



New challenges in public sector governance

By **Julie Garland McLellan***

- *Two main templates for governance structures recommended, depending on which Act an organisation comes under*
- *Often challenging to identify when changes in scope or operations necessitate changes to structure of governance*
- *Governance often codified in guidelines and rules which can contradict each other, creating significant complexity*

is no easy task. Governance practitioners in the public sector are aware of the consequences of poor governance. The question is not why do we need good governance but what is good governance and, most importantly, how can we achieve it?

To answer that question correctly governance practitioners must understand:

- practical (as opposed to theoretical) governance
- the governance objectives of their own organisation
- the link between governance, compliance and culture
- how to define, identify and manage conflicts of interest
- how to establish appropriate structures for good governance
- when to use committees, teams or hierarchies
- governance of diverse stakeholders and their expectations
- how to apply and monitor the APS values or state government values.

These issues must be placed in the appropriate context. The only rationale for government ownership is that of the public good. This may be served in a number of ways across the sector. Each organisation is governed in a different way and using a different structure that should be selected to be appropriate for the organisation.

Diverse governance objectives

Governance fulfils many objectives including performance and compliance functions. People within the governance hierarchy have a number of roles.

- They set the policy and strategy of the organisation to ensure it meets the needs of the shareholder.
- They obtain (or request) the resources required to implement the strategy and deliver the policy outcomes.
- They monitor the risks to the strategy and ensure that these are effectively managed.
- They establish systems for compliance and ensure that these are used.

The Australian Public Sector generates almost a quarter of Australia's economic activity. It is imperative that this activity be well governed to meet society's rightful expectations. Governance within the sector is difficult because the activities are often complex and directed at parts of the economy where free markets would provide unacceptable outcomes. Complexity is present at local, State and Commonwealth levels.

Although there is no formal requirement for company secretaries in most government sector organisations there are company secretaries and other governance professionals operating within the sector. The government sector, like its corporate counterpart, will adopt structures and roles that add value. In many organisations the company secretary role, or a similar role, is performed by either an individual or a small department. Even where there is no board there is often a secretariat providing support services to the governing team and developing systems for promulgating good governance throughout the operations.

What is public sector governance?

Company secretaries must be confident that they can define and deliver appropriate and effective governance strategies for their organisations. This

- They monitor performance and ensure that it conforms to plan.
- They provide accountability and report to the shareholder and other stakeholders.

Many state and territory governments place an obligation on the governing team to consider or balance environmental, social and economic outcomes. Other organisations may still have this expectation but not have a formal written requirement in their enabling legislation.

There is a trend within the sector for grouping compliance and auditing functions within a governance department. This increases efficiency and effectiveness but can lead to an excessive focus on control and reporting objectives of governance at the expense of strategic and policy objectives. An effective governance hierarchy will provide both strategic and compliance outcomes.

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Defining governance

Brendan Butler provided an excellent definition. ‘If management is about running a company, governance is about seeing that it is run properly.’¹

The ASX Corporate Governance Council recognises Owen J in the HIH Royal Commission in defining corporate governance as:

the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations.²

This definition is relevant because most public sector organisations aspire to the highest and newest standards of governance. These organisations creatively adapt and implement the ASX Corporate Governance Council’s recommendations.

In his *Review of the Corporate Governance of Statutory Authorities and Office Holders*, John Uhrig AC, defined governance as:

the arrangements, by which the power of those who implement the strategy and direction of an organisation is both delegated and limited to ensure the organisation’s success, taking into account the environment in which the organisation is operating.³

The Australian Public Service Commission adopted the definition of the Australian National Audit Office and Department of Prime Minister and Cabinet that:

Governance covers the set of responsibilities and practices, policies and procedures, exercised by an agency’s executive, to provide strategic direction, ensure objectives are achieved, manage risks and use resources responsibly and with accountability.⁴

Each public sector organisation must either select or define governance to suit the organisation.

Selecting an appropriate structure

Perhaps the most important decision affecting governance is the selection of an appropriate organisation form or structure. It is not surprising, given the diversity of the sector, that there are myriad structures in use across the public sector. This multiplicity of structural forms makes it hard for governance professionals within departments to understand the governance requirements of organisations that they own or interact with.

One of the aims of the Uhrig Review was to make recommendations for standardising and simplifying the governance structures. The review found that entities undertaking similar functions did not have comparable governance arrangements: some had boards while others did not. Similarly, some were subject to the resource management requirements of the *Financial Management and Accountability Act 1997* (FMAA) and others to the *Commonwealth Authorities and Companies Act 1997* (CACA). Clearly, if form should follow function, this state of affairs was suboptimal.

Uhrig suggested two templates for governance. The ‘board template’ was recommended where government delegates full powers to act to a board, or does not fully own the assets or equity of a statutory authority. The ‘executive management template’ was recommended in other cases. As a general rule (although with exceptions) the ‘board template’ is most suited to organisations operating under the CACA while the ‘executive management template’ is better suited to organisations operating under the FMAA. Uhrig accepted that there would still be a need for some hybrid governance structures.

The government was criticised for its slow reaction to the review. This criticism has proved unfounded and unjust. There was some delay before the first organisations changed their structures to comply with the recommendations. These changes were (as far as an external observer can evaluate) well planned before implementation, well implemented and allowed time to become consolidated and accepted before further change was contemplated. The first organisations to change served as examples for subsequently changing organisations to follow. This process minimised disruption and allowed development and dissemination of good practice in implementing the changes. Six years after the review there has been a large amount of change and a remarkably small amount of confusion, disruption or politicisation of the process.

Some changes are still being made. The process is not likely to ever be formally 'finished'; as needs change so will governance structures.

Although the Uhrig Review was confined to the Commonwealth sector the principles developed apply to state and territory government organisations. There is evidence that these bodies have also been streamlined, simplified and standardised to make governance easier.

A challenge for public sector governance practitioners is to recognise when changes in operations or scope justify a change in organisational structure. The Department of Finance produced a guidance manual in August 2005 entitled *Governance Arrangements for Australian Government Bodies*. This document outlines principles for helping to determine the most appropriate structures and governance arrangements for Australian Government bodies and is recommended reading for governance practitioners in the sector.⁵ Most Treasury or Finance departments in state and territory governments have similar guidance publications.

Governing boards, advisory boards or committees

The public sector makes great and effective use of committees. Most department and ministerial office staff are familiar with committee structures and operations. Where problems arise is staff assuming that boards operate in the same way as committees.

Committees are excellent for representing stakeholders in decision-making so that no outcomes will be unacceptable to any of the represented stakeholders. This is a highly desirable function in government. Committee members owe their duty to the people they represent or to the people that nominated them. They are able to accept a suboptimal overall outcome if it allows for avoidance of an unacceptable outcome for their constituents or nominators.

Boards owe their allegiance only to the organisation or to its shareholder.⁶ Board members

should not put any interest ahead of the interests of the organisation. This generally leads to more optimal outcomes but at a cost to certain interests. No board should ever allow a stakeholder group to be so adversely affected by its decisions that the community and reputation effects negate the

positive outcomes. Most boards will be willing to sacrifice popularity to gain effectiveness. This can seem alien to many experienced public servants. A good governance professional can provide support and guidance when board members grapple with what can be emotive and intractable issues.⁷

Uhrig made the point that governing boards should only be used if they are given the power and freedom to act. With great power comes great responsibility. Governing board members are personally liable for many actions of the organisations they govern, even if they are not personally involved and have no ability to influence those actions. It is important for governance professionals to recognise the pressures upon board members and to assist them in managing these demands to discharge their duties and deliver the desired outcomes. Some governance practitioners hesitate to suggest board member education and performance review. Most board members appreciate such assistance.

Government often gains external insights without ceding control through the use of advisory boards. These boards allow access to the skills and insights of private sector board members but do not delegate the power to direct, only the requirement to provide advice.

It is important that these distinctions be understood especially when setting board remuneration policy. People who are carrying a 24/7 responsibility should not be remunerated by sitting fees.

Governance in practice and in theory

Within the public sector there are many layers and types of governance.

- Organisational governance tends to be used to describe the way in which an organisation is controlled and directed to achieve its purpose.
- Corporate governance is generally assumed to be a more restricted version of organisational governments and relates to the separation of duties between shareholders, directors, and management in order to appropriately govern a commercial entity.

Governing boards must define the desired culture and ensure that it is achieved in practice. The board must be visible to staff and yet not circumvent proper chains of communication and command. Governance professionals can assist the board by ensuring that culture is discussed and measured in relation to the strategy.

- Self-governance is the ability to effectively manage one's own emotions and reactions so as to improve effectiveness in a given environment.

Governance is frequently codified and communicated in guidelines and rules. This generates significant complexity. This situation is exacerbated by the many different definitions of governance and also by the impractical idea that complete compliance is always achievable. Governance must change at each level to fit the functions and situation of the governing team.

A good example of conflicting rules is found in local government organisations where many of the state and territory Acts require councillors to represent both the interests of a ward or division and the interests of the local government area as a whole. There is no guidance on how to prioritise when these interests do not coincide.

Another example is the application of conflict of interest guidelines which, in small towns where all directors know all residents, can lead to the entire board being conflicted on an issue that in theory should cause them to abstain from discussion or decision-making. Realistic policies based on disclosure and management are better than unachievable policies based on avoidance.

These are areas where a pragmatic and experienced governance professional is an invaluable source of assistance to the board.

The importance of culture

Many employees rely on their own and the organisation's values and culture to guide their actions rather than referring back to rules, policies or guidelines. This works when the individual and the organisation culture are aligned with the governance strategy. Disasters can occur when there is divergence between the two. For instance, in 2004, at the start of an investigation, the CEO of Energex, a Queensland Government-owned organisation, committed suicide. It later emerged he had been paid thousands of dollars' worth of personal expenses, without the knowledge of most board members. The tragic events are a stark reminder of the high cost of culturally inappropriate, but legally correct, actions.

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APS values

The Australian Public Service Commission provides a range of information on governance for the public

sector under the title of 'foundations of governance'.

One of the most valuable contributions is the publication and promulgation of the APS values. These are legally enforceable and should be well-known by governance practitioners. Consistent application of the values across the sector enhances governance. Unfortunately many governance practitioners are not familiar with the values.

The *APS Values and Code of Conduct in practice*⁸ are regularly updated to reflect current advice on ethical issues affecting the APS.

Some state and territory governments also have legislation or codes of conduct that impose values. It is important that governance practitioners are aware of these and can assist in their application.

Learning from mistakes — lessons from the Palmer and Comrie reports

The incorrect detention of Cornelia Rau and expatriation of Vivian Alvarez Solon led to the Palmer and Comrie reports which highlighted a number of governance failures.

Palmer's recommendations included improving training, data management, record keeping, and coordination with state offices. In a chapter on culture, structure and operations, Palmer found:

evidence of deafness to the concerns voiced repeatedly by a wide range of stakeholders...and a culture that ignores criticism and is unduly defensive, process motivated and unwilling to question itself.

Palmer also found the approach of management 'to the complexities of implementing policy to be "process rich" and "outcomes poor"'.

The Comrie Report supported many recommendations made in the Palmer Report. It highlighted problems with coordination, the IT systems and systems for assessing and managing the health (particularly the mental health) of detainees. Comrie agreed with Palmer on issues of culture.

The Proust Report was commissioned to report on the progress of reforms in December 2008. It found significant changes had occurred and that most of the recommendations of the Reports had been implemented. This is a sterling achievement in three years. The report covers the recommendations and the extent of their implementation as well as the magnitude of the cultural change.

Cultural change programs have been a major factor in ensuring a different and more positive approach. The Reports and their implementation have relevance to the entire sector and other organisations are now building and maintaining effective cultures to support their policies and procedures.

Dealing with diversity

One of the factors supporting change is the increased diversity of governing teams in the sector. The government sector has made great progress in inclusive governance and it is now uncommon for boards and senior executive teams to be entirely composed of male Anglo-Celtic senior executives.

While acknowledging the benefits of diversity it is important to remember that it also creates complexity. This is especially relevant where the government has included people from non-traditional backgrounds in governance. These people need help and support in gaining knowledge to enable them to be effective. Governance practitioners should be proactive in offering education, experience and access to advice to assist in this. It is unfair to expect people who don't know what they don't know to fix their deficiencies without assistance.

Another area that has increased diversity is the current trend towards including citizens in decision-making. It is now common for communities to be consulted, informed and even allowed to decide on issues that were formerly the preserve of confidential strategy making. Good governance professionals can assist in determining how best to include people, designing robust procedures for inclusion, communication and feedback.

The link between good governance and performance

Governance professionals assume a link between good governance and good outcomes. Many attempts to demonstrate a conclusive link in practice have failed because the definition of good governance practices has relied too heavily on certain structures or activities, which are not in themselves sufficient to generate future good outcomes. A more holistic definition of governance, such as that put forward by Butler, is more likely to correlate with future performance but harder to measure. A good governance framework should guide the actions of individuals by providing clarity of direction as to appropriate behaviour and decision-making.

The Uhrig Review stated that a well-governed organisation will clearly understand what it is required to achieve, be organised to achieve it and focus on ensuring it achieves its goals.

Uhrig identified three elements that were core to successful governance and must be present if the link to good outcomes was to be substantiated.

- *Understanding success* — It is clear that for good outcomes to be achieved the people who are working towards those outcomes must understand what the desired outcome is. Thus

governance covers the establishment of a sense of purpose and clear performance expectations.

- *Organising for success* — This involves implementing the right organisational structures to control and manage the activities that must be undertaken. It also includes ensuring that power exists, is delegated, is limited, and is exercised in order for the entity to achieve its purpose.
- *Accountability for success* — A robust governance framework should, through transparency and accountability mechanisms, link power to responsibility and performance to review.

The challenge for governance professionals in the public sector is to focus on these three attributes, even as the sector undergoes additional extensive change, to provide evidence of a conclusive link between governance and performance.

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Notes

- 1 Butler B, 1999, *Corporate Governance in the Public Sector*, Fourth Annual Public Sector Symposium, Brisbane
- 2 ASX Corporate Governance Council, 2007, *Corporate Governance Principles and Recommendations*, 2nd Edition
- 3 Uhrig AC J, 2003 *Review of the Corporate Governance of Statutory Authorities and Office Holders*
- 4 ANAO and Department of the Prime Minister and Cabinet, 2006, *Implementation of Programme and Policy Initiatives: Making Implementation Matter*, Better Practice Guide
- 5 The manual is available on the Finance website at <<http://www.finance.gov.au/financial-framework/governance/governance-arrangements-for-australian-government-bodies.html>> [28 July 2009]
- 6 Organisations in the Australian public sector have only one shareholder, the relevant Parliament. In organisations constituted as incorporated entities, the shareholder is represented by the relevant Ministers. In most states or territories and the Commonwealth this representation is provided by the Shareholder Minister (who is usually the Treasurer) and the Portfolio Minister. Some jurisdictions have a third Minister who may take part in exercising the shareholder role
- 7 *Bennetts v Fire Commissioners of NSW* (1967) 87 WN (PH) NSW 307 is an excellent case study for new board members who need to understand the role of board members and their nominees.
- 8 Available at <<http://www.apsc.gov.au/values/conductguidelines.htm>> [28 July 2009] ●