

Public Service and Merit Protection Commission (PSMPC)

Strategies for Better Governance

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INTRODUCTION

The profile given to corporate governance in the public sector has been one of the most positive stimuli for change and better performance in the last decade. It may not have received top billing among the specific reform agenda items but it has always been seen as a front row contributor to a highly performing Australian Public Service (APS) that has universal application to all Commonwealth bodies.

The concept of corporate governance may cover a spectrum from a predominantly static view of organisational control to a more dynamic orientation towards results. For example, the House of Commons Committee of Public Accounts defines corporate governance as being:

*concerned with structures and processes for decision making, accountability, control and behaviour in the top of organisations.*¹

Other definitions give greater emphasis to performance, thus conveying both performance and conformance aspects to corporate governance. For instance, Adrian Cadbury² in his landmark report on corporate governance said:

(Company boards) must be free to drive their companies forward within a framework of effective accountability. This is the essence of any system of good corporate governance.

This notion of corporate governance that emphasises both performance and conformance sits more easily in today's APS context.

In addressing this topic of public sector governance, or corporate governance in the APS, I will cover:

- an overview of the Australian Public Service today and factors which are likely to influence public sector governance going forward;
- some views on corporate governance, particularly in the public sector context; and
- a distillation of issues arising from recent audit activity which bear on agency governance.

In doing this, I wish to emphasise the importance of governance processes which are effective enough to contain the time spent on control and conformance matters, and allowing greater scope for agencies to address strategy and long-term performance issues.

AUSTRALIAN PUBLIC SERVICE TODAY

The APS today is required to manage rapid policy change, shorter deadlines, better customer focus and higher standards of accountability. All with no prospect of quieter times.

Before considering corporate governance in this context, it is worth taking stock: what is expected of the public sector and where does the future lie?

The Prime Minister said, in the Sir Robert Garran Oration in 1997, that:

*An accountable, non-partisan and professional public service which responds creatively to the change roles and demands of government is a great national asset. Preserving its value and nurturing its innovation is a priority for this government.*³

The Prime Minister⁴ went out of his way to recognise that the public service he found in 1996 was, in many of its operations, markedly improved on the service he had known in the 1970s and early 1980s; the budgetary and financial systems have been streamlined and there is greater emphasis on results in place of the past concentration on processes and inputs; central agencies exercise far less control over the staffing and finances of other agencies; and there is more competition in the delivery of programs both within the public service and outside; and there is vastly more interest shown in delivering high-quality service to the public.

The Howard Government, like its predecessors, has pointed out the public sector is not quarantined from playing its part in making the Australian economy internally competitive. The focus of the agenda of public sector reform has been directed with this end in mind. And there is no denying the gains from public sector reforms and their contribution to micro-economic reform in Australia.⁵ It is a broadly-based agenda which seeks to redefine the role of the public service.

Strong public sector performance, in the context of an administrative framework that encourages improvement and respects values, will be critical to the ongoing success of the APS. Indeed, the Attorney-General has indicated the imperative for the public sector to perform is greater now than ever before.⁶

The Minister Assisting the Prime Minister for the Public Service⁷ has stated that the Government's objective has been:

to focus the APS on its core activities – policy development, legislative implementation and the contracting and oversight of service delivery.

The role of the public sector is now subject to continuous re-examination with the definition of core services itself being subject to review. For new policy initiatives, it is no longer accepted as an article of faith that they will be implemented by the APS; rather, the Service would be expected to manage the implementation by a third party. More broadly, the government has sought, through structural change (eg transfer of responsibility to the states) and competition, to increase the choice of delivery methods to enhance efficiency and/or better achieve program outcomes.

The Prime Minister⁸ has indicated that he believes there will always be an irreducible minimum of public service functions and illustrated this by referring to defence, justice, a social security safety net, the monitoring of outcomes of, and alternatives to, existing policies, high-quality economic, constitutional and other policy advice. Nevertheless, there would be a range of views on how this might translate in practice

meaning that public sector performance is still a constant in the equation going forward.

At the heart of public sector reform is the issue of how to provide the right framework and incentives to continue to drive improvements in overall public sector performance while preserving the values which, in the public interest, differentiate the APS from other organisations. At the agency level, the issues are how to cohesively operationalise change while continuing to deliver on core responsibilities.

We now have a contemporary legislative framework in place including the:

- Financial Management and Accountability Act;
- Commonwealth Authorities and Companies Act;
- Public Service Act; and
- Workplace Relations Act

Central to the new legislative framework is the clear responsibility of Chief Executive Officers/heads of public sector agencies for promoting the efficient, effective and ethical use of resources. Chief Executives carry now more responsibility than in the past both due to the legislative changes and also because of the devolution of authority to agencies from the coordinating agencies for a wide range of personnel, workplace relations and financial management functions. Basically, they need a clear view of their role and mission, broad shoulders and good support.

In addition, we now have a clearly articulated set of Values set out in Section 10(1) of the Public Service Act 1999 which define the Australian Public Service and differentiate it from other organisations. All APS employees are required to uphold the APS Values and to comply with any directions by the Public Service Commissioner in relation to them. The Values may be reduced to 5 key elements, namely:

- an impartial, apolitical and ethical public service;
- a public service that is responsive to the Government;
- a public service that delivers services fairly and courteously to the Australian public;
- a fair workplace; and
- a focus on achieving results and being accountable for performance.

There is nothing in the APS Values which suggests an old-world view of the APS – they outline the values required of a highly performing, best practice organisation. Further, when taken in conjunction with the devolution of responsibility for most employment matters to agency heads, they provide the basis for the removal of much of the safety-net prescription we have had in past years.

Thus in a framework sense, at a global level, it is clear enough what is expected of today's APS.

Tuning the Antenna

We also need to know the view of key stakeholders, which way the wind is blowing, and any developments other than those previously mentioned which may influence strategic decision-making by agencies. This is because one of the key challenges for corporate governance can be portrayed as ‘seeing the future first’⁹.

Reports and pronouncements by the Government and the Parliament, and overseas developments give a steer on the key messages.

The Government

There are several key areas where the Government has signalled more attention is required by the APS to lift its performance.

Firstly, there is a recognition that robust public sector leadership is crucial to making the most of the new framework for the Public Service. Success in this environment requires leaders who can establish a shared vision and a sense of purpose, and inspire, coach and enable the achievement of goals¹⁰. Added to these characteristics should be the ability of leaders to hold the confidence of Government, the Parliament and agency staff in carrying the agency forward.

Secondly, there is the task for APS agencies to continue to examine critically the way in which they perform their functions to determine whether they should continue to be performed by the public service or through other service providers, and to implement performance improvement initiatives to increase cost effectiveness where functions remain in the service.¹¹ The decision by the Government to require agencies to market test the provision of corporate services is a sign that the Government may not be persuaded that the APS is being sufficiently responsive to the need to test alternative methods of service delivery.

Thirdly, the public sector can only contribute to the changing world economy if it is able to respond quickly, flexibly and decisively to the ever-changing demands of global competition; the public sector’s focus should be on results, and positive outcomes.¹²

The Parliament

There are several generic issues raised by the Parliament and its committees which deserve attention going forward because they go to their ability to be properly informed about matters of public administration. These matters also go to the standing of the APS, in the long run. It is essential that the APS manage its relationship with the Parliament while still serving the government of the day.

One issue recently highlighted by the Senate Finance & Public Administration Committee is ‘*the apparent lack of understanding in the Australian Public Service about parliamentary accountability*’¹³. The Committee (majority) indicated it had been hindered in its IT outsourcing inquiry because of the unhelpful attitude taken by two of the agencies involved. The Committee’s concerns related to the information made available to the Committee and the time taken to provide responses, when information was provided.

The Committee suggested that departments and ministers should:

.....work with, and not against, the Committee in seeking ways that can satisfy the Committee's need to have access to certain information while addressing the very real concerns about protecting the confidentiality of material.¹⁴

These are matters for agencies to consider in the context of the Government's Guidelines for Official Witnesses before Parliamentary Committees which are aimed at encouraging the freest possible flow of information about the factual and technical background to policies and their administration between the public service, the parliament and the public.

More broadly, the growing use of commercial-in-confidence provisions in contracts has been an issue of concern for parliamentary committees.

With the move to the greater use of outsourcing, areas of program delivery which were previously within the legitimate purview of Committees are now being placed off limits. Harry Evans, Clerk of the Senate, has reported that:

Senators have become alarmed at the frequency with which information is being withheld from the Parliament on the ground that it is commercial-in-confidence.

...claims of confidentiality have been extended far beyond their proper bounds. It is now regularly claimed that commercial information is confidential regardless of whether any damage would be caused by its disclosure.¹⁵

The JCPAA has stated that:

Accountability and parliamentary scrutiny is being eroded through the application of commercial-in-confidence to all or parts of government contracts.¹⁶

In providing evidence to the Senate F&PAL Committee, the ANAO encouraged a stronger preventative approach to the overuse of commercial-in-confidence provisions in contracts. Amongst other things, the ANAO suggested that before agreeing to a demand by another party for the inclusion of confidentiality provisions, the Commonwealth should be satisfied that confidentiality is necessary in the circumstances having regard to the public interest (emphasis added). We also suggested that, should some degree of confidentiality be considered appropriate, the Commonwealth should seek to include a provision which provides an exception with respect to disclosure to a parliamentary committee, if only on a confidential basis. A recently tabled performance audit¹⁷ addresses this topic and provides criteria to allow agencies to assess whether proposed contract provisions should be treated confidentially.

A further issue concerns the ongoing difficulties that parliamentary committees have faced in following the presentation by agencies of material in the accrual-based outcomes-output framework.

Difficulties include:

- variability in the definition of outputs – some outputs are very highly aggregated and others were quite specific;
- apparent lack of consistency in the approach to distinguishing between departmental and administered items – the definition of control is crucial to the distinction between administered and departmental items, but it has proved difficult for agencies to apply and even more difficult for senators to understand; the reasons for the departmental/administered judgment must be robust and transparent;
- failure to disclose discrete entities, such as the Office of the Status of Women and the Australian Quarantine Inspection Service;
- lack of alignment between the organisational structure of the agency to the outputs-outcomes framework. Where agency outputs do not reflect the organisational structure, a clear description of the methods used to allocate costs should be provided;
- stability of the outcomes-outputs structure – committees would be concerned if major changes were to take place as it would make it difficult to keep track of expenditure year to year. Further when a function is moved from one portfolio to another, it should be slotted transparently into the new framework and at a similar reporting level from whence it came; and
- measuring progress towards outcomes which are long-term goals - the adoption of intermediate targets is a good way forward.

It is noteworthy that the Joint Committee of Public Accounts of Audit has recently commenced an inquiry into accrual budget documentation with the objective of enhancing the usefulness of this documentation for the purposes of parliamentary scrutiny. The review is considering the effectiveness of current budget documentation including the Portfolio Budget statements, Annual Reports and Portfolio Additional Estimates and will identify options for enhancing the format and content of this documentation. Matters being considered by the Committee during this review include the integration of these documents and the level of detail and consistency of financial, output and outcome information presented within these documents.

International Developments

A scan of reports on public administration from Canada¹⁸, United Kingdom¹⁹ and New Zealand²⁰ shows the following priorities are to be addressed:

- modernising service delivery through one-stop access to government information by citizens (Canada);
- improving the linkage between policy and implementation, particularly in respect to cross-departmental issues – joined-up government (United Kingdom);
- strengthening policy capacity by creating working groups which bring together the expertise and perspectives of many departments; collaborating widely with external parties in developing policy initiatives and grouping policy proposals for government consideration by themes (Canada);

- better supporting Ministers who are responsible for the ownership interest in public service departments or, in other words, ensuring departments are capable of handling the challenges of the future (New Zealand);
- focussing on people – attracting and retaining the best and brightest minds, and motivating staff (Canada); and
- seeking to achieve the right balance between central control and devolved decision making (New Zealand).

In addition, participants at an OECD symposium on *Shaping the government of the future* identified a number of pressures governments are likely to face in the decades ahead, including:

- a decline in trust in government;
- a better educated and more knowledgeable citizenry;
- increasingly diverse and fragmented societies;
- greater authority given to supranational and subnational bodies;
- changing patterns of employment and lifestyle.²¹

Summary of influences

There are some clear messages emerging if these issues are shaken down:

- APS agencies must be responsive to the government of the day – to respond quickly, flexibly and decisively; and through their actions, instil confidence in public administration to the community at large;
- accountability of agencies through Ministers to the Parliament needs to be further refined having regard to stakeholder feedback, and reporting rationalised and integrated;
- a collaborative approach to policy development and service delivery across agencies will be required to overcome organisational boundary issues in delivering public services;
- technology will be a very significant driver of change, and programs, going forward – it will be a key to sustaining competitive advantage and delivering results; and
- leadership and retention and attraction of quality staff (including incentive and reward systems) will be critical to ongoing success.

These factors clearly represent current or emerging issues facing the APS. It is thus reasonable to expect that these factors would influence an agency's vision and, in turn, bear on the strategies employed to build capability to achieve longer-term agency goals. Agencies' success in responding effectively to these emerging developments while continuing to deliver on core business will be heavily influenced by their corporate governance arrangements.

AGENCY CORPORATE GOVERNANCE

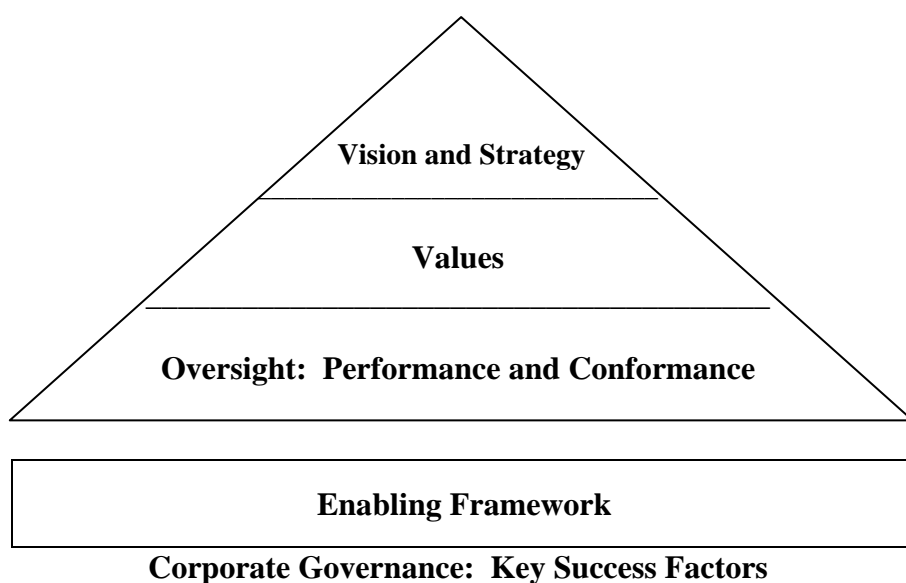
Governance is a critical element in determining organisational prosperity and accountability. It is about how organisations are lead and controlled. Therefore, a key strategic decision for agencies is what form of governance should be adopted to

deliver the results, to the standards expected, consistent with Government policy. This model should have regard to the above-mentioned developments that suggest we will see more emphasis on collaborative approaches in delivering public services in the future.

It is fair to say that most agencies have put in place many of the elements of good corporate governance. These include corporate plans setting out corporate objectives and strategies; business planning; audit committees; control structures, including risk management; public sector and/or agency values; performance information; service charters and evaluation and review. More work is still required to integrate these elements and present them in a way that people in the organisation can understand both their purpose and the ways the elements combine to achieve stronger organisational performance and discharge accountability obligations.

Legislatively, and in practice, it is the Chief Executive Officer that is responsible for the administration of an agency. The buck stops with them, in most cases. And it would be fair to say that with the greater devolution of authority to agencies in recent years, the responsibilities on CEOs have probably never been greater. Further, there is no suggestion on the part of the Government or Parliament that accountability expectations will be downgraded; if anything, the reforms suggest that enhanced authority and flexibility requires enhanced accountabilities.

Several years ago the ANAO released a paper outlining principles for agency corporate governance.²² The paper recognised that a CEO of a public sector agency has responsibility to implement government policy with a considerable amount of flexibility for determining overall operational policy and implementation. It also recognised that within this framework an executive board could be given collaborative responsibilities for key roles including strategic direction; performance and conformance oversight; and development of a comprehensive and formal framework for reporting on agency performance and conformance. This may be illustrated in the following manner



There are clear differences between the public and private sectors, a point well made more recently by the Attorney General:²³

the public sector necessarily still has numerous responsibilities to the Parliament and to the taxpaying public that the private sector does not.

Public sector agencies have to satisfy a diverse range of political, social and economic objectives which subject them to a variety of external constraints.

Because of these wide-ranging responsibilities, it is now quite common within the Australian Public Service for CEOs to establish executive boards with charters. In several cases, the executive boards have external members to complement the skills and perspectives of agency executive members. This approach of including external members is gaining currency, particularly in the larger agencies with more complex administrative responsibilities and/or significant prospective change agendas. In a recent interview, Dick Warburton commented that :

*...in a converging world many of today's business issues are increasingly relevant across a spectrum of industries. Senior executives are becoming ever more aware of the importance of sharing knowledge across industry to manage risks and maximise opportunities.*²⁴

In the absence of legislation to the contrary, however, boards established by agency CEOs are only advisory with the CEO retaining legislative responsibility for the administration of the agency. There is thus a concentration in one position of a substantial amount of responsibility and authority. Just how the CEO interacts with other members of the advisory board is influenced by the personality, skills and view of the role of the board.

Generally speaking, the top four responsibilities of boards²⁵, in order of significance, are seen to be:

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

In this context, it is interesting to note that a survey of Australian company directors²⁶ when asked how they would prefer to spend their time on the various board activities compared with present practice, on average, they would like to spend less time on assuring the health of the financial and control systems; on assuring the health of the company's operations and capabilities; on monitoring current company results; and on ensuring compliance with regulations and laws; and to spend more time on debating and approving future strategy. Russell Reynolds Associates has just released its 2001 International Survey of Institutional Investors²⁷ which reinforces these views. While directed at the private sector, two of the key messages for CEOs have relevance to the public sector:

- CEO's strategy and vision are key issues for institutional investors, not far behind financial performance because of the relationship between these two factors. It is important to continually and effectively outline and communicate corporate strategy and vision.
- Nearly 80 percent of all global investors see succession planning as a major concern. There is a widespread concern that companies are not properly grooming internal candidates to take the helm.

It is likely that the above sentiments would be echoed by public sector senior executives as well.

There is no question that one of the real challenges facing agencies is how to devote the necessary time and energy to longer term strategic initiatives and new approaches while managing on a day-to-day basis. There are no easy answers to this but suffice to say that agencies need to invest today for tomorrow and consciously put in place strategies to deliver better targeted and more efficient outcomes and to ensure they have the capability to deliver on this, ie organisational alignment should follow strategy.

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

One of the solutions to the challenge of lack of time and focus in the private sector, raised in the context of the Company Law Review Bill 1997, is to borrow from the doctrine of the separation of powers, and establish 'compound' boards; a board of directors, to manage the company's business; corporate governance boards, to manage inherent conflicts; and a council of stakeholders, to communicate risks of operations. While there can be argument about the dissection of key responsibilities, the allocation of responsibilities to particular board sub-committees with appropriate accountabilities is good practice. This approach can also highlight strengths and weaknesses in board compositions in terms of the skills and experience that matter in a governance sense.

In a June 2001 article in the Australian Financial Review²⁸ about the (modest) Chairman of the Australian Maritime Safety Authority and now of the Civil Aviation Safety Authority, Mr Ted Anson, it said:

On his aviation experience, Anson freely admits to having none and believes this does not present the slightest problem.

"When the minister first approached me about it, my first comment to him was that I don't know about this. I have nil experience in the aviation sector. In fact, I wouldn't even know what tyre pressure you put on a jumbo."

But as the minister said, “I’m not there to run the day-to-day business of CASA. We have a very strong management team that will do that under direction and guidance from the board who has aviation-type members sitting around the table.”

What Anson does make clear, and what his minister has in private assured him, is that the job of chairman is primarily one of corporate governance and for that he doesn’t need a pilot’s licence.

It is apparent that the solution for delivering programs in the APS going forward will involve partnerships with some other public and/or private sector agencies. The Prime Minister, in his Garran Oration in 2001, observed that a particular challenge for the public service:

is the capacity of departments to successfully interact with each other in pursuit of whole of government goals and more broadly, for the entire Service to work in partnership with other bureaucracies, with business and with community groups as resources and responsibility are devolved closer to where problems or opportunities exist.²⁹

The Prime Minister also indicated that:

Whole of government approaches, collectively owned by several Ministers, will increasingly become a common response.³⁰

These developments provide a pointer to taking public administration to the next stage. This can only be effective if there is confidence that agencies provide the necessary platform for this development, in terms of governance, capability and capacity. In terms of delivery, information technology is the enabler which will allow the citizen to be served by the APS rather than a particular department or agency.

While in terms of governance, there should be an understanding on the contribution each agency can make to the new program objectives, there will also need to be a collective responsibility to achieve the objectives under governance arrangements appropriate for the task. We are fortunate that, historically, this collective approach reflects the culture of the APS. However, clear understandings on the responsibilities of the parties to the joint venture are required and where the risks lie.

In some cases, as previously indicated, the private sector may also be involved because of its particular expertise and scale economies. There are also some potential downsides which should not be overlooked and which may need to be compensated for in terms of the solution proposed.

While the market form of organisation is thought by its proponents to excel at certain types of cost containment, and is a favoured means for terminating old programs, it is less certain that it is able to build new systems of quality service delivery and to create effective institutional linkages within policy sectors. Network advocates have begun to suggest that the competitive market bureaucracy may not mobilise support, share information successfully, invest

in new technologies, create common service standards, and focus upon the individual needs of suppliers and clients. Furthermore, it is suggested, markets may undervalue the rights of individual clients when the cost of difficult clients is higher than the benefit to be gained from “creaming” only the better priced customers.³¹

It is interesting to note in the United Kingdom that:

An early outcome of the modernization agenda has been a partial retreat from the belief in competitive markets as a solution to the problems of public service provision. Greater attention is now being given to ‘joining up’ those public services that became increasingly fragmented under the previous regime.

...There have also been various policy pronouncements regarding the need for greater collaboration between purchasers and providers, and for more strategic inter-agency approaches towards the development of public services.³²

This approach has been termed the ‘third way’³³ in the UK, which is a mixed economy of the best features of market and bureaucratic designs.

Government bureaucracies simply do not have the information-processing capacity of markets – they are unable to solve the co-ordination problem nor can they successfully mimic the incentives established in markets. Markets, however, are also deficient in important and significant respects. They are not efficient except under very restrictive and special conditions. Moreover, they produce welfare distributions that are not socially just.

There is, therefore, the need to find a balance; a ‘third way’.....

In considering possible future developments in the APS context, Pat Barrett³⁴ has suggested that:

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 probably redefine the various relationships between government and the community over time. As well, they erode differences between the public and private sectors.

One of the key issues arising from these developments is whether the current administrative arrangements and regime of incentives encourages networked responses when this is in the citizens’ interests. With organisational boundaries becoming less important in terms of program delivery, it is likely that governance arrangements will evolve to compensate for any current limitations. There is a fairly solid track record of this occurring on the policy front already; less so when it comes to administrative solutions. The governance factors which are important at an agency

level are important here, particularly those concerning responsibility and accountability.

Risk Management

Corporate governance is concerned with achieving results while taking account of risk.

As previously mentioned, agencies are expected to deliver results, to the standards expected, consistent with Government policy. Thus, risk management should play an important role in agency governance to achieve this outcome. It will become even more important in a networked or joined-up environment.

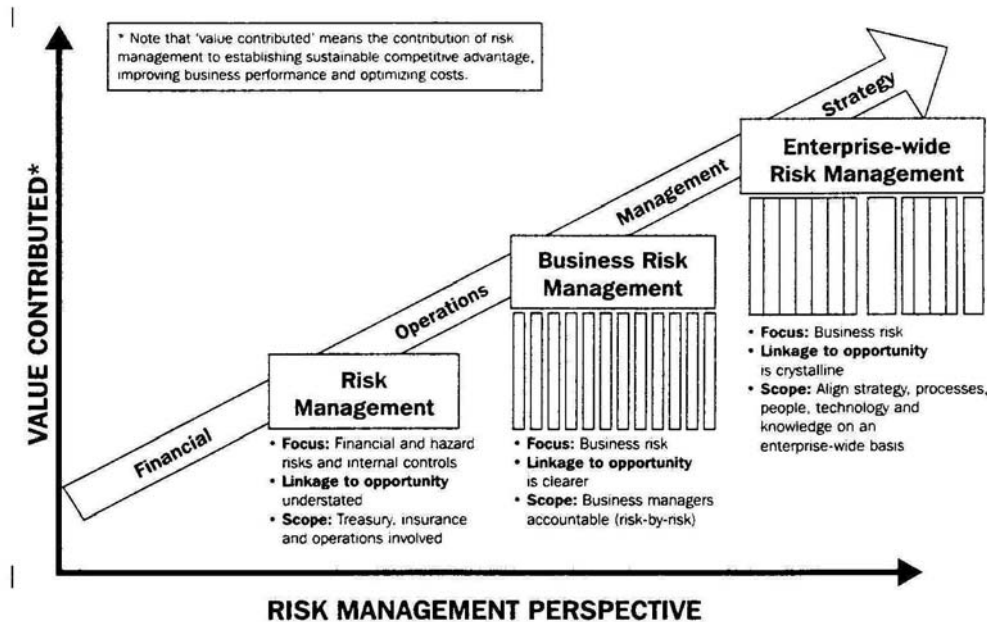
Risk management in the APS was given a high profile in 1996 through the publication of the Management Advisory Board and its Management Improvement Advisory Committee of Guidelines for Managing Risk in the Australian Public Service.³⁵ The ANAO, through its work, has continued to emphasise the importance of risk management in maximising program effectiveness and providing greater transparency in decision-making processes.

Formal risk management may have been seen to be 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. This is particularly important as the nature and significance of risks change in the public sector as the role of the public sector itself changes. The lack of suitable risk management practices generally features in examples of poor administration that get highlighted from time to time.

It is noteworthy also that risk management should not be seen as a reason to disregard sound processes in the pursuit of outcomes. The then Chair of the Senate F&PAL Committee has made the point that:

[Risk management] does not mean that managers can expect to be judged only on the efficiency and effectiveness of their results and be able to claim that the mix of inputs chosen, how they are applied and the selection of who is to supply them is outside the reviewer's area of concern. The fundamental principles of accountability have not changed: information still needs to be readily available to allow reviewers to make their own assessments about the legal and proper use of inputs and the ethical behaviour of the people involved in the processes. Managers cannot simply claim that the ends justify the means.³⁶

It has been a very positive development in recent times to see the number of agencies that have involved their executive board and senior management in risk management at the organisational level and then required each program area or organisational unit to, in turn, prepare risk management plans. Risk management is a concept that should be embraced at all levels of organisations, as set out in the following table.



(Source: Arthur Andersen, *Managing risk, managing value*, Great Britain, 2000)

It is also worth mentioning that risk management must be given the time and commitment to allow a genuine consideration of risks and mitigation strategies, rather than an exercise which is based on form. The other point to bear in mind, is that we can generally identify the risks but assessing the potential magnitude of the risks is an area which requires mature and experienced judgment. Hence the importance of the involvement of senior staff in the process.

It is noteworthy too that CPA Australia's Public Sector Centre of Excellence has recently established a research project entitled 'Risk Management in the Australian Public Sector'³⁷ to examine:

- the current state of play of risk management in the public sector;
- the identification and development of case studies of leading public sector organisations; and
- A 'Better Practice Risk Management Guide' for use by the public sector.

The results will be informative in gauging whether risk management has been embedded in the APS culture.

RECENT ISSUES ARISING FROM AUDIT COVERAGE

Common Themes

Audit reports over recent years have highlighted the value of corporate governance as a stimulus to performance and a constructive vehicle for self-assessment and review.

The application of an effective governance model and embedding a culture of risk management are umbrella requirements for today's public sector agencies.

In addition, there are some noteworthy areas and common themes where weaknesses may arise in public administration which agencies should take account of in their governance arrangements. All relate to core business of the APS. They include:

- policy development;
- contract management;
- management exporting;
- costing of services; and
- internal control and good housekeeping.

Many of the audit reports undertaken by the ANAO address these key management fundamentals.

These audits confirm that it is not only the vision or plan that is critical to success but the implementation and this requires senior management involvement and/or oversight to deliver the results. Severe reputational damage sustained by poor administration in the public sector so it is incumbent on all agencies to have in place mechanisms to continually assess operational performance, and conformance with statutes and agency procedures.

*Policy Development*³⁸

The APS has a strong reputation internationally for its policy development skills. For example:

- the development of the labour market income support policies since the mid-90s;
- managing the balance between public and private health care, by providing choice while ensuring universal access;
- our ability to contain the costs of pharmaceuticals while making available drugs to those who need them at a reasonable price; and
- the financial management reforms are seen as progressive and viewed positively internationally.

The Treasurer said recently that:

In the world economy, we are considered to be a pretty top performer, but we are a country of 20 million people.

*The US is a country of 275 million, Britain is a country of 60 million. Just to be considered in the top league, we have to be better than them at policy, because they have economies of scale which we don't have.*³⁹

The ANAO is currently undertaking an audit of the policy development process in three departments to assess whether departmental quality management systems for policy advisings are appropriate, and the advice provided met expected standards for policy output. We are also developing a set of better practice principles to allow agencies to assess their quality assurance and management of the policy advisory function. The audit report will be tabled before the end of the year.

The approach to policy development today compared to a decade ago tends to be more inclusive of stakeholders to give a greater level of confidence that the outcome is robust and properly targeted. This avoids, or more realistically limits, the need to change policy and legislation on the run. Where, however, there is a risk that individuals or organisations consulted could benefit from knowledge gained during the consultation phase it is essential that agencies' development implement a risk management strategy to maintain the integrity of sensitive information.⁴⁰ Agencies should consider the need for confidentiality and how any potential or actual conflicts of interest will be developed.

The level and standard of documentation necessary to support an administrative process are always a matter of judgment but it would be expected that it would increase as the consequences of decisions and actions increase. It is important for policy developers to establish what Ministers' expectations are with respect to briefings, documentation, identification of risks and other key issues. It is good practice for departments to maintain a record of oral briefings on significant issues and any resulting events and decisions, particularly when time pressures preclude provision of written advice. Again, briefings and records maintained need not be lengthy, but need to be fit for purpose.

Agencies with policy responsibilities also need to ensure that policy development has regard to implementation issues which are likely to be relevant to the policy's success. This involves consulting, where appropriate, with other areas of government or private sector providers, on the relevant implementation issues. This (the feedback loop) is especially important going forward where there is likely to be greater separation between policy development and implementation.

Contract management

With the trend towards greater outsourcing of particular functions or services, consistent with Government policy and the pursuit of administrative efficiencies by agencies, contract management is becoming a more critical element of agency operation. In the 1999-2000 financial year, some 129,000 Commonwealth contracts totalling \$9.9 billion were notified by gazettal.

A large amount of information and better practice guidance has been issued on the topic of contracting, predominantly focussed on the front-end of the contract process, that is those stages leading to contract signature.^{41 42 43 44 45}

As might be expected, the ANAO has reviewed a wide range of tender selection and contract management activities by agencies. While there are exceptions, audits undertaken in recent years suggest that agencies generally undertake the selection processes quite well. Nevertheless, public sector managers should be cognisant of the potential risks which might arise from contractual arrangements with private sector interests, such as⁴⁶:

- 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 a 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, to manage delivery of community service obligations, or to transfer or sell an interest in the project.

When it comes to risk, the overarching principle is that risk should be allocated to the party best able to manage and control that risk.⁴⁷

A key point for agencies to appreciate is that the nature of the relationship changes once delivery of a function moves from the public to the private sector. We have recently issued a Better Practice Guide on contract management which is intended to assist agencies in managing contractual relationships. As the Guide indicates, private sector service providers are in business to make money and to increase their shareholder value. Commonwealth organisations, the recipients of these services, enter into the contracts primarily seeking the best value for money. These views are different but are not mutually exclusive. They can create significant risks and opportunities. Some of these risks can be managed through establishment of an effective operational framework during the contract negotiations, which goes a long way to enabling effective management of the contract over its life.

If parties enter into a contract with a good understanding of the other's objectives, needs, goals and risks, it is possible that a best-fit solution will be found for the service delivery and opportunities can be maximised for all concerned. The OECD has indicated that:

*A good contract is one that strikes, at a level which will be robust over time, a balance between specification and trust which is appropriate to the risks of non-performance but does not either impose unnecessary transaction costs or inhibit the capacity or motivation of the agency to contribute anonymously and creatively to the enterprise in question.*⁴⁸

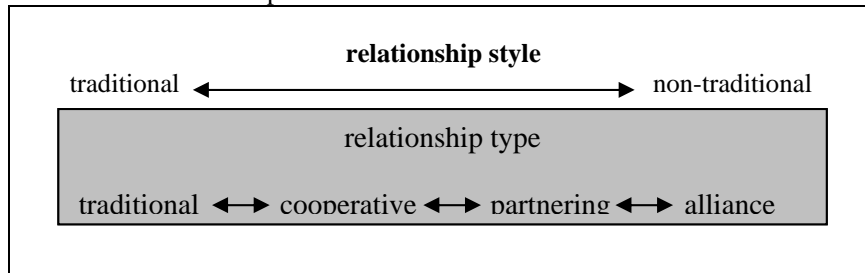
The ANAO Better Practice Guide contains research and experiences of better practices in contract management in Australia and internationally.

Contract administration relationships are generally categorised as either traditional or non-traditional:

- the traditional relationship is formal, with an approach based on control by the customer and compliance by the vendor; and
- non-traditional relationships are categorised as flexible and cooperative arrangements in which the customer and supplier share common goals.

The four common relationship types form a continuum as follows:

Figure 1 - The contract relationship continuum



The guide focuses on the application of risk management to each of the final contract management lifecycle stages and endeavours to provide both practical advice and examples of better practice to assist contract managers to establish a framework for the 'transition in', ongoing management and succession planning stages of the contract management lifecycle.

The Auditor-General tabled an audit⁴⁹ last year on the new method of project alliancing which requires appropriate incentives to encourage 'best for project' behaviour from the agency and the commercial alliance partners to achieve the cost, time and quality requirements of the project. Under the risk/reward regime of the alliance agreement, the agency and the commercial alliance partners would share any cost savings against budget in the proportion of 70:30 respectively. At the time of the audit, the agency and the commercial alliance partners were to contribute to any cost overruns against budget in the proportion of 30:70 respectively, until the latter's cost overrun cap of some \$7.2 million was reached. Cost overruns in excess of this cap were to be funded 100 per cent by the agency. The alliance agreement provided for the first \$3 million of the agency's share of any cost overruns to come from the funds otherwise set aside for the commercial alliance partners to reward 'outstanding' quality performance on this project.

It is essential that agencies have the right number and level of skills to effectively manage contracts because the agency is still responsible and accountable for the delivery of public services. Agencies must have the knowledge and understanding of the activity or business element that has been contracted out and have a clear appreciation of whether the business objectives are being met. Further, such experience is essential for any contract renewal process. Where core functions are concerned, agencies cannot afford to contract out their managerial competence in these areas.

Agencies remain accountable for the delivery of public services. A recent JCPAA Report indicates that:

Under the existing accountability framework, contracting out of government services can lead to less accountability. From a performance and outcome perspective, the Industry Commission, for example, suggests contracting out leads to enhanced accountability through the need to more carefully specify performance and outcomes. But this only holds if the contractual information is public.⁵⁰

It is critical agencies consider the information they require to effectively manage outsourced arrangements, inform decisions on the achievement of program objectives and meet internal and external accountability obligations. In this context, information to meet external accountability obligations should not be seen as an additional impost but a derivative of information required for sound program management.

The ANAO has been encouraging the inclusion of suitable clauses in contracts for agencies, and the ANAO, to enable the timely access to information, particularly where held on the provider's premises. While the need for the external auditor to have access to the premises of third party service providers is likely, in practice, to be required in very few situations, such access, where necessary, would contribute to an audit being undertaken in an efficient and cooperative manner. The Commonwealth Procurement Guidelines are being modified to include reference to the standard access clauses.

Management reporting

A common theme in ANAO audits is that performance measurement and reporting are intrinsic to the whole process of public management, including planning, implementing, monitoring, evaluation and public accountability. Performance results included in agency annual reports provide an important record of an agency's progress towards meeting objectives and their publication makes it possible for stakeholders to exert pressure for improvement, where this is required. Well presented and informative reports can help Parliament and the public assess how well public money is being spent and what is being achieved with it. Such reports are therefore essential for stakeholder assurance.⁵¹

Most agencies have developed, appropriately, some form of balanced scorecard to assess their own performance in terms of both the financial and non-financial indicators for key result areas. Most executive reporting systems, however, leave room for considerable improvement when it comes to producing integrated management information. Given the level of change as a result of the public sector reforms and restructuring, this is not surprising. At the same time, the criticality of quality information for decision making means that systems integration and focussed management information must be on the priority list for most agencies. Without credible performance information, there is no baseline to assess performance and measure improvements in effectiveness.

It almost goes without saying that managers should use information provided by such reports to inform their decision-making, and for accountability purposes.

Costing of services

Under the current budgeting regime whereby agencies are funded for the price of outputs, it is essential that there is a good understanding of the 'costs of production' whether an agency is primarily responsible for policy or service delivery. The consequence of not knowing these costs puts agencies at a management disadvantage because costs are a key component of decisions including those concerned with:

- agency funding negotiations;
- internal resource allocation;
- cost-recovery (e.g. charges, levies);
- cost-effectiveness/outsourcing; and
- external reporting.

Costing of services in the APS is still at a relatively unsophisticated stage except from agencies that have had a commercial arm to their operations for some time. The effort to date, understandably, has focussed on the statutory accounts and high level management reporting.

Going forward, it is apparent that costing of services will require further attention to ensure that agency management is able to obtain the cost information it requires for internal purposes and external accountability purposes. Among the more noticeable shortcomings of current costing approaches is firstly a lack of a comprehensive and contemporary costing policy and secondly the costing systems are structured on an organisational or geographic basis and don't readily allow costing of types of services delivered. Given the emphasis on service delivery (and outputs) in today's APS, addressing these matters will increasingly be a priority. Consideration of these matters generally then takes us into a discussion of whether some system of time recording or estimation is required.

A number of agencies are trialing time recording but most still adopt some form of estimation to allocate staff time to particular services.

A final comment on costing (broadly defined). The nature of transactions between the public and private sector are becoming more complex as the public sector looks for more comprehensive and flexible solutions to program delivery. It is essential that agencies appreciate the accounting implications of these transactions in terms of their rights and obligations, and that the accounting for these transactions reflect their substance. Exposure Draft 100 *Arrangements for the Provision of Public Infrastructure by Other Entities – Disclosure Requirements* (issued in December 1999) highlights some of the accounting issues arising from complex accounting transactions. The Exposure Draft does not seek to modify existing requirements for the recognition of assets, liabilities, revenues and expenses but to seek greater disclosure on the nature and duration of each new arrangement for the provision of public infrastructure.

Costing of services is a topic we have focussed on in recent performance audits and it is a component of a recent Better Practice Guide⁵². The Beyond Bean Counting publications by the Management Advisory Board and latterly by CPA Australia also make important contributions in this key business issue.

Control structures and housekeeping

With the level of emphasis given to outputs and outcomes as part of the reform agenda, the importance of effective control structures and good housekeeping can often be overlooked. An effective control structure provides a fundamental linkage between an organisation's strategic objectives and those functions and tasks undertaken to achieve the objectives.⁵³ A control structure assists with:

- efficiency and effectiveness of outputs and outcomes;
- reliable financial reports; and
- compliance with laws and regulations.

There is no question that administrative processes should be streamlined and cost-effective; and that processes should be viewed as enablers of an organisation's objectives and responsibilities. Good process is designed to deliver long term performance. There is a risk, in a period of significant change, that the importance of effective control structures will be overlooked or not given sufficient emphasis. And history would show that government and public administration will be judged harshly if effective governance and control structures are not in place. For these reasons it was pleasing to see the initiative taken by the Attorney-General's Department, the Australian Competition and Consumer Commission and the Department of Finance and Administration to sponsor a seminar for agency CEOs and senior executives on 'Integrating Conformance with Performance' to reinforce the importance of administering policies and programs in a way that promotes good government, accountable government in a way that conforms to the standards of ethics and propriety that the community expects from the public sector.⁵⁴

Certainly our audit coverage would suggest agencies need to give more attention to conformance, as a complement to sound risk management, in the following areas:

- collection, receipt and management of appropriations, levies and other revenues;
- processes supporting payment of accounts including bank reconciliations, segregation of duties, delegations, debt recovery process, quality assurance processes and IT access, and security;
- ongoing deficiencies in HRMIS functionality;
- asset control including the timely recording of acquisitions and disposals, reconciliation of asset registers to financial systems and review of useful lives; and
- information technology controls including management of system implementations, access security controls and program change controls.

There is further scope for improvement in mechanisms used by agencies to ensure funds are expended in accordance with formal budgetary processes relating to departmental and administered appropriations. In addition, it is apparent that some agencies do not have in place appropriate procedures to ensure managers responsible

for approving expenditure are aware of the annual approved appropriations structure and the legislative implications underpinning the approval of expenditure process.⁵⁵

With the heavy focus on accrual accounting and reporting, it is critical that agencies do not take their eye off the traditional control mechanisms, particularly appropriation controls. The audit opinion on the accounts of two departments for 1999-2000 were qualified due to significant constitutional breaches arising from expenditure without appropriation cover.

At a managerial level, the move to accrual budgeting and the focus on outputs and outcomes have underlined the importance of sound performance management with the goal of supporting the development of a stronger performance culture in the public sector. Indications are that we still have a way to go here. The monthly and quarterly reporting regimes are designed to assist agencies to better manage in accordance with budgets but essentially the solution rests with an agency's own governance arrangements.

Other audit issues

If you are responsible for an area of administration in government, I would encourage you to look at our website (www.anao.gov.au) for reports which touch on audits of similar areas to benefit from the experience of others. Our website allows you to search by theme, by agency, by title, by keywords etc to allow you to quickly get to the issues you are interested in. You may also register on our email list for copies of all our reports, or particular reports, as they are tabled.

CONCLUSION

Agencies are facing challenging times. The APS is expected to uphold the APS Values, which are framed to provide the underpinning for a high performing APS, and run on business lines in a very competitive market for resources. Effective governance is an essential element for success in this environment.

Getting the incentives right, both at an APS framework level and agency level, in a public sector environment to deliver performance and accountability to the standard expected is an issue at which the public sector reforms have been directed for a long time. It is a journey rather than a destination.

The impetus towards networked solutions, and partnerships and alliances with the private sector to deliver services, offer gains in terms of improved targeting and service delivery but this environment will require APS managers to have their eyes wide open to manage the risks and be responsive to the performance and accountability demands of Government and the Parliament. Balancing the public interest considerations with bottom line performance measures will continue to be an issue.

The very clear message though is that agencies have more control over their own destiny than any time in the past. It is important that this be recognised and agencies act consistent with their responsibilities under legislation and government policies.

Effective governance, which reinforces the APS values, is the key to success for agencies. There is a need to be attuned to stakeholder issues, learn from the past, but importantly be responsive, results orientated and accountable. This places heavy demands on CEOs and senior managers in providing the leadership to align the organisational culture to the APS Values and to hold the confidence of stakeholders and staff in carrying their organisations forward.

To be able to devote the necessary time to strategy and long-term performance, agencies should have governance arrangements which are based on an effective control framework, sound executive management reporting systems and a culture which holds managers accountable for performance.

Managers will increasingly be held accountable for results as the quality of performance and financial information increases. Such results must also give sufficient emphasis to agencies' capacity to learn, adapt and innovate in recognition of the importance of these attributes in a highly performing APS.

The goal for APS agencies should be to contain the time spent on control and conformance matters by senior management, without devaluing the importance of these factors, to allow greater emphasis to be given to strategy and positioning for the future. This position will only be achieved if CEOs have confidence that the management and control framework in place is operating effectively; and this will only be achieved if the organisational culture values this outcome.

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