercial information might have commercial value to others, there are often overriding obligations that require it to be released. This is so for commercial information held in the private sector and, a fortiori, it applies to the public sector.'*<sup>83</sup>

Second, commercial confidentiality concerns have also been addressed by a number of Australian Federal Government parliamentary inquiries.<sup>84</sup> 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*<sup>85</sup>, addressed a motion that 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<sup>86</sup>.

The Committee's report noted that, at almost every budget estimates hearing, information is denied to Senators on the grounds that it is commercially confidential. The Committee tabled an initial report in June 2000.

In parallel, the ANAO had advised that it would consider conducting a performance audit on the issue of confidentiality provisions in Commonwealth contracts. The ANAO report, to which I refer below, was tabled on 24 May 2001 after which the Committee prepared a second and final report on the mechanism proposed in the general notice of motion (No. 489). The motion is now a Senate order. The Committee noted in its second report:

*the order [of June 2001] works as a safeguard against the overuse of confidentiality claims in Commonwealth contracts. Agencies now need to think carefully about whether there is a genuine reason for keeping material confidential and restricting access to details of public expenditure<sup>87</sup>.*

This is an 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. More recently, the Senate Finance and Public Administration References Committee commented that:

*The need for confidentiality should be interpreted as narrowly as possible to ensure that the maximum amount of information is in the public domain.<sup>88</sup>*

Third, the ANAO's performance audit of the use of confidential provisions in contracts focused attention on the issues. The report's main conclusions were:

- there was no consistency across government on the use of commercial-in-confidence in contracts;
- consideration of what should be confidential in governments is not addressed in a rigorous way;
- where there are confidentiality provisions in contracts, there is usually no indication of what in the contract is confidential;
- there was uncertainty on what information should be classified as confidential; and
- contracts should include provisions for information to be disclosed to parliamentary committees.<sup>89</sup>

The audit report made three recommendations that were generally agreed by the agencies concerned. As well, the ANAO developed some criteria for agencies in determining whether contractual provisions should be treated as confidential.<sup>90</sup> These criteria are



designed to assist agencies to make a decision on the inherent quality of the information before the information is accepted or handed over – rather than focusing on the circumstances surrounding the provision of the information. The report also gave examples of generally what would not be considered confidential<sup>91</sup> and examples of what would be considered confidential.<sup>92</sup>

In effect, there has been a reversal of the principle of onus of proof, requiring the party that argues for non-disclosure to show that it would be harmful to its commercial interests. It has been my view for some time that only relatively few contract provisions can be viewed as generally commercially sensitive and that the onus should be on the person claiming confidentiality to argue the merits of the case.

In tender documentation issued now, prospective tenderers are asked to indicate in their tender responses what information, if any, they consider confidential noting the clear indication that agencies will have a narrow view on the matter. As an example, my Office has just signed a contract for printing services where these principles were applied. In the event, no provisions of the contract were deemed confidential including pricing information.

Enforcing this concept, the Senate Finance and Public Administration References<sup>93</sup> supported the set of criteria developed by the ANAO for determining whether a sound basis exists for deeming information in contracts confidential.

My Office has very recently released a Report on the Senate Order referred to above.<sup>94</sup> Interestingly, the audit found that of the 64 contracts examined, 40 had confidentiality provisions that would now not be appropriate under the new criteria developed for guiding decisions on confidentiality clauses in contracts with government.

That said, SAIs need to be sensitive to the need to respect the confidentiality of genuine ‘commercial in confidence’ information. The ANAO has 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.

The message here is that external scrutiny (through, for example, the activities of Parliamentary Committees and SAIs) is an essential element in ensuring that public accountability is not eroded, by default, through contracting out. Just as it is incumbent upon public sector agencies to ensure they have a sound understanding of the commercial nature of any contract, private sector entities need to recognise that there are overlaying public accountability issues, not present in purely private sector transactions, that need to be addressed. The latter need not unnecessarily deter private sector participation if handled appropriately.

### III. PERFORMANCE MANAGEMENT – A FOCUS ON RESULTS

*A traditional, centralised bureaucracy has been replaced by a system that seeks to hold public sector managers accountable for delivering outputs purchased by Cabinet Ministers.*<sup>95</sup>

and

*Within the government sector, a trend has now developed placing more emphasis on the reporting of performance. The associated transparency makes the case for sound governance stronger.*<sup>96</sup>

Before examining the audit/supervision issues associated with the shift to outcomes and results I thought it would be useful to provide an overview of the output, outcomes, accounting and budgeting framework developed and adopted in Australia.

*For Australia, the development of its management framework took longer and was the product of balancing principle and pragmatism and combining a strategic focus with experimentation....In recent years Australia has moved closer to, if not beyond, New Zealand and the United Kingdom, with the greater emphasis on market principles. The feature that mark it out include the emphasis on outputs, devolution, performance management, accountability, evaluation and values.*<sup>97</sup>

#### THE AUSTRALIAN GOVERNMENT'S BUDGETARY FRAMEWORK

In order to adequately assess performance there is a need to identify both the financial and non-financial drivers of an organisation's business. Within the Australian government sector, such assessment is underpinned by the introduction of the outcomes and outputs framework associated with the implementation of accrual budgeting. The outcomes and outputs framework is intended to assist management decision-making and performance by focussing attention on the Government's goals and objectives (outcomes). The identification of appropriate performance indicators, together with reporting of actual results against these performance indicators, is a key plank within this new accountability framework and a central element of supervision.

The accrual-based outcomes and outputs budgetary framework for managing resources in the public sector was introduced during 1999–2000. In prior years, the Commonwealth Budget was prepared using a Program Management and Budgeting (PMB) framework where program objectives were specified and performance indicators were used to measure results against these objectives.

The budgetary framework places more discipline on measurement and assessment of the extent to which outputs are delivered to achieve desired outcomes (in accordance with government policy). Essentially, the framework is aimed at improving both how the work of government is measured (through the application of the accrual-based budgeting and reporting) and what is measured (through specifying outcomes, administered items and outputs).

The two basic objectives of the outcomes/outputs framework, are to:

*improve agencies' corporate governance and enhance public accountability. Managing through outcomes and outputs helps improve decision making and performance... It can also help improve the understanding and knowledge of those outside the agency who have an interest in its performance, including ministers, parliament and external accountability bodies such as the Auditor-General<sup>98</sup>*

Under this framework, all government agencies are required to specify their outcomes and outputs and identify relevant performance measures. Agencies, through their chief executives, are ultimately responsible for delivering outputs that contribute to outcomes consistent with Government policy and are required to publish performance information in key accountability documents such as their Portfolio Budget Statements (PBS)<sup>99</sup> and Annual Reports.<sup>100</sup>

In the Australian context, outcomes and outputs (and administered items) have been defined as follows:

*An **outcome** is the impact sought or expected by government in a given policy arena. The focus is on change and consequences: what effect can government have on the community, economy and/or national interest? Outcome statements also perform a specific legal function by describing the purposes of appropriated funds.*

***Outputs** are the actual deliverables—goods and services—agencies produce to generate the desired outcomes specified by government. Users of these goods and services can include members of the general public, industries or sectors, ministers, members of Parliament, other agencies or even, in some instances, interests (e.g., the national interest). A client, in other words, can be anyone outside the agency who benefits from the work of the agency.*

***Administered items** are those resources administered by the agency on behalf of the Government (such as transfer payments to the States, grants and benefits) to contribute to a specified outcome. They are identified separately from departmental items (that is, departmental outputs) because they involve different accountability requirements.<sup>101</sup>*

Parliament appropriates money to a specific outcome. Agencies are required to state outcomes in terms of the impact intended by Government on the Australian community with outcome statements expressing the Government's objectives and priorities.

When specifying outputs, and determining an appropriate output level, the specific nature of the products or services being delivered under the output should be considered, such as:

- how well defined is the client or target group?
- how uniform and tangible are the products or services delivered under the output? and
- is there a well-defined market or commonly recognised description or standard for the product or service?<sup>102</sup>

Clearly, outputs need to be aligned with outcomes in order to ensure that the production of specified outputs will result in the achievement of desired outcomes. Without this alignment the production of outputs may result in unintended outcomes.<sup>103</sup>

## **Annual Reporting**

Annual Reports and Portfolio Budget Statements are the principal external reports produced by agencies. Annual Reports are reports from agency heads to the portfolio minister, for tabling in the Parliament. They are formal accountability mechanisms between government and agencies and from agencies through (or on behalf of) government to Parliament.<sup>104</sup>

## **Portfolio Budget Statements (PBS)**

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

*Resource management with an emphasis on measuring performance, in terms of what is being produced, what is being achieved and what is the cost of individual goods and services...*<sup>105</sup>

Portfolio Budget Statements (PBS) explain the proposed allocation of resources to Government outcomes by agencies. However, the format of the PBS has been of continuing interest to Parliament and its Committees and has been the subject of some criticism.

The Joint Committee of Public Accounts and Audit (JCPAA) noted concern among Members of Parliament regarding the impact of the new budget format on their ability to scrutinise proposed government expenditure<sup>106</sup>. More recently, the JCPAA announced (April 2001) a wide ranging review of accrual budget documentation, to inquire into the effectiveness of, and options for enhancing, the format and content of current Budget documentation including the PBS and Annual Reports, for the purposes of Parliamentary scrutiny.<sup>107</sup>

Additionally, the Senate Finance and Public Administration Legislation Committee has conducted three inquiries into the format of the PBS. The Committee's third report, *The Format of the Portfolio Budget Statements Third Report*, tabled in November 2000, noted:

*The PBS are also used as the agenda for estimates hearings, in which the provisions of the Appropriation Bills are examined by eight Senate legislation committees...The achievement of outcomes, while undoubtedly*

*important, is not the only issue—Senators look to the PBS for an explanation of inputs and an indication that the processes involved were proper.*<sup>108</sup>

and that

*‘input’ and ‘process’ issues are likely to continue being asked in that forum, even though the appropriations are now directed to outcomes. And the structure of the PBS does not assist in the formulating of questions on input and process.*<sup>109</sup>

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

*Performance management ensures accountability because it generates valid and reliable data on program impact on the allocation of resources and on the economy, efficiency, effectiveness and integrity with which the government’s finances are run.*<sup>110</sup>

## **THE ANAO’S AUDIT COVERAGE OF PERFORMANCE INFORMATION**

The ANAO’s performance audit work has recognised the challenges facing agencies in this new environment. This sentiment is echoed in the ‘Vertigan Report’ commissioned by Australian Departments of Treasury and Finance:

*The complexity of the task of specifying outcomes in a way in which government and external stakeholders find useful and of specifying outputs in a way in which agency management finds contributes to their management tasks makes it highly improbable that it will have been completed to the satisfaction of all interested parties on the first attempt. Experience suggests that it may take two or three attempts before there is an acceptable level of satisfaction with the specification of outcomes and outputs in each agency.*<sup>111</sup>

The ANAO is keen to identify the issues facing agencies early in the life of the framework so that they can be addressed, but also, and importantly, offer practicable solutions. While the validity and reliability of performance information is a key consideration in most ANAO performance audits, we have undertaken two audits specifically considering performance information. The first of these, Report No 46, *ATO Performance Reporting under the Outcomes and Outputs Framework*, was tabled in June 2001<sup>112</sup>.

The ANAO was responding to a request from the Senate Finance and Public Administration Legislation Committee to review agency performance information. The Australian Taxation Office (ATO) was chosen for the significance of its performance, to assist the ATO in reviewing performance reporting under its outcome and outputs framework, as well as to assess progress being made and lessons learnt. However, it is

expected that all agencies will improve their performance information over time as they obtain more experience with the new framework.

The audit found that, while the ATO has established an outcome and outputs framework, there was scope to improve the specification, clarity and measurability of its outcome, outputs and performance measures and to enhance its performance monitoring and reporting arrangements. The audit made 10 recommendations aimed at improving the ATO's management of its performance reporting under its current outcome and outputs framework.

In undertaking the audit the ANAO developed a number of principles of better practice in relation to specifying performance measures and to measuring, assessing and reporting performance. In consultation with the Australian Bureau of Statistics, the ANAO developed a set of criteria based on methodology used by Statistics Canada to review ATO performance measures. It is envisaged that the audit, while focused on the ATO, can also provide timely and relevant advice to other APS agencies.

The ANAO also conducted a cross-portfolio audit to assess performance information in the PBSs 2000-2001 and Annual Reports for 1999-2000.<sup>113</sup> The Report concluded that, overall, performance information in the PBS should be improved to enable agencies to establish and demonstrate the links between outcomes, outputs and performance indicators.

*A common limitation in the performance information in all 10 audited agencies' PBS and annual reports related to effectiveness indicators which did not actually measure outcome performance.*<sup>114</sup>

And in a theme I will come to later, the Report noted:

*it was important to track overall outcomes achieved across the layers of government and through the various partnerships with other agencies, including non-government bodies, as well as the particular contribution made by the specific Commonwealth agency to the outcome.*<sup>115</sup>

Overall, the Report also concluded that it would be difficult for Parliament and other stakeholders to assess agency performance with reasonable assurance as the performance information did not always include targets, or that the targets that were provided were often vague and or ambiguous.

## **AUDITING/SUPERVISION – THE POLICY VERSUS IMPLEMENTATION ISSUE**

Performance audits evaluate the economy, efficiency and effectiveness of the management of public sector entities by examining and assessing resource use; related information systems; outputs and outcomes, including performance targets, indicators, assessments and measures; monitoring systems; and legal compliance.

I understand that in the European Union, all SAIs except Greece, have a remit to undertake performance audits. Here in Italy, the role of the Corte dei Conti was expanded in the 1994 legislation to examine aspects of performance<sup>116</sup>. In the Australian context, the performance audit functions does not extend to auditing the performance of Ministers nor to examining or reporting on the appropriateness of government policy. However, the

ANAO's performance audits can, and do, evaluate how effectively and efficiently government policy has been implemented. Sometimes there can be a perception of an audit commenting on policy, particularly where the implementation performance reflects a problem with the policy itself rather than with its delivery.

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

The four national audit agencies making up the Public Audit Forum in the United Kingdom believe that:

*'... there are three fundamental principles which underpin public audit:*

- ❑ *the independence of public sector auditors from the organisations being audited;*
- ❑ *the wide scope of public audit that is covering the audit of financial statements, legislatively (or legality), propriety (or probity) and value for money; and*
- ❑ *the ability of public auditors to make the results of these audits available to the public, and to democratically elected representatives.'*<sup>117</sup>

One particular challenge in this environment of change is the increasing tension regarding the role of SAIs and the boundaries between government policy and its implementation. The issue was given some prominence in Australia following two performance audits my Office undertook recently - property sales and IT Outsourcing.<sup>118</sup> The nub of the issue is summed up by Professor Richard Mulgan, an academic at the Australian National University:

*The principles of performance auditing allow the Auditor-General to assess whether government policy has been efficiently and effectively implemented but they require him to take government policy as given. Had the Auditor General crossed the line [in these two audits] which bars him from questioning government policy? Certainly the Opposition treated the report as providing ammunition not only against [the Department of] Finance but also against the Minister and government policy. On the other hand, the Auditor General was clearly aware of the potential difficulty and his report takes care to confine the audit to claim that his audit was confined to implementation and administration. Criticism is aimed exclusively at Finance and the substance of its advice to government...*

and

*On the whole, public opinion, as expressed in media comment, seems to side with the Auditor-General. He was exercising his time-honoured role as investigator of government inefficiency and guardian of the public purse. Pointing out that public funds would be wasted by a particular method chosen for selling governments properties could hardly be beyond the purview of the public's financial watchdog.<sup>119</sup>*

I responded to Professor Mulgan's article, making the point that:

*Policy advising is an output of Finance and it is clearly within the mandate of the Auditor-General to review how effectively the department delivered its output. That the government subsequently may have endorsed a policy based on such advice does not take away from the mandate of the Auditor-General to review the department's development of the advice nor its possible implications.<sup>120</sup>*

Clearly, it is politicians not public servants who take responsibility for policy and it is for this reason that performance audits are restricted to the efficiency, effectiveness and propriety with which policy is implemented. As I noted earlier, they are not extended to cover the merits of the policy itself. However problems can arise where policy is difficult to separate from implementation, for example as in the subject matter of the above comments:

*What was the policy in this case [that is, property sales] ? To maximise long-term benefit to the Commonwealth by selling buildings only where it is profitable to do so? In this case, the Auditor General, had every right to indicate where financial losses were likely. Such losses would indicate that the policy was badly implemented. Alternatively, the policy may have been to divest the government of a large number of buildings within a stated time, even if the long-term effects on the Commonwealth were doubtful...In this case, the Auditor-General could be seen to be on more dangerous grounds in questioning the criteria for putting buildings on the market or suggesting that prospective sales should have been reconsidered if the price was inadequate.<sup>121</sup>*

One 'positive' to come out of this tension is the recognition that government policy objectives need to be stated in less ambiguous terms with the lines between policy and implementation made reasonably clear.

*Performance audit assumes a clear distinction between policy objectives (set by elected governments) and policy implementation (carried out by servants or contractors). Auditors are assumed to leave the objectives to government and confine themselves to the efficiency, effectiveness and probity with which these objectives have been implemented.<sup>122</sup>*

That said, the performance audit mandate has become an essential element in the accountability process of any public jurisdiction, especially the new public management environment. It is not a static process and there will be a continuing emphasis on



improving the service to Parliament. Conflict and controversy may be inevitable but as one senior Australian bureaucrat remarked:

*The bulk of performance audits are good at working out what is happening in a field, giving a useful report on it and striking an appropriate balance in not dabbling in policy and seriously discussing how implementation is going.*<sup>123</sup>

## ASSESSING PERFORMANCE

As can be seen in the Australian arena, a major difficulty is not only to define outcomes in a credible manner but also to relate organisational outputs in a meaningful (measurable) way to those outcomes, or at least to intermediate outcomes. Assessing performance in the new environment will involve the use of techniques such as the balanced scorecard which:

*...complements the financial measures with operational measures on customer satisfaction, internal processes, and the organisation's innovation and improvement activities - these operational measures are drivers of future financial performance.*<sup>124</sup>

The balanced scorecard approach, which has been adopted in a number of agencies<sup>125</sup>, underlines the importance of the various linkages and their understanding and management such as between strategy and operations, budgets and performance. It also requires that attention be given to measuring performance where practicable and to articulating a credible basis for assessing qualitative or so-called 'soft' indicators of success. A parallel is the distinction between price and the value for money concept, with the latter often embracing many non-price factors. It is useful to bear in mind a recent observation as follows:

*The paradox of measurement holds for many public service functions. That is, the stronger the attempts to measure the inherently incommensurable, the more such quantification tends to become a substitute for judgement, experience, and commonsense in the governing process*<sup>126</sup>.

As well, attention has been drawn to several unintended consequences of measurement that may not only invalidate conclusions on public sector performance, but can also negatively influence that performance.<sup>127</sup> Without ongoing attention, performance measures can deteriorate over time, thus creating a weak correlation between the measures and actual performance. This has been referred to as the Performance Paradox.<sup>128</sup> Undoubtedly, measurement problems do make it difficult to be certain about the validity of performance assessment which not only focuses attention on qualitative factors, but also on regular evaluation. Extension of a more horizontal accountability focus on performance evaluation can assist performance assessment.

The New Zealand Controller and Auditor General's recent report on 'Reporting Public Sector Performance'<sup>129</sup>, sees performance in public sector terms as follows :

- Results – what an agency achieves, its actual outcomes , the impact of government activities on the community, and how the community is better or worse off as a result of these activities.

- Interactions with the public – process of the agency and the delivery goods and services (outputs) to the public.
- Costs – inputs, the resources met by the taxpayer which are applied to the task. Costs also include any decline in the agency’s capability.

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

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

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

*...Australians would not lose sight of social implications of our pursuit of economic growth.*<sup>130</sup>

Some Australian private sector corporations, such as Rio Tinto, have lead the way in this kind of reporting. BP Australia is another example of a company that has long embraced TBL in recognition of its wider accountability requirements. However, such recognition in the private sector is not new. For example, General Robert E Wood, who led Sears. Roebuck & Company from 1924-1954 believed a large corporation was more than an economic institution; it was a social and political one as well. In the Sears Annual Report for 1936, he wrote:

*In the days of changing social, economic and political values, it seems worthwhile...to render an account of your management’s stewardship, not merely from the viewpoint of financial reports but also along the lines of those general broad social responsibilities which cannot be presented mathematically and yet are of prime importance*<sup>131</sup>.

Proponents of TBL consider that public and other stakeholders’ expectations in an increasingly globalised business and communications environment would provide the drivers for a shift away from the traditional input-output based model of accountability towards a focus on economic prosperity, environmental quality and social justice.<sup>132</sup>

Key barriers to the adoption of TBL reporting include the lack of standard methodologies; the lack of appropriate skills, knowledge and/or experience; the difficulties of identifying

social and environmental costs; and the valuation of liabilities. However, some organisations are moving to develop comprehensive guidance for reporting environmental and social information. For example:

- there is an Exposure Draft before the Australian Accounting Research Foundation put out by the International Auditing Practices Committee (IPAC) for comment on Assurance Engagements on Environmental Reports;
- a social accounting standard was released in 1998 by the Council for Economic Priorities entitled SA8000;
- in November 1999, the Institute of Social and Ethical Accountability launched AA1000, which is concerned with the process of setting up social and ethical accounting and auditing systems;
- the Global Reporting Initiative (GRI) has been convened by the Coalition for Environmentally Responsible Economies in partnership with the United Nations Environment program to develop and disseminate globally applicable sustainability reporting guidelines for voluntary use; and
- the International Standard Organisation's (ISO's) Consumer Policy Committee has agreed to explore the possibility and desirability of developing ISO standards to benchmark corporate social responsibility and report its recommendations by June 2002.<sup>133</sup>

This is clearly still a 'greenfield' area for research and development. Moreover, because of the transborder and global issues inherent in TBL, the development of appropriate methodologies and indicators would benefit from international input. Both the major professional accounting bodies in Australia have been devoting increasing attention to TBL in their publications and conferences. This puts added pressure, in my view, on the public sector to make commensurate effort, if not to take a more leading role in such reporting as part of good corporate governance.

#### **IV. CORPORATE GOVERNANCE**

As a lead in to this section, I have selected a 'grab' from a recent TV interview with David Morgan, the CEO of one of our major banks and a former senior Treasury Official, where he was speaking, amongst other things, on the fallout from the Enron collapse. He said:

*One really has to have a hard look at accounting standards that permit manipulation and permit a victory of form over substance, and as global accounting standards are converging even if they are only present in the US, it is something that we need to be concerned about and engaged in. The second is the whole issue of independence of auditors and the third is the whole issue of corporate ethics. Because, at the end of the day, you can't legislate goodness, and important as accounting standards are, and as independent auditors are, corporate governance is really a state of mind and it is around the integrity of the company and its leadership, and I think Enron is going to provide appropriately a real refocus on this.*<sup>134</sup>

This statement by David Morgan provides a useful introduction to the issues I now wish to explore – the nature of corporate governance, ethical behaviour, risk management, and auditor independence (setting aside the accounting standards debate for another time and place).

## FRAMEWORK ISSUES

*In both the private and the public sectors, there is a trend towards ever increasing demand for accountability and transparency as well as increasing awareness of the necessity for having checks and balances. Governance and associated subjects have become, both explicitly and implicitly, important issues for business, government, politics, and last but not least for the general public.*<sup>135</sup>

Corporate governance is one of those fundamental, yet in some ways fuzzy, concepts that, on one hand, many organisations claim to understand and implement, but on the other, do not come to grips with in practice. We find that governance issues have usually been at the heart of the recent spate of corporate failures here in Australia and I suspect in the Enron case also.

In simple terms, corporate governance is about how an organisation is managed, its corporate and other structures, its culture, its policies and strategies, and the ways in which it deals with its various stakeholders. It is concerned with structures and processes for decision-making and with the controls and behaviour that support effective accountability for performance outcomes/results. Key components of corporate governance in both the private and public sectors are business planning, internal controls including risk management, performance monitoring and accountability and relationships with stakeholders.

The Netherlands Ministry of Finance observes that ‘governance and therefore government governance, in actual fact comprises management – control – supervision – accountability.’<sup>136</sup> Hence:

*Governance is defined as safeguarding the interrelationship between management, control and supervision by government organisations and by organisations set up by government authorities, aimed at realising policy objectives efficiently and effectively, as well as communicating openly thereon and providing an account thereof for the benefit of the stakeholders.*<sup>137</sup>

The Ministry also defines governance as embracing ‘the whole policy chain from ministry/local authority to hived-off implementing body[ies].’<sup>138</sup>

Bryan Horrigan, Professor of Law at the University of Canberra,<sup>139</sup> looks at corporate governance in both the private and public sectors having the following dimensions:

Mission Governance	-	Business planning.
Ownership Governance	-	Multiple owners and multiple agencies and constituencies.
Structural Governance	-	Two –tiered boards.
Strategy Governance	-	Corporate and business plans.
Performance Governance	-	Including organisational, individual, processes, outcomes and measures.
Conformance Governance	-	Including compliance, due diligence, financial and legal risk management.
Decision–Making Governance	-	Including internal and external relationship management and communication.
Accountability Governance	-	Owners and shareholders as well as stakeholders.
Value-Capital Enhancement	-	Including long term sustainability of corporate capital, as well as ‘triple bottom line’ emphasis on financial, environmental, and social capital.

Drawing on Professor Horrigan’s work further, integration across and within governance dimensions is important, for example, incorporating a public sector agency’s community service obligations in an outsourced contract raises governance issues of conformance, accountability and sustainability. Equally important is integration associated with concepts of ‘joined up government’ (UK), ‘horizontal government’ (Canada), and ‘integrated government’ (Australia).

Regardless of which framework is used, good corporate governance in both the public and private sectors requires a clear identification and articulation of: the definitions of responsibility; a real understanding of relationships between the organisation’s stakeholders and those entrusted to manage its resources and deliver its outcomes; and support from management, particularly from the top of an organisation. In a complex operating environment, such as is evident in the Australian Public Service, these requirements become that much more important for both accountability and performance (and results) to a range of stakeholders.

Importantly, good corporate governance is based on a clear code of ethical behaviour and integrity which is binding on management and staff and communicated to stakeholders. Such a culture is also essential for the establishment of sound risk management approaches and the confidence it can give to those stakeholders in the organisation and in what it does. A robust accountability approach to encourage better performance through sound risk

management is integral to any corporate governance framework and is simply good business sense.<sup>140</sup>

While there has been convergence between the private and public sectors, it is important to recognise the basic differences between the administrative and management structures of both sectors 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 requires different models of corporate governance. That is, one size does not fit all even though there will be common elements.

The values, standards and practices which 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. In Australia, the new public service values are a key element in the Government's public sector reform program and have been included in the new *Public Service Act 1999*. The following are some of the values that agency heads are required to uphold and promote within their organisations:

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

Regulations require agency heads to integrate these values into the culture of their agency. The ANAO, to take one example, has as its key values ***independence, objectivity, professionalism, and knowledge*** and understanding of the public sector environment. These values are guided by the ANAO Code of Conduct which has been developed within the framework of the new Australian Public Service values and the Australian Public Service Code of Conduct, together with the Codes of Ethics promulgated by the professional accounting bodies.

## **DEFINING ROLES AND RESPONSIBILITIES**

The principles of corporate governance requires those involved to identify and articulate their responsibilities and their relationships; consider who is responsible for what, to whom, and by when; acknowledge the relationship that exist between stakeholders and those who are entrusted to manage resources and deliver outcomes. It provides a way forward to those, whether in the public or private sectors, who find themselves in somewhat different relationships than either have experienced before.

Hence, a clear understanding and appreciation of the roles and responsibilities of the relevant participants in the governance framework: importantly, those of the responsible Minister(s), Board and CEO are a key component of sound accountability. The flip side is that the absence of these features 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, usually begins with a discussion of the role of the Board of Directors, who have a central role to play. This was clearly indicated by Sir Ronald Hampel's Committee on Corporate Governance which has been extensively quoted in governance literature, namely:

*'It is the Board's responsibility to ensure good governance and to account to shareholders for their record in this regard.'*<sup>141</sup>

One important distinction to recognise in the public sector is: (a) those agencies that are governed by the CEO, possibly with the assistance of a board of management in an advisory capacity; and (b) those organisations that have a governing board to which the CEO should preferably be accountable, such as government business enterprises (GBEs) and companies. While the latter have more in common with the private sector, they also have added complexities as a result of the additional party in the accountability chain.

In the private sector, there are clearly defined relationships between the board of directors, including the chairperson of the board, and the CEO responsible for the ongoing management of the agency.<sup>142</sup> However, this model is not readily transportable to the public sector, even with GBEs, because of the different roles and relationships between the responsible Minister(s), the CEO and (possibly) the Board.

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 derivative [my underlining] of the duty to stockholders.'*<sup>143</sup>

Similarly, Richard Humphry, while Managing Director and CEO of the Australian Stock Exchange, expressed the view that a private sector board would be abrogating its fundamental responsibility to its shareholders if it responded to issues in a manner that went beyond the traditional internal focus on shareholders.<sup>144</sup> While a board's primary responsibility should be to its shareholders, it is notable that 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. As Donald Perkins, the former Chairman and CEO of Jewel Companies Inc, commented in Ivor Francis' book 'Future Directions – The power of the Competitive Board':

*In my redefined role, a director's responsibility is to do everything possible to assure the long term health of the enterprise....you will immediately*

*recognise that this may be inconsistent with the short term wealth of shareholders'*<sup>145</sup>

In the public sector, citizens bear some similarities to shareholders or the beneficiaries of a trust. In practical terms, boards, CEOs and management should be very aware of their responsibilities to the government (as owners or custodians and regulators), to the Parliament (as representatives of citizens and legislators) and to citizens (as ultimate owners as well as in their particular client roles as citizens).

The ANAO discussion paper '*Corporate Governance in Commonwealth Authorities and Companies*'<sup>146</sup> suggests that there may be opportunities to formalise relationships between the Board, the CEO, including management, and responsible Minister(s), perhaps through the development of a Board Charter. Alternatively, written agreement or memorandum of understanding could be prepared outlining roles and responsibilities as is done, say, in New Zealand.

## **EFFECTIVE CORPORATE GOVERNANCE**

In the last decade, Australian Public Service 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 and effective service to 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 any way so that people in the organisation understand both their overall purpose and the various ways the various elements are linked 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 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 well understood and applied throughout those organisations. If implemented effectively, corporate governance should provide the integrated strategic management framework necessary to achieve the output and outcome performance standards required to fulfil organisational goals and objectives. Corporate governance also assists agencies discharge their accountability obligations.

Effective public sector governance also requires support and leadership from the Board (where applicable), the CEO and executive management of organisations and a strong commitment to quality control and client service throughout the agency. An effective framework requires clear identification and articulation of responsibility and a real understanding and appreciation of the various relationships between the organisation's stakeholders and those who are entrusted to manage resources and deliver required outputs and outcomes. It should be based on a set of values including a clearly specified code of ethical and professional behaviour which is binding on management and staff and communicated to stakeholders. Such a culture is essential for the establishment of sound risk management approaches and the confidence it can give to stakeholders in the organisation and what it does. Public sector executives leading by example is perhaps the most effective way to encourage accountability and improve performance.



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. That is, corporate governance is not just about process as some critics are now observing. There has been some debate in Australia about the need for a focus on performance rather than on conformance.<sup>147</sup> In essence, the challenge for any organisation is to get the right balance between those objectives at any point in time and over time. There has not been any real support to date in Australia for the Continental European model of two-tier boards with the management board being responsible for the performance and the supervisory board being responsible for the conformance of the entity.

Moreover, there are positive examples where both objectives are being achieved contributing to greater understanding and commitment at all levels of the organisation. The work that the ANAO has previously done with Australian public service agencies has clearly indicated the contribution that good corporate governance can make to an organisation's performance and to the confidence and assurance of stakeholders.

Other critics have also commented that insufficient attention is being given to the importance of people and their personal capabilities and capacities in achieving required results. A key aspect of corporate governance is to ensure that all participants are aware of, and accept, their roles, responsibilities and accountabilities and that they have a sound understanding and appreciation of the latter's practical importance in meeting the public interest. The framework is very people oriented involving better communication; a more systematic approach to corporate management; a greater emphasis on corporate and ethical conduct; risk management; skills development; relationship with citizens as clients; and quality service delivery.

The ANAO released a discussion paper entitled '*Principles for Core Public Sector Corporate Governance: Applying Principles and Practice of Corporate Governance in Budget Funded Agencies*' to foster good corporate governance in the public sector..<sup>148</sup> This paper was designed to fill the gap in core public sector awareness of the opportunities provided for improved management performance and accountability through better integration of the various elements of the corporate governance framework within agencies. As well, the paper included a checklist designed to assist CEOs to assess the strengths and weaknesses of their agencies' current governance framework. The discussion paper was not meant to provide a comprehensive model for each agency, its aim was to identify the following key operating principles that should underpin a sound corporate governance framework in the public sector - these principles should be reflected in organisational structures and processes, external reporting, internal controls and standards of behaviour of the organisation.

- **openness** is about providing stakeholders with confidence regarding the decision-making processes and actions of public sector agencies in the management of their activities. Being open, through meaningful consultation with stakeholders and communication of complete, accurate and transparent information leads to effective and timely action and lends itself to necessary scrutiny;

- **integrity** is based on honesty, objectivity as well as high standards of propriety and probity in the stewardship of public funds and the management of an agency’s affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the agency. Integrity is reflected in the agency’s decision-making procedures and in the quality of its performance reporting;
- **accountability** is the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities and roles are clearly defined through a robust organisational structure; and
- **leadership** involves clearly setting out the values and standards of the agency. It includes defining the culture of the organisation and the behaviour of everyone in it.<sup>149</sup>

We are currently undertaking early work aimed at developing updated experience and guidance to assist in the maintenance of sound corporate governance frameworks in all public sector organisations. We have been aware of the move towards general principles on corporate governance as advocated by the OECD.<sup>150</sup>

#### **RISK AND CONTROL – AS PART OF AN INTEGRATED CORPORATE GOVERNANCE FRAMEWORK**

Clearly defined roles and responsibilities are good business practice and are essential for the measurement of and accountability for performance. Control structures, incorporating sound risk management, are a particularly relevant element of an effective governance framework because of their importance in promoting effective performance and ensuring proper accountability. The Netherlands Ministry of Finance notes the essential point, ‘It is important for an administrator in the public sector to know and control the risks associated with his or her position in public administration.’<sup>151</sup>

The ANAO publication ‘*Control Structures in the Commonwealth Public Sector - Controlling Performance and Outcomes: A Better Practice Guide to Effective Control*’<sup>152</sup> defines control 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.’<sup>153</sup>*

The control structures within a corporate governance framework provide assurance to clients and the Parliament that an agency is operating in the public interest and 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 may indicate less than optimal business practices as well as the opportunity to commit fraud.<sup>154</sup>

## Risk management

Formal risk management may have been viewed as discretionary in the past but it is now an essential element of sound corporate governance and management practice. The goal is to embed a culture of risk management in organisations so that consideration of risks and risk mitigation strategies becomes second nature to managers at all levels. I have just been advised that an international guide to risk management terminology (ISO/IEC Guide 73) has been agreed and should be available in the next month or so. It is an important starting point for the development of a common language for those engaged in the management of risk. It is regarded as another step in the development of risk management as an integral part of effective corporate governance.

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, has significantly increased the risk profile of agencies. The public sector must manage the risks inherent in a more 'market oriented' environment if it is to achieve the levels of performance required and satisfy whatever accountability requirements have been determined. More than ever, this situation will require a formal, systematic approach to identifying, managing and monitoring risk. The intuitive, and often reactive, approach to managing risk that has characterised public sector management in the past will not be sufficient. Reacting 'after the horse has bolted' is often quite costly and damaging to the credibility of agencies and Ministers. A more strategic approach is required to stay contestable in such an environment.

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

*aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the uncertainties the enterprise faces as it creates value<sup>155</sup>*

This approach minimises the influence of the management 'stove pipes'; leading to a more holistic, integrated, proactive and process oriented approach being taken to manage all key risks and opportunities.

This theme has been picked up in the CPA Australia's publication 'Enterprise-Wide Risk Management'.<sup>156</sup>

The growing recognition and acceptance of risk management as a central element of good corporate governance (and as a legitimate management tool to assist in strategic and operational planning) has many potential benefits in the context of the changing public sector operating environment. Such an approach encourages a more outward looking

examination of the role of the organisation, thereby increasing customer/client focus, including a greater emphasis on outcomes, as well as concentrating on resource priorities and performance assessment as part of management decision-making. The risk management framework is also a useful means for management to be assured of this approach, including being able to defend their decision-making publicly.

The ANAO fosters the view that risk management is an essential element of corporate governance underlying many of the reforms that are currently taking place in the public sector. To restate my point, 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. 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 risk management can only become more critical.

Risk management is primarily the responsibility of the CEO and/or board. Effective governance arrangements require 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.<sup>157</sup>

To be effective, the risk management process needs to be rigorous and systematic.<sup>158</sup> 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.

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.

## **CONTROL SYSTEMS**

Complementary to a sound risk management approach is a robust system of administrative control. The emphasis is on a more systematic approach to decision-making to manage, rather than avoid, risk. Some systems operate like a thermostat, identifying and correcting deviations from pre-set standards while other controls are interactive. A good example is the growing use of computer-oriented rulebase (or expert) systems, particularly to administer 'complex legislative and policy material'.<sup>159</sup>

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

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 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. It is interesting to note that Federal Government legislation requires all Commonwealth organisations to have an audit committee. Yet it is only recently that a recommendation was made for corporations to have a committee as a condition of Australian Stock Exchange Listing.<sup>160</sup>

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

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

In the ANAO's experience, it is difficult to overstate the importance of integrating the agency's approach to control with its overall risk management approach in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment and monitoring of risks. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively.<sup>161</sup>

The key to developing an effective control framework lies in achieving the right 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. That is in this new NPM environment there is a need to balance control and autonomy - the 'Ying and Yang' of Management <sup>162</sup>, and as Richard Norman states:

*All organisations face a central problem of autonomy and control. ...Too much autonomy and too little control can undermine coordination and prevent the delivery of a consistent service and product. Too much control at the center can undermine motivation among those who are furthest from the source of power....The challenge is to balance the control necessary for a united strategy with sufficient autonomy to foster initiative and responsiveness* <sup>163</sup>

and

*Public sectors that fail to provide sufficient managerial freedoms will foster unresponsiveness, bureaucratic behaviour of the sort that created the appetite for the NPM proposals from the early 1980s. On the other hand public sectors that fail to hold their managers accountable, risk loss of control by democratically elected representative to unelected public entrepreneurs who choose how they spend the public's money (Lewis)* <sup>164</sup>

As well,

*Clearer lines of accountability are central to providing greater management freedoms....The extent to which you are given trust and advised that you are going to be held accountable acts as a very strong incentive.* <sup>165</sup>

The control structure will provide a linkage between the agency's strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the organisation's objectives and which adds value by focusing control efforts on the 'big picture'. 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.

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

Finally, it must be kept in mind that 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 is effected by staff at all levels.

## AUDIT INDEPENDENCE

Returning to the David Morgan thoughts at the start of this section, I will touch briefly on the important aspect of audit independence. While SAIs have statutory independence, recent events here in Australia and in the US have brought independence issues to the forefront; it is a complex one with far reaching consequences for both the auditing profession and the general public.

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

The potential effect of non-audit services on auditor independence has long been an area of concern. This has been compounded of late due to the significant increase in the amounts of these additional services being performed. An interesting statistic that demonstrates the magnitude of this growth is that revenues from management and advisory services of the five largest public accounting firms is estimated to constitute half of total revenues for these firms compared to only 13 per cent of total revenues in 1981.<sup>166</sup>

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

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

*“Yet increased economic pressure on the profession, coupled with greater competition and consolidation, mandated that we bring clarity and light to the necessarily subjective nature of independence.”<sup>167</sup>*

In February 2001, the SEC released a final ruling on the requirements for auditor independence which sets forth restrictions on financial, employment and business relationships between an accountant and an audit client and restrictions on an accountant providing certain non audit services to an audit client. The ruling provides four principles by which to measure an auditor’s independence. These state that an accountant is not independent when the accountant:

- has mutual or conflicting interest with the audit client;

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

Still in the US, the Comptroller General and head of the General Accounting Office (GAO) recently announced (25 January 2002) significant changes to the auditor independence requirements under Government Accounting Standards <sup>168</sup>. The new standards deal with a range of auditor independence issues with the most significant changes relating to the rules associated with non-audit, or consulting services. The rules are to apply for periods beginning on, or after, 1 October next.

The standard includes a principle-based approach to addressing the independence issue supplemented with certain safeguards <sup>169</sup>. The new independence standard for non-audit services is based on two overarching principles:

- auditors should not perform management functions or make management decisions; and
- auditors should not audit their own work or provide non-audit services in situations where the amounts or services involved are significant/material to the subject matter of the audit.

For non-audit services not caught by the above principles, certain supplemental safeguards need to be met, for example personnel who perform non-audit work would be precluded from performing audit related work. The American Institute of CPAs (AICPA) cautioned its members about the tighter restrictions on non-audit services than those in the current AICPA's audit standards. Consequently, the AICPA is listing issues and questions to be addressed in implementation guidance.<sup>170</sup>

In Australia, auditor independence is regulated by two primary sources; the legislative requirements of the Corporations Law and the Statement of Auditing Practice (AUP) 32 "*Audit Independence*". However, Australian auditors have also been under scrutiny. An important part of this scrutiny has been the Federal Government inquiry into the state of audit independence in Australia. The result is the Ramsay Report, released on 4 October 2001.<sup>171</sup> In welcoming the Report, the Minister for Financial Services and Regulation observed that:

*We must ensure the independence of auditors is preserved and that stakeholders are secure with the knowledge that the auditor is objective and independent.*<sup>172</sup>

Professor Ramsay indicates a range of relationships with the client which would result in an auditor not being independent. These cover employment, financial and business relationships. Interestingly, he recommended that the regulation of non-audit services provided by audit firms to their clients be dealt with in professional ethical rules, suitably updated to reflect proposals being made by the International Federation of Accountants (IFAC). Perhaps more controversially, he also recommended the establishment of an Auditor Independence Supervisory Board to be funded by the professional accounting



bodies. The other recommendations that I want to refer to here are those relating to amendments to the Corporations Act indicating a general statement of principle requiring an auditor to be independent and for the auditor to make an annual declaration, addressed to the board of directors, that the auditor has maintained its independence in accordance with the Corporations Law and the rules of the professional Accounting bodies.

This issue is causing accounting firms to examine their structures with Pricewaterhouse Coopers and Deloitte Touche Tohmatsu, for example, announcing they would separate their consulting business and Andersen reviewing its partnership structure. In Australia, the accounting bodies are currently reviewing the audit independence issue but noting the following observation:

*Australia's professional accounting bodies, such as CPA Australia, are content with this country's self-regulatory regime, although it and the Institute of Chartered Accountants have distributed a discussion paper on the existing standards of audit independence. This is in contrast to the American Institute of CPA's, which this month [February 2002] took the extraordinary decision to support moves to ban accounting firms from providing audit clients with internal audits or system integration.*<sup>173</sup>

In summary, what is clear is that the public's perception of auditor independence is critical and, in the words of the Chief Accountant of the SEC, "*Enduring public confidence begins with the auditor.*"<sup>174</sup> In these respects, I should mention that the mandate of Auditors-General is usually legislated by Parliament with funding normally provided by means of parliamentary appropriations. In my case, I am an independent Officer of the Parliament.

## **V. IMPLICATIONS OF A MORE COLLABORATIVE APPROACH**

In the earlier discussion on the convergence of the public and private sectors the notion of partnerships in the delivery of public services was foreshadowed. However, there are some particular issues that I now wish to discuss in this regard in addition to those already canvassed. But first, and by way of an introduction, I will touch on the factors influencing the move towards the public sector working in partnership with the private sector (or working in partnership with another agency) through purchaser/provider arrangements to deliver public services.

Ideally, citizens should not need to understand the way in which government is structured in order to secure the services they need, nor should they necessarily have to deal with any number of government departments in order to progress a particular course of action. Hence, a major aim of modern public administration has been expressed as creating the ability to deliver services that appear seamless to the recipient.<sup>175</sup>

This usually involves 'the spanning of traditional boundaries among government departments, between public sector agencies and private and third sector organisations, and between citizens and communities, on the one hand, and government decision making, on the other.'<sup>176</sup> In the past agencies have often been focused exclusively on achieving their own specific objectives reflecting responsibilities and funding that they control directly, while this can be effective in delivering many of a government's programs, it can result in agencies adopting too a narrow focus and not considering the whole of government goals.

As the Australian Prime Minister said recently:

*Another challenge is the capacity of departments to successfully interact with each other in pursuit of whole of government goals and more broadly, for the entire public service to work in partnership with other bureaucracies, with business and with community groups as resources and responsibilities are devolved closer to where problems or opportunities exist.<sup>177</sup>*

and

*We live in an increasingly complex and interdependent environment and there is no doubt that, in recent years, issues have more consistently reached across traditional portfolio boundaries. This trend will continue. Whole of government approaches collectively owned by several ministers, will increasingly become a common response.<sup>178</sup>*

Additionally, the advent of the Internet and other communication initiatives has added to pressures to operate across organisational boundaries to provide greater flexibility, cooperation and responsiveness within and between the public and private sectors. Recently, the Australian Government's online entry point – [australia.gov.au](http://australia.gov.au) – was launched providing citizens with access to a full range of government services through one location which will eventually comprise 18 portals (arranged into customer and subject topics) with links to all areas of the Federal Government and to State and Local Governments.<sup>179</sup> The big challenges for us are the development and use of broadband technology, with a broadband wireless service not being available in Australia until at least the end of 2003.

In the United Kingdom, the Modernising Government White Paper (March 1999) called for public sector agencies to work in partnership across organisational boundaries to deliver integrated and seamless services, that is, the concept of 'joined up' government. This concept has been the cornerstone of the Blair government's modernisation program.

These new 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. 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. The realisation of joined-up government services will require considerable cooperation across departments and across levels of government in order to deliver transparent, customer-focussed solutions. A good description comes from the policy of Modernising Government in the UK, as follows:

*Joining up is a mind-set and a culture. It is not a system or a structure. The concept of joining up recognises that no one has all the knowledge and resources, or controls all the levels to bring about sustainable solutions to complex issues.*

and

*The key to joined-up government is to learn about shared purpose, teamwork, partnerships and building relationships. Joined-up organisations are built around the knowledge and know-how of people. This differs from the organisational model of the past which was built around tasks, units and titles.*<sup>180</sup>

The British Comptroller and Auditor General recently produced a most comprehensive report on 'Joining Up to Improve Public Services'.<sup>181</sup> While the report not surprisingly focused on the United Kingdom experience (the impact of five joint working initiatives), it also provided examples of joined-up initiatives in a range of other countries, which convey some indication of the wider take-up of the approach. The important simple proposition is that joint working is intended to improve the delivery of public services. Briefly, better coordination and joint working between organisations are considered to have considerable potential to improve public services by looking at the broader impact of policies and strategies, tackling intractable social issues, improving service delivery, promoting innovation and improving cost effectiveness. Of course, joint working can take many forms.

Figure 10 of the report sets out the risks which, if not given sufficient attention, can result in the approach not being successful.<sup>182</sup> Both the Cabinet Office and the Treasury have a role in promoting joint working and monitoring its achievement. As with other public service reforms, an important challenge is changing the culture and/or behaviours in both the public sector and of program recipients (citizens). Cross-cutting Public Service Agreements are promoting joint working by focussing attention on shared responsibility for achieving nominated objectives together with measurable targets to monitor the delivery of those objectives. Similar Agreements apply in other countries such as the United States of America (US) and New Zealand. The identified elements for a sound accountability and regulatory framework necessary to support joint working are similar to those required for sound corporate governance.

In Australia, the network bureaucracy concept is gaining favour as a means of delivering more responsive public services to citizens. For example, one recent ANAO report<sup>183</sup> 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, was established as the Australian Government's one stop shop for social security and employment services. It is responsible for the integrated delivery of a wide range Commonwealth social and economic payments and services and provides services to 6.4 million customers each year, involving nine million benefit payments and an annual cost approaching \$50 billion. It employs over 22,000 staff to deliver these services on behalf of 16 Commonwealth departments and agencies and all state housing authorities under a formal purchaser/provider arrangements.<sup>184</sup>

Drawing on a Canadian example, the TJF (Transitional Jobs Fund) was developed under the new approaches to service delivery. The service delivery network was completely re-engineered through the creation of a new network that involved replacing the 450 Canada Employment Centres with 100 'parent' Human Resource Centres Canada (HRCCs) and 200 satellites. Professor Good makes the point that maintaining the service levels require a

one-stop, single-window service, extensive use of electronic service through the use of kiosks, strengthening and expanded telephone call centres, partnerships with service providers, and contracting with private sector delivery partners.<sup>185</sup>

However, experience has shown us that there is not one single model or ‘silver bullet’ that has universal application but rather each arrangement needs to be tailored to each particular circumstance. Indeed, not all public-private partnerships will, or should, move from contact service delivery arrangements to collaborative partnerships in their truest form. Types of public-private partnerships are, and will become increasingly more, numerous and diverse and their management will not lend itself to a single set of management techniques.<sup>186</sup> Professor Good identifies the two polar positions:<sup>187</sup>

- ‘collaborative arrangements’ in which a government shares policy and program development, risk and operational planning, and design and management of the program with another party or parties who deliver the program or service, and
- ‘delegated arrangements’ in which a government, within a broad policy framework, has delegated key planning and operational decisions to the discretion of another party such as a provincial government or a private or voluntary sector organisation.

At a symposium held in Canberra in April 2001 – New Players, Partners, and Processes: a public sector without boundaries? – Professors Langford and Edwards ask the following thought-provoking questions:

*Is boundary eradication going to become nothing more than a strategy by governments to shift risk and tough challenges to other levels of government and organizations in other sectors? By blurring the boundary of the public sector to include private and third sector organizations as contractors and partners in service delivery agents and collaborators in policy making and regulation, are governments slyly turning watchful stakeholders into state-funded lapdogs? Is the full-blown collaborative partnership model more risk than adverse politicians and our traditional Westminster model governments can really handle? Put another way, are governments and potential private and third sector partners prepared to take the steps required to build trust and longer-term power sharing arrangement? Are central agencies capable of making the shift from central control to guidance so that they can position themselves to offer the advice required by government departments to productively engage in boundary spanning? Will the demands for traditional accountability overwhelm the potential for boundary spanning to drive creativity by turning the relationships into opportunities for innovation and learning? Can governments shed their traditional and distinctive recruitment and retention strategies and compete effectively for the human resources needed to staff a boundary spanning public service?*<sup>188</sup>

Similarly, in a recent article, Christopher Sheil makes the point:

*The idea of entering into a partnership veils the nature of the relationships involved in PPPs [public-private partnerships], suggesting positive connotations of equality, with both sides working towards a joint goal.*

*The risk here is that these connotations will tend to disarm the bureaucracy, encourage institutional capture, allowing some institutions privileged access to market and political intelligence and generally interfering with the necessarily hard-headed and unprejudiced evaluation of whether these interactions are socially beneficial.*<sup>189</sup>

While I do not propose to address all these points individually I anticipate that closely examining the corporate governance arrangements in these ‘partnership’ or ‘horizontal management’ arrangements will touch on many of the questions raised by Professors Langford and Edwards and Christopher Sheil. However, I should also add that the public verdict on public-private partnerships under the UK approach, particularly in the areas of transport, health and education services, appears to be mixed.<sup>190</sup> Undoubtedly there are constraints and tensions which have to be managed, particularly in determining what areas of government best lend themselves to such an approach and the nature and extent of any related arrangements.

### **CORPORATE GOVERNANCE UNDER PARTNERSHIP ARRANGEMENTS**

In any arrangement 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, are essential.

Dr Peter Shergold, then Secretary, Department of Employment, Workplace Relations and Small Business, Australia, provides additional guidance when he listed in his words the ‘five distinct components to ensure effective governance in an outsourced environment’ - namely:

- First, **probity**, which is vitally important, particularly in the tender process and in the allocation of business.
- Second, **audit**, which needs to be undertaken continuously, both by one’s own contract managers and auditors on a prudent and transparent risk management basis and externally by the Australian National Audit Office.
- Third, **evaluation**, in order to assess on an ongoing basis the performance of programs and the cost effectiveness of their delivery so as to make improvements on an iterative basis.
- Fourth, **accountability** through Ministers to Parliament.
- Fifth, **public scrutiny**, usually by the media.<sup>191</sup>

Delivering services under the ‘joined-up’ arrangements raises the Corporate governance ‘bar’ considerably, particularly in terms of ‘joint’ performance and results to be achieved. Accountability for performance applies both within an agency and across-agencies. For example, a peer review report of the Cabinet Office role in Modernising Government offered the following comment on the corporate role of Permanent Secretaries:

*Permanent Secretaries have an individual and a collective responsibility. An individual responsibility to serve their respective ministers, to oversee the performance and ongoing improvement of their department. They also have a collective responsibility to serve the government as a whole by supporting and moving forward the government agenda. They have a collective responsibility to modernise the Civil Service as an institution and to ensure that it is up to today's challenges.*<sup>192</sup>

Accountability in the areas of community service obligations, equity in service delivery and a high standard of ethics within a legislatively-based values system, are particularly critical to public sector agencies working in concert to deliver, effectively, joined-up services. Attention to the principles of corporate governance in this context 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 outputs and outcomes.

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

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

and

*In a purchaser/provider situation there is even more tension, and the notion of contracts or agreements between agencies in themselves are points of tension that are not being satisfactorily resolved. That is why you have this issue of horizontal management. I do not care what you call it, but the fact is we have a tension and that needs to be resolved. The private sector model focuses very much on the institution. You might ask, “What does corporate governance mean if you have shared responsibilities?” It comes back to who is the coordinator and who is responsible and where is the shared responsibility.*<sup>193</sup>

Looking at the Canadian experience the message is creating greater clarity for almost every management task:

*clear program objectives, clear and focused accountability, clear roles and responsibilities of partners, clear and reliable results information, etc. The reality is that the objectives in partnerships, as they are in most government programs, are usually multiple, conflicting and vague. Accountabilities among partners are always multiple, inevitably complex and often fuzzy. The roles and responsibilities are often both contradictory and complementary at the same time. And the results information is rarely totally accurate and often incomplete. The Transitional Jobs Fund (TJF) and Canada Jobs Fund (CJF) were no exception.*<sup>194</sup>

However the reality is ‘getting more clarity on one dimension – be it objectives, accountability, or results – will invariably come at a cost. That cost might be rigidity, paper burden, slow responsiveness, missed opportunity, or increased resources’.<sup>195</sup> There will be other tensions:

*Determining the new boundaries for ‘new governance’ arrangements touches upon some basic tensions across important values: accountability and quality service, political responsiveness and political neutrality, resource efficiency and building capacity, engaging citizens and political representativeness.*<sup>196</sup>

*With the onset of public-private collaborative partnerships yet another role, that of a diplomat and negotiator, will emerge. Public service managers must now combine three potentially conflicting roles: provide policy advice to the ministers, manage their own departments, and manage external relations with the many agencies now linked to departments through contacts, agreements, and partnerships.*<sup>197</sup>

Let me briefly give you two Australian examples, albeit between public sector agencies. These arrangements between agencies tend to be quasi-contractual, based on ‘relational’, rather than ‘legal’, agreements, for example Memoranda of Understanding. An example is the Strategic Partnership Agreement between the Department of Health and Aged Care and the Health Insurance Commission in relation to Medicare and the Pharmaceutical Benefits Scheme. A Senior Management Committee considers strategic issues and provides a forum for consultation and co-ordination and a joint report on performance. The Agreement provides an extensive set of principles, protocols, mechanisms and procedures specifically designed to articulate and govern the relationship between the two agencies with respect to the delivery of the health programs and services involved.

Another example is the Business Partnership Agreement (signed on 31 July 2001) between the Department of Family and Community Services (FaCS) and the service delivery agency, Centrelink, which:

- recognises the blend of partnership and purchaser-provider models inherent in the relationship;

- addresses the major concerns, expressed by FaCS and Centrelink, in the day-to-day operations of the relationship;
- restructures the committees to improve their effectiveness;
- incorporates principles underlying the *Australians Working Together* package;
- develops a business assurance protocol;
- trials the tying of payments to successful service delivery; and
- develops the organisational level key performance indicators.<sup>198</sup>

FaCS is developing a Partnership Framework within which its relationships with the non-government sector will operate. It will include the importance of partnerships in achieving outcomes, accountability and co-operation, and different approaches FaCS may take to different relationships.<sup>199</sup> The following is a related observation from a private sector perspective:

*...the move to collaborative outsourcing agreements is an admission that the most successful outsourcing organisations are the ones that have a clear idea what they want the outcomes to be, rather than trying to manage (my underlining) the outsourcer.<sup>200</sup>*

Associated with this move towards network bureaucracies is the renewed focus on the needs of citizens as clients or customers. This is, at least partly, a consequence of a government decision to introduce Service Charters in order to promote a more open and customer-focused Australian Public Service. All 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. Two whole-of-government reports have been presented to Parliament reporting, among other things, performance against the 'principles for developing a Service Charter'. The second report concluded that:

*Service Charters are proving to be key instruments for innovation and for driving effective service delivery in the 21<sup>st</sup> Century.<sup>201</sup>*

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 real 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.

The Service Charter 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 their performance – in



effect trading-off some degree of their individual control for agreement about their joint performance and results to be achieved.

To summarise then, the main themes arising from these ‘joined up’ arrangements are:

1. The new participatory governance is time consuming, resource intensive, difficult and, one could argue, selective with regards to who participates. But although difficult, the task is not impossible. Australia and Canada are reasonably placed for the challenges of horizontal accountability due to the long-standing complex patterns of cooperation between levels of government created by federalism and experiences in employing alternative service delivery mechanisms, especially within the community sector.<sup>202</sup>
2. Not only do departments/agencies have the same reporting obligations to Parliament, but they should also ensure that partners can live up to these reporting standards as well.<sup>203</sup>
3. Demands for horizontal governance and collaboration will continue to multiply. Although governments have long had to manage horizontally, the premise is that many of the factors noted above will increase the amount of horizontal work that needs to be accomplished by public servants and their departments. Another way to put this is that, while executives have long been involved in horizontal management, ‘horizontality’ now affects the work of middle and front-line public servants.
4. Horizontal initiatives may outweigh the capacity of departments and the centre to manage. Casting a broader net will surely tax central monitoring and oversight capacities. For this reason, a more promising strategy is to cultivate new values, identify relevant pockets of knowledge, and link mentors to managers.
5. Vertical structure, incentives, and accountabilities will persist. The expanding number of horizontal projects, or greater demand for horizontal competencies of officials at all levels, does not mean the end of ‘vertical government’. Accountability and resource allocation is exercised in a top-down manner because of our system of Parliamentary government and because we need hierarchy to coordinate and organise vast amounts of expertise across a large country. Thus, improving horizontal management will not, and should not, supplant vertical systems, and therefore strategies must work within and supplement vertical systems to better address contemporary policy and service delivery challenges.<sup>204</sup>
6. The need to encouraging better reporting and accountability. The Canadian Auditor General observed that while departments had embraced results reporting, he raised concern about the extent to which it is actually utilized for the purposes of accountability, monitoring, and planning by departments and central agencies.<sup>205</sup>
7. External independent audit is a critical element in the accountability chain and that the access issues addressed earlier are essential for SAIs to fulfil their performance audit mandate. Clearly, the importance of the independence of SAIs cannot be overstated. As the public and private sectors converge; as the management environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that SAIs have all the professional and functional freedom required to fulfil fearlessly, professionally and independently, the role required of them.

## VI. CONCLUDING REMARKS

Sound corporate governance frameworks are the key to the development of suitable networks and partnerships. There is no doubt that a competitive environment has emerged for the provision of public services ( and the provision of policy advice to government). It is axiomatic that robust supervision, audit and accountability mechanisms must be put in place to support these new arrangements.

*The difficulties of achieving policy goals are often overwhelming, even when government holds most of the cards. These challenges are exacerbated as government cedes operational control and enters into more complex private relationships.*<sup>206</sup>

With the emphasis now on improving performance, managing risk, and reporting on performance, in quantitative if not in qualitative terms, the governance arrangements put in place should increase participation, strengthen accountability mechanisms, and open channels of communication within, and across, organisations. In this way, the public sector can be more confident about delivering defined outcomes (results) and being accountable for the way in which results are achieved. Indeed, we have a greater emphasis on performance management and accountability for that performance whether the activity is performed by public or private sector organisations. Some suggest that the components of a reform, for example greater administrative flexibility, can have greater impact on the former requirements than does the latter issue as to who actually conducts the activity.<sup>207</sup>

It goes without saying that the privatisation of the public sector does not obviate the need for proper accountability for the stewardship of public resources, as it is accountability and transparency that is fundamental to a democratic system. Accountability cannot be outsourced, according to the Parliament. However,

*What is extremely important is a much better understanding of the nature of the accountability process.*<sup>208</sup>

There are undoubtedly tensions between the demands made for both vertical and horizontal accountability. We are all well aware of the legal and economic requirements of the direct line of authority under the vertical tradition. But is the use of contracts and contracting to be reviewed:

*'as an efficient alternative to legal mandates, value-based collaboration, and hierarchy'*<sup>209</sup>

under the emerging governance arrangements I have discussed? While recognising the concerns underlying Parliamentary comments about agencies not outsourcing accountability, there is a practical issue as to whether the nature and degree of the independence in some partnership, networking and/or other collaborative arrangements should require at least some sharing of accountability in the horizontal relationship. But what would that mean in practice and how would it impact on governance? In my view, these are issues for the Government and Parliament to resolve as part of the democratic process. Is the question then:

*'one of tailoring accountability arrangements to reflect a mix of vertical and horizontal imperatives, depending on how much consensus and how much risk is to be accepted'*<sup>210</sup>?

The implicit trade-offs are not simple to resolve because they can involve issues of shared values and ethics, trust, confidence and the disparate, sometimes conflicting, demands and/or expectations of various stakeholders. I have no difficulty in agreeing that approaches and tools will need to be different for competitive environments as opposed to those using more collaborative arrangements. But that is a somewhat simplistic observation, considering that there are likely to be a range of different approaches to the delivery of government outputs and outcomes involving different accountability treatments. In particular, it needs to be recognised that:

*Different systems for setting strategic direction and for accountability and audit illustrate a substantial mis-match between the systems developed in the past and what is needed for a future of joined up service.*<sup>211</sup>

Clearly, the on-going challenge for the public sector auditor will continue to be meeting performance and accountability expectations, whatever the approach taken to this changing environment. This will increasingly involve establishing agreed modes of network/partnership governance to ensure proper integration and coordination of networking activities essential to the effective operation and delivery of services. Such governance arrangements need to be well understood and accepted by all concerned and the arrangements will need to be dynamic and flexible to meet the needs of all participants including, importantly, those of citizens. It is not difficult to agree that appropriate accountability arrangements should be integrated with whatever arrangements are chosen.

Moreover, with the greater involvement of the private sector in service delivery there is the added complication of generating common understandings, cultures, values and notions of accountability and responsibility. As well, there is a need for public servants to be alert to, and preferably understand, commercial imperatives and practices. In particular, greater knowledge of, and experience with, contract negotiations and management are essential. These are tensions that have to be addressed and/or dissolved. I earlier referred to the need for cultural change. At least in one respect the following comment highlights a shared concern:

*...public administration has to become increasingly aware of the conflicting cultural conditions besetting public managers, notably the conflict between preserving departmental accountability and developing entrepreneurial flair.*<sup>212</sup>

As part of this broader responsibility, auditors will also need to be prepared, and equipped, to engage in 'real time auditing' with more scope for preventative action and a learning process for all stakeholders in order to ensure that proper accountability and required performance and results are achieved by both individual agencies and private sector firms, particularly in any 'shared' arrangement or partnership as part of joined-up government. In the same vein, auditors can also contribute to the development of suitable accountability

framework for this changing environment. The vexed issue of achieving value for money taking into account non-price factors, such as quality of service, is one example.

As I have stressed previously, from an audit viewpoint, full access to information is required (as well as to government assets, including on private sector premises as necessary). SAIs need to be able to assure Parliaments and Executive Governments about legal compliance, probity, security, privacy and ethical behaviour as well as providing an opinion on financial reporting and the systems and controls on which such reporting is based. We also need to be able to put in place a sound basis on which to assess the performance of private sector providers as well as of the ‘purchasing’ agencies. Nevertheless, we also have to be aware of observed unintended consequences of performance assessment leading to the suggestion that ‘a balance has to be found between too much and not enough measure pressure’.<sup>213</sup>

A development that needs reinforcing is the upgrading of the role of audit committees in the public sector and the contribution that auditors can make in this context. The value-added comes from two main areas: first, their ‘independent’ perspective of the control environment and performance of the organisation and its programs; and second, their knowledge of better practice gained from the oversight of a wide range and variety of public sector bodies. These perspectives can provide a positive stimulus to audit committee deliberations and organisational performance.

In the previously referenced Netherlands’ government governance paper, the importance of effective governance arrangements is highlighted especially when things go wrong, or look like going wrong, for example:

*A number of instances in public administration have created a breeding ground for improvements in administration. As a consequence of all these incidents, whether they involved fraud, improper administration, badly informed managers of failing supervision, corporate governance in the private and in the public sector have become subjects that are widely discussed and written about.*<sup>214</sup>

and

*Some instances, influenced by the focus on core activities and market ideology, involve the hiving off or outsourcing public services through decentralisation and privatisation.*<sup>215</sup>

Hence, my presentation has focused on the ‘Government Governance Cycle’ and the interrelationship between management, control, supervision, and accountability. I have indicated that these concepts fit comfortably with the Australian framework explained in my paper. Moreover, and while it is true that ‘no one size fits all’, there do not seem to be any real differences in issues of principle. My Office has identified governance issues as one enduring theme to be addressed in undertaking performance audits. In this regard, I was interested in the ‘Governance Analysis Model’ outlined in the Netherlands’ paper that has been circulated to you. Clearly, there are important lessons to be learnt from comparative jurisdictions. I therefore look forward to the opportunity to exchange views and experiences at this Laboratory on Government Governance in Regione Lombardia. Thanks for your attention and interest.

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