Auditor-General of Queensland
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Corporate Governance
Beyond Compliance
A Review of Certain Government Departments

4 June 1999

Queensland

Prepared Under Sections 99 and 101 of the
Financial Administration and Audit Act 1977

To

The Honourable the Speaker

of the Legislative Assembly of Queensland

Mr Speaker

This Report is the seventh in the series for 1998-99. The Report deals with the results of an audit review of corporate governance and associated risk management practices within certain government departments.

In accordance with s.105 of the *Financial Administration and Audit Act 1977*, I provide the Report to you and would appreciate if you could arrange for it to be laid before the Legislative Assembly.

L J Scanlan

Auditor-General of Queensland

Queensland Audit Office

Brisbane

4 June 1999

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Foreword

Foreword

The concept of corporate governance embodies a number of existing management tools. The value of corporate governance is that it draws these tools together into a logical, interrelated set of elements which have universal application. However, as organisations vary in size, complexity and legislative environments there are a number of frameworks within which the elements may be applied.

The implementation of an effective corporate governance framework within an organisation requires an understanding of the underlying principles and their inter-relationship. Implementation therefore goes beyond mere compliance and encompasses performance. Implementation of the elements as a process driven exercise will not guarantee an effective corporate governance framework.

Corporate governance had its origin in the private sector but recently has been gaining acceptance within the public sector and this Report examines its application across Queensland Government departments. The underlying principles of corporate governance have been referred to throughout the Report in association with audit findings and recommendations in order to provide best practice guidance for departmental management.

As with all improvement opportunities there needs to be a balance between the cost of implementation and the benefits provided by such improvements. The elements of corporate governance are in themselves an aid to more efficient, effective and economical operations, but any advantage can be negated by ineffective implementation. Accountable officers should therefore ensure that the frameworks developed to apply the elements of corporate governance are cost effective.

I encourage all public sector managers to consider the findings of this Report and to review the corporate governance frameworks operating within their agencies with a view to improving the efficiency, effectiveness and economy of their operations.

Section 1.
Executive Summary

1. Executive Summary

1.1 Introduction

Corporate governance is the manner in which an agency is managed and governed in order to achieve its strategic goals and operational objectives. A sound control environment provides reliability to an organisation in achieving these goals and objectives and may be considered effective when the risks to the organisation are reduced to an acceptable level.

This interpretation dwells heavily on control and oversight, but there is also a need for an organisation to be flexible in order to respond to changes in its internal and external environments. Risk management provides both the control and the resilience.

Risk management is therefore a fundamental part of corporate governance. It not only provides the strategy for treating risks which might impede an organisation in the pursuit of its goals and objectives, but also supplies the flexibility for the organisation to respond to unexpected risks and take advantage of unexpected opportunities.

The concept of corporate governance embodies a number of management tools which have existed for some time. The value of corporate governance is that it draws these tools together into a logical, interrelated set of elements which have universal application.

The application of the elements of corporate governance will vary with the size, complexity and legislative environment of the entity. It is therefore important that departmental management have a full understanding of the underlying principles and basis of corporate governance. Implementation of the corporate governance elements for the sake of compliance or as a process-driven exercise will not guarantee an effective corporate governance framework.

The cost of the corporate governance elements must also be considered and accountable officers should therefore ensure that the frameworks developed to apply the elements of corporate governance are cost effective.

An overview of the responsibilities and common operational principles to be considered when implementing a corporate governance framework in a department is included in Appendix A. This Report, however, does not claim to provide answers for all situations, but is intended as a foundation for decision-making and further refinement.

In my view corporate governance is one of the cornerstones of sound stewardship and effective management. Accordingly, an audit examination in relation to corporate governance and associated risk management practices within certain government departments was conducted under the broad powers contained in s.80 of the *Financial Administration and Audit Act 1977*, which provides that the Auditor-General may conduct an audit of the performance management systems of a public sector entity.

In conducting this audit, reference was made to a number of publications as outlined in Appendix B of this Report with particular regard being paid to Queensland Treasury guidelines on audit committees and risk management.

While the primary aim of this audit was to identify best practice guidance for departmental management, I also had regard to the following recommendation in the Report of the Queensland Commission of Audit (June 1996) —

> *The Auditor-General should be requested to report on the adequacy of risk management practices in agencies from time to time in order to encourage more active risk management within government.*

Initially I intended to examine the corporate governance frameworks of all budget sector agencies, but on the completion of the audit of thirteen departments I believed that I had identified sufficient evidence of best practice to conclude the audit and thus free resources for other emerging issues. The Departments examined as part of this review are outlined in Appendix C. The audit findings of each department reviewed have been provided to the appropriate accountable officer.

The Queensland Audit Office (QAO) has also taken advantage of the opportunity to review its own corporate governance and risk management practices and is currently implementing recommendations from this review. In due course I intend to examine the corporate governance frameworks within the remaining public sector entities as part of the on-going audit process.

In order to provide best practice guidance for departmental management, the underlying principles of corporate governance have been referred to throughout this Report in association with the audit findings and recommendations.

In addition, the recommendations included in this Report address all of the opportunities for improvement identified during the review irrespective of their frequency of occurrence as a further guide to best practice.

A risk exposure that the public sector has had to manage during the last decade has been the replacement of Directors-General at some departments following changes in government. A sound corporate governance framework which incorporates a strong control environment and a controlled flow of information to and from the accountable officer is invaluable in ensuring a smooth transition in the event of any future change.

A sound and robust corporate governance framework, balancing accountability with cost effectiveness will also be necessary to ensure the successful introduction of accrual output budgeting into Queensland budget sector agencies.

1.2 Overall Audit Opinion

Corporate Governance

Departments included in the review had a number of the elements of corporate governance in place, but only a relatively small group were applying them as an inter-related set of principles focussed on achieving their strategic goals and operational objectives. These departments also demonstrated a commitment to and an understanding of the role of risk management in corporate governance and have developed or are in the process of developing a systematic risk management system covering all of their business activities.

Audit found that corporate governance could be improved in the majority of departments reviewed through the refinement of management practices which need to be developed into an integrated set of procedures aimed at achieving the departmental mission, purpose and goals. The recommendations contained in this Report identify opportunities in this respect.

Risk Management

In general, the departments reviewed were applying risk management practices in various key operational areas. Less than half of the departments however, had undertaken a comprehensive risk identification process across all business activities. Of these, only three departments had systematically applied the management procedures of risk analysis, assessment and treatment outlined in Section 6.3 of this Report and only one department had fully implemented risk monitoring procedures and practices.

The development of a systematic and co-ordinated risk management system is critical to the establishment of an effective control environment and would provide assurance that a department will achieve its goals and objectives with an acceptable level of residual risk.

Management Response

In general, responses to this review and to the individual reports have been positive. Departments have accepted the recommendations and have been progressively introducing a number of improvements to management practices. Recommendations which have general application to the Queensland public sector are set out below.

1.3 Recommendations — Corporate Governance (Section 5)

1.3.1 Management Structure and Operations *(Section 5.2)*

- Consideration should be given to developing a more strategic focus for executive groups to assist the accountable officer in setting goals and objectives for the department and in monitoring conformance and performance to ensure that the department's goals and objectives will be met.
- Terms of reference clearly defining the roles and responsibilities of executive groups and committees and their members should be established. These documents should be approved by the accountable officer and be readily available to all members of the executive groups and committees.
- Consideration should be given to providing formal induction processes for new members of executive groups and committees which would include information sessions on corporate governance and the strategic role intended for the executive group or committee.
- Accountable officers should ensure that official executive group and committee minutes and supporting reports, submissions etc. are drawn up and filed in a manner that ensures that —
  - the proceedings of each meeting are accurately recorded;
  - responsibility and time lines for action items are assigned and monitored; and
  - original copies of minutes and supporting reports, submissions etc. are readily available as records of proceedings.
- Consideration should be given to providing formal training to officers responsible for maintaining official group or committee minutes.
- The information needs of executive groups and committees should be assessed in line with their specific requirements to clearly determine the type, quality, format and frequency of information that they require. Such information should include a risk management focus and be communicated to the appropriate line managers.
- The information system should also include processes for communicating information downwards and laterally to ensure that all staff are provided with timely information necessary for them to discharge their responsibilities.
- Executive groups and committees should undertake a balanced annual self evaluation process to assess whether they are meeting their objectives in accordance with their terms of reference.
- Such evaluations should also review the overall governance framework for the department to provide assurance that accountability is being delivered in the most cost-effective manner.
- When reviewing the appropriateness of the membership of their audit committees, departments should refer to the *Guidelines on Audit Committees* issued by Queensland Treasury as well as other best practice guides.

- In particular departments should give consideration to appointing suitably qualified, external members to their audit committees.
- Consideration should also be given to inviting QAO representatives to attend all audit committee meetings in an observer/advisor role to take advantage of their capacity to provide objective advice on matters relevant to the committee.

1.3.2 Management Standards *(Section 5.3)*

- Departments should introduce a quality assurance process over administrative policy development to ensure relevance and consistency from a whole of department perspective.
- Existing policies should be regularly reviewed for alignment with legislation and the overall goals and objectives of the department.
- Departments should review their code of conduct framework to ensure that —
    - external members of advisory groups and committees are covered with regard to expected ethical standards, particularly in regard to conflicts of interest and confidentiality issues; and
    - trend analysis and monitoring procedures for compliance with the code of conduct are developed as part of the department's fraud prevention strategy.
- Departments should ensure that there is a mechanism in place for the induction of temporary and casual employees and external service providers in relation to expected management standards.
- Departments should assess the coverage and level of success in conjunction with the transition of their policies, delegations and codes of conduct to the new electronic format (Intranet) by monitoring the level of activity on their networks. Such monitoring may also be useful in identifying training opportunities with respect to particular policies, delegations and ethical standards.

1.3.3 Control, Monitoring and Reporting *(Section 5.4)*

- Departments should ensure that —
    - the information being reported to executive groups provides a summary of all activities including balanced reporting of both financial and non-financial performance against targets; and
    - there is independent scrutiny in relation to the completeness and accuracy of the information reported to executive groups and committees.

- In order to assist accountable officers in discharging their duties under the *Financial Administration and Audit Act 1977*, audit committees should ensure that —
  - the internal audit charter complies with s.77 of the *Financial Management Standard 1997* and is regularly reviewed to ensure continued compliance with the statutory requirements and relevance to the department's operations;
  - the internal audit unit is adequately resourced in terms of staffing and skills mix to enable a balanced work program to be undertaken;
  - the strategic and annual plans of the internal audit unit present a balance of financial compliance, information systems and operational audit matters aligned with the risk profile of the department;
  - the internal audit unit completes its work plans in a timely fashion;
  - recommendations by the internal audit unit are implemented by management in a timely fashion; and
  - the internal audit unit is subjected to an external peer review at least every five years.

1.3.4 External Accountability *(Section 5.5)*

- Adequate systems and processes should be developed to manage the production of quality financial statements in a timely manner.
- The appointment and retention of appropriately qualified and experienced staff is paramount to the successful completion of this process and need to be addressed through the delivery of appropriate training programs and succession planning.
- Audit committees should adopt a monitoring role over the management of the annual financial statement preparation process in order to ensure the quality and timeliness of the statements presented to the accountable officer for certification.
- Departmental Annual Reports should clearly disclose all relevant corporate governance practices in operation during the year. Such disclosure should include as a minimum —
  - details of executive group and committee structures and operations;
  - the department's ethical procedures, values and practices;
  - the operations of the internal audit unit; and
  - detailed reference to the department's risk management philosophy and practical application.
- All departments should review their ethics disclosure in their annual reports to ensure compliance with the requirements of the *Public Sector Ethics Act 1994*.

1.4 Recommendations — Risk Management (Section 6)

1.4.1 Management Support *(Section 6.1)*

- Departments should review their support procedures with respect to risk management to ensure that staff are committed to the identification of risks and the development and maintenance of internal control systems and other strategies to manage those risks.

1.4.2 Risk Management Policy *(Section 6.2)*

- Departments should ensure that their risk management policy clearly sets out their position with respect to risk management and the roles and responsibilities of staff.
- This policy should provide detailed guidance on risk management practices to be adopted across the department including —
  - risk registers;
  - guidance as to what constitutes acceptable risks;
  - linkages between risk management and the strategic plan;
  - the level of documentation required; and
  - the reporting process.

1.4.3 Manage, Monitor and Review Risks *(Section 6.3)*

- In accordance with the *Financial Management Standard 1997*, departments should continue to develop and implement as a matter of urgency a systematic and co-ordinated risk management framework for both the department and entities responsible to the department in order to address and manage all their risks.
- This framework should include the identification, analysis, assessment, treatment and monitoring of risks in accordance with best practice principles outlined in the Australian/New Zealand Standard on Risk Management (AS/NZS 4360:1995).

Section 2.
Introduction

2. Introduction

2.1 Corporate Governance

QAO regards corporate governance as a cornerstone of sound stewardship and effective management. The concept of corporate governance embodies a number of management tools which have existed for some time. The value of corporate governance is that it draws these tools together into a logical, interrelated set of elements.

By definition corporate governance is the manner in which an organisation is controlled and governed in order to achieve its strategic goals and operational objectives. Inherent in this definition is the development of goals and objectives and the establishment of controls to ensure that the goals and objectives will be met.

The first element of corporate governance is therefore the development of goals and objectives through corporate planning. This is followed by a number of other corporate governance elements which are aimed at ensuring the goals and objectives will be met. These elements include —

- development of operational plans to achieve the strategic goals and operational objectives;
- development of an organisational structure and the roles and responsibilities of staff;
- establishment of delegations to ensure responsibilities are matched with necessary authority;
- development of a code of conduct to provide employees with an expected standard of behaviour which is directed at fraud prevention, client service and creating a culture which fosters continuous improvement;
- development of reporting and monitoring processes that ensure —
  - conformance with laws, policies, procedures, and the code of conduct; and
  - that performance is measured against the corporate plan;
- development of internal and external reporting processes to provide accountability;
- development of an information plan that ensures —
  - all board-like bodies and committees receive quality information in a timely fashion to assist in the stewardship of the organisation;
  - continuous improvement information is openly shared throughout the organisation;
  - all staff are provided with information necessary for them to discharge their responsibilities and this information is communicated in a timely manner; and
  - a corporate and risk management culture is developed and maintained within the organisation.

- development of a systematic and co-ordinated risk management system across all business activities. Such a system provides reasonable assurance that the organisation will achieve its goals and objectives and provides the flexibility for the organisation to respond to unexpected risks and to take advantage of unexpected opportunities.

These elements have universal application to all types of organisations. However, as organisations vary widely in size, complexity and legislative environments there are a number of frameworks within which the elements may be applied.

The implementation of an effective corporate governance framework in an organisation requires an understanding of the underlying principles and their inter-relationship. It therefore goes beyond mere compliance as implementation of the elements solely as a process driven exercise will not ensure an effective corporate governance framework.

An overview of the responsibilities and common operational principles to be considered when implementing a corporate governance framework in a department is outlined in Appendix A. However, this Report does not claim to provide answers for all situations, but is intended as a foundation for decision making and further refinement.

As with all improvement opportunities there needs to be a balance between the cost of implementation and the benefits provided by such improvements. The elements of corporate governance are in themselves an aid to more efficient, effective and economical operations, but any advantage can be negated by ineffective implementation. Accountable officers should therefore ensure that the frameworks developed to apply the elements of corporate governance are cost effective.

Corporate governance had its origin in the private sector, where shareholders delegate many of their responsibilities as owners to company directors, who together as a board oversee the executive management of the business on their behalf.

In the public sector, corporate governance is the way in which Parliament, Government and public sector entities relate to one another in stewardship matters. Due to the diversity of operations in the Queensland public sector different governance frameworks operate within the following types of public sector entities —

- Statutory Bodies (including Universities);
- Statutory Authorities;
- Government Owned Corporations;
- Local Governments;
- Aboriginal and Island Councils; and
- Departments.

Statutory Bodies, Government Owned Corporations, Local Governments and Aboriginal and Island Councils more closely resemble the private sector in that they have management boards constituted under legislation, non-executive members on the board and a non-executive member as chairperson.

There are however a range of issues in the public sector which go beyond the private sector objective of the maximisation of shareholder value. These issues include a more stringent public accountability and the need to take into account a variety of public policy considerations.

Departments provide a very different model. They do not have management boards, but may have an executive group whose function is to provide support for the accountable officer in stewardship of the department. This arrangement has a number of differences from the private sector model. These include —

- accountability lies with a single person in the chief executive or Director-General — the accountable officer as prescribed in the Financial Administration and Audit Act;
- members of the department's management group are also executive officers whereas company boards are mostly comprised of non-executive members; and
- the chairman of the departmental executive group is normally the accountable officer whereas in private sector companies the role of chief executive is most often separate from that of chairman of the board.

Notwithstanding these differences, the corporate governance elements may be applied to the control and direction of departments. Executive groups are served by committees and effective information flow, clarity in role definition, an effective control environment, the balance of responsibility and authority, effective reporting lines and accountability are essential for their proper functioning.

This report details the overall findings and recommendations emerging from the audit examination of corporate governance across budget sector agencies.

2.2 Risk Management

Risk management involves the systematic identification, analysis, assessment, treatment and monitoring of risks. The concept has its origin in the insurance industry, but its scope has widened to cover all business risks.

Internal control is a related subject and has its origin in the accounting profession. As with risk management, it has broadened its scope to embrace all business activities such that the concepts of internal control and risk management have converged. Risk management therefore is a tool which assists in the development of an organisation's control environment and plays a key part in corporate governance.

The *Public Finance Standards 1990 (PFS)* were amended in 1993 to include a standard and brief practice statements for risk management. The *Financial Management Standard 1997* which replaced the PFS places responsibility on each accountable officer and statutory body to develop and implement systems for effectively managing risks that may affect the entity's operations.

The Australian/New Zealand Standard on Risk Management (AS/NZS 4360:1995) contains clear guidelines for the establishment of a risk management function. The commentary to s.84 of the Financial Management Standard recommends consideration be given to the Standard on risk management.

2.3 Legislation

Corporate governance principles and their application to departments can be identified in various government legislation, policies, guidelines and standards that set out the responsibilities placed on accountable officers to manage their departments efficiently, effectively and economically.

Included in the legislative environment are mandatory corporate governance tools to be used by accountable officers in discharging these responsibilities. A number of the elements making up this statutory environment are outlined below.

2.3.1 Financial Administration and Audit Act

Under s.35 of the Financial Administration and Audit Act, the chief executive of a department is the accountable officer. Section 36 of the Act sets out the functions and duties of the accountable officer which include the establishment of an internal audit function with direct reporting lines to the accountable officer.

2.3.2 Financial Management Standard

The prime objectives of corporate governance include setting the strategic direction for the organisation and the establishment and monitoring of effective controls. The elements for effective corporate governance in Queensland Government departments and statutory bodies are set out in the Financial Management Standard.

Governance elements embodied in this Standard include —

- requirements for strategic, operational, information technology and physical asset management plans;
- establishment of an organisational structure, internal controls, board-like bodies and supporting committees to oversee the governance of the organisation;
- development of management standards such as codes of conduct, policies and delegations which clearly set out ethical standards, roles, responsibilities and authorities; and
- implementation of accountability structures that provide resource management, performance management, internal control, internal audit, risk management and reporting.

2.3.3 Libraries and Archives Act 1988

This Act covers the making, preservation and custody of public records. It places a responsibility on chief executive officers to ensure that complete and accurate records of the activities of the Department are made and preserved.

2.3.4 Public Sector Ethics Act 1994

This Act provides that a set of ethics principles be assembled in a code of conduct tailored to an agency's operations. The *Public Sector Ethics Act 1994* places responsibility on chief executives to prepare a code of conduct, provide access and training for staff, apply the ethics principles to the agency's administration and to report publicly on its implementation.

2.4 Government Policies and Standards

Schedule 1 to the *Financial Management Standard 1997* includes a list of those documents that are issued by the Treasurer or published by the Treasury Department and with which accountable officers and statutory bodies must comply. The relevant documents include —

- ‘Client Service Standards Policy Guidelines’ (1995).
- ‘Commercialisation of Government Service Functions in Queensland’ as tabled in the Legislative Assembly 23 November 1994.
- ‘Guidelines on Audit Committees’ (1993).
- ‘Guidelines on Insurance’ (1993).
- ‘Minimum Reporting Requirements for the Preparation of General Purpose Financial Statements of Government Departments.
- ‘Physical Asset Strategic Planning Guidelines’ (1995).
- ‘Project Evaluation Guidelines’ (1997).

A range of other guidelines have also been issued by the Treasury Department and are listed in the Annual Report of that agency. Some of the guidelines providing best practice in corporate governance include —

- Guidelines on Risk Management and Insurance - January 1997.
- Private Sector Investment in Public Infrastructure and Service Delivery – September 1997.
- Cost Effective Internal Control – November 1997.
- Recording and Valuation of Non-Current Assets – June 1997.

Section 3.
The Queensland Public Sector Environment

3. The Queensland Public Sector Environment

The Queensland public sector has been undergoing considerable change in recent years involving an evolutionary progression from the prescriptive Treasurer's Instructions and Minister's Directions towards greater managerial autonomy.

Public Finance Standards

In 1988 the *Financial Administration and Audit Act 1977* was amended to replace these prescriptive requirements with the Public Finance Standards. The Standards which came into force on 1 July 1990 placed a responsibility on accountable officers to establish systems, practices and procedures appropriate for their particular operations in line with the broad policies set out in the Standards. Accompanying the new responsibilities were accountability measures through provisions which set out the requirements for strategic planning, program management and in particular performance review and reporting. In 1993 the Public Finance Standards were amended to include a standard and brief practice statement on risk management.

The Public Finance Standards therefore addressed more than financial accounting practices and included significant broad management principles. The Standards also retained elements of guidance in the form of practice statements.

Financial Management Strategy

In June 1994, the Treasurer released a statement on the Government's Financial Management Strategy for 1994–1998 with the aim of ensuring that the Government's financial management policies, standards and practices represented world best practice in public sector financial management. The goals were to -—

- ensure that Government services were provided on the basis of the best value for money (efficiency, economy and effectiveness);
- maintain the State's infrastructure in a condition appropriate for present and future generations; and
- preserve the long term financial stability of the State.

Seven principles underpinned these goals —

- client focus;
- fiscal discipline;
- high standards of expertise of staff;
- clarity of objectives;
- performance measurement and evaluation;
- management authority and autonomy; and
- accountability.

Financial Management Standard

In 1997 the Public Finance Standards were revised and reissued as the Financial Management Standard to reflect the above goals and principles. The new Standard contains a further easing of prescription and places greater responsibility on managers to implement their own procedures, systems and practices.

This trend of decreasing prescription has resulted in a number of changes to the way in which the public sector is managed and the manner in which managers are held accountable. This is reflected in the following elements —

- a focus on leadership and effective strategic planning with development of clear goals and objectives;
- a clear definition of roles and responsibilities with matching authority for all staff;
- greater autonomy for managers in the use of resources;
- development of an effective control environment;
- greater accountability through performance reporting; and
- creation of an ethical environment with a focus on continuous improvement, client service and fraud prevention.

The Financial Management Standard embraces all of the above elements, formally introduces the concept of audit committees to the public sector and strengthens the requirements for risk management. In so doing, the Financial Management Standard imparts a distinct corporate governance flavour to public sector management. It is not surprising therefore that these trends have resulted in the application of private sector corporate governance principles to the stewardship of public sector entities.

The current trend has also meant that program management and more recently accrual output budgeting, with their focus on outcomes and performance, have introduced elements of risk taking which need to be balanced with the more traditional public sector practices of compliance, control and risk aversion. Risk management provides the means for achieving this balance by managing risk exposures proactively and forming the foundation of sound control practices. The issues of corporate governance and risk management are therefore inseparable and it is to be noted that the lack of good corporate governance presents a significant risk exposure in itself.

One of the risk exposures that the public sector has had to manage during the last decade has been the replacement of Directors-General at some departments following changes in government. A sound corporate governance framework which incorporates a strong control environment and a controlled flow of information to and from the accountable officer is invaluable in ensuring a smooth transition in the event of any future change.

A sound and robust corporate governance framework, balancing accountability with cost effectiveness will also be necessary to ensure the successful introduction of accrual output budgeting into Queensland budget sector agencies.

Section 4.
Audit Process

4. Audit Process

4.1 Audit Scope

An audit examination in relation to corporate governance and associated risk management practices within government departments was conducted under the broad powers contained in s.80 of the Financial Administration and Audit Act, which provides that the Auditor-General may conduct an audit of the performance management systems of a public sector entity. In conducting this audit, reference was made to a number of publications as outlined in Appendix B of this Report, with particular regard being paid to Queensland Treasury guidelines on audit committees and risk management.

While this review was aimed at providing best practice guidance for departmental management I also had regard to the following recommendation in the Report of the Queensland Commission of Audit (June 1996) —

> *The Auditor-General should be requested to report on the adequacy of risk management practices in agencies from time to time in order to encourage more active risk management within government.*

The audit examination was conducted in accordance with QAO's *Guidelines for the Conduct of Audits of Performance Management Systems* published in March 1995.

4.2 Audit Coverage

Initially I intended examining the corporate governance frameworks of all budget sector agencies, but upon the completion of the review of 13 departments I believed that I had identified sufficient evidence of best practice to conclude the audit and thus free resources for other emerging issues. The Departments examined are listed in Appendix C. As resources and time permits I intend to examine the corporate governance frameworks within the remaining public sector entities. Individual reports covering the findings in the 13 departments have been provided to the appropriate accountable officers.

QAO has taken advantage of this opportunity to review its own corporate governance and risk management practices and is implementing a number of recommendations from this review.

The individual audit methodologies used for the corporate governance and the risk management components of the audit examination are detailed below. In this Report risk management has been treated in detail and has been reported separately from corporate governance.

Audit Process

4.3 Audit Methodology — Corporate Governance

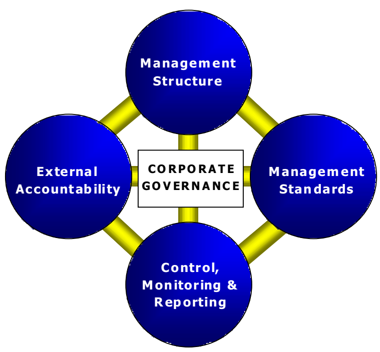
The audit objectives with regard to corporate governance were to establish whether in each entity —

- appropriate systems were in place in relation to the establishment of boards, advisory committees or similar management groups, their composition, function and terms of reference;
- relevant responsibilities and powers of governing boards and executive management had been clarified, and were appropriately aligned; and
- procedures existed to facilitate information flow to and from the boards.

The framework (Figure 1) developed by QAO to assess the standard of corporate governance across departments in line with the above objectives divides the concept of corporate governance into two distinct areas, *viz* the organisational framework and the accountability framework.

- Organisational Framework
  - *Management Structure:* Examines the organisational structures in place to support the accountable officer and examines the composition, terms of reference and operational issues of the various executive groups and committees which have been established.
  - *Management Standards:* Examines the existence and adequacy of Codes of Conduct and departmental policies and examines the roles and responsibilities defined through the delegation process.
- Accountability Framework
  - *Control, Monitoring and Reporting:* Examines the effectiveness of the control environment, the associated internal audit function and the flow of information to and from Executive Management.
  - *External Accountability:* Examines the manner in which an agency provides accountability to Parliament including the reporting of financial and non-financial performance.

Figure 1: Corporate Governance Framework



4.4 Audit Methodology — Risk Management

The audit objectives with regard to risk management were to establish whether in each entity —

- risks had been identified, recorded and assessed;
- strategies had been developed and implemented for the treatment of risks;
- a regular review was conducted of the significant risks and the strategies used to limit exposure to those risks;
- the risk profile had been regularly reviewed; and
- risk management practices and plans had been linked with strategic objectives.

The framework (Figure 2) developed by QAO to assess the standard of risk management across departments in relation to the above audit objectives is based upon the Australian/New Zealand 4360:1995 Standard on Risk Management. The testing program divided the concept of risk management into four distinct areas as follows —

- Risk management support;
- Risk management policy;
- Management of risks; and
- Monitoring and review of risks.

Figure 2: Risk Management Framework

The relationship between these areas and the AS/NZS 4360:1995 Standard is detailed below —

QAO Category	Derived from AS/NZ 4360:1995
Risk Management Support	Step 1 – Support of senior management
Risk Management Policy	Step 2 – Development of an organisational policy
	Step 3 – Communication of the policy
Management of Risks	Step 4 – Management of Risks at the organisational level
	Step 5 – Management of Risks at the program, project and team level
Monitoring and Review of Risks	Step 6 – Monitor and Review

Audit Process

Section 5. Corporate Governance — Results of Audit

5. Corporate Governance — Results of Audit

5.1 Audit Framework

This audit assembles the principles of corporate governance under the following headings —

ORGANISATIONAL FRAMEWORK	ACCOUNTABILITY FRAMEWORK
◆ Management Structure - ◆ executive groups ◆ committees. ◆ Management Standards - ◆ policies ◆ delegations ◆ code of conduct.	◆ Control, Monitoring and Reporting - ◆ internal reporting ◆ internal audit and audit committee. ◆ External Accountability - ◆ financial stewardship ◆ corporate governance disclosure.

Management Structure and Management Standards provide a framework through which the accountable officer provides leadership and direction for the department. Control, Monitoring and Reporting provide the control environment through which accountable officers can be assured that their department will achieve its goals and objectives. The Accountability Framework also embodies External Accountability mechanisms which provide the Parliament with assurance that accountable officers are managing their departments efficiently, effectively and economically.

5.2 Management Structure and Operations

This part of the audit examination covers the organisational structures in place to support accountable officers and examines the composition, terms of reference and operational issues of the various executive groups and committees which have been established.

The chief executive of a department is also the accountable officer in terms of the *Financial Administration and Audit Act 1977* and there is no shared accountability irrespective of the formation of executive groups and committees. Notwithstanding this, the establishment of executive groups and committees can play a significant role in assisting the accountable officer with the governance of the department. Such groups provide a forum which —

- promotes the development of a culture of collective responsibility amongst senior managers;
- monitors elements of conformance and performance to ensure that the department's goals and objectives will continue to be met;
- facilitates the generation of ideas; and
- assists in promoting a corporate culture throughout the department.

Underpinning an effective corporate governance framework is a quality information system and the foundation of this information system is quality records.

In reviewing this aspect of corporate governance, QAO examined the business conducted by executive groups and whether such executive groups and the committees which serve them have —

- appropriate terms of reference detailing roles and responsibilities;
- information sessions for new members outlining the business of the group or committee and its role in the governance of the department;
- maintained quality records of their proceedings and decisions;
- determined their information needs and communicated them to the appropriate line managers;
- a self evaluation process to review the performance of the group or committee against their terms of reference; and
- external members on the executive group or committee.

5.2.1 Terms of Reference — Executive Group and Committee

In order to assist accountable officers in successfully discharging their responsibilities, it has become common practice to establish executive groups and committees that report to the accountable officer.

One of the keys to the successful operation of executive groups and committees is the establishment of appropriate terms of reference approved by the accountable officer. Terms of reference clearly define the roles and responsibilities of the executive groups and committees and their members in the governance of the department. Without appropriate terms of reference the executive group or committee has no clear direction.

Complementing appropriate terms of reference are information sessions for new members in order to familiarise them with their roles and responsibilities as members of the group or committee. On-going information sessions with respect to corporate governance issues are also seen as beneficial in maintaining the competencies of the executive group and committee members.

Audit Findings

All departments surveyed had some form of executive group supporting the accountable officer and in a majority of departments, the executive group was receiving a combination of financial and non-financial information. Audit noted however, that there were improvement opportunities with respect to the development of a more focused corporate function for such groups through the implementation of more balanced conformance and performance reporting.

Generally executive groups were supported by committees. All departments had established audit committees and most had established risk management committees. While only a minority of departments had established Finance and Legislative Committees, Audit found that generally other formal processes had been put in place to effectively carry out the monitoring and reporting functions normally undertaken by such committees.

In the majority of cases adequate terms of reference for the executive groups and committees had been established and appropriately approved. However, there were a number of executive groups amongst the departments reviewed which were operating without terms of reference. QAO also noted that effective information sessions for new members of executive groups or committees occurred in only a minority of the departments reviewed.

Recommendations

- **Consideration should be given to developing a more strategic focus for executive groups to assist the accountable officer in setting goals and objectives for the department and in monitoring conformance and performance to ensure that the department's goals and objectives will be met.**
- **Terms of reference clearly defining the roles and responsibilities of executive groups and committees and their members should be established. These documents should be approved by the accountable officer and readily available to all members of executive groups and committees.**
- **Consideration should be given to providing formal induction processes for new members of executive groups and committees that would include information sessions on corporate governance and the strategic role intended for the executive group or committee.**

5.2.2 Quality of Records

Executive group and committee meeting records should provide a detailed account of proceedings and decisions made. The recording and follow-up of action items are key tasks.

Such meeting papers form part of the public records of a department and the chief executive is responsible for maintaining proper standards in the creation, keeping and management of public records under the chief executive's control.

Audit Findings

The majority of executive groups and committees were maintaining quality records in that —

- official minutes were centrally stored and readily accessible;
- associated submissions and other records were stored in an orderly fashion;
- a designated officer was responsible for their management;
- the nature of each agenda item was clearly presented;
- the minutes contained —
  - a list of attendees;
  - confirmation of the previous minutes;
  - follow-up of action items;
  - clear statements of action items including responsibility and time lines; and
  - the signature of the chairman.

However, there were a small number of instances where the records were either incomplete or inappropriately stored and Audit was unable to view a complete set of official records.

Recommendations

- **Accountable officers should ensure that official executive group and committee minutes and supporting reports, submissions etc. are drawn up and filed in a manner that ensures that —**
  - **the proceedings of each meeting are accurately recorded;**
  - **responsibility and time lines for action items are assigned and monitored; and**
  - **original copies of minutes and supporting reports, submissions etc. are readily available as records of proceedings.**
- **Consideration should be given to providing formal training to officers responsible for maintaining official group or committee minutes.**

5.2.3 Information Requirements

Executive groups and committees require timely, relevant and reliable information for sound decision-making and for effective oversight of the department's operations. Decisions from senior management must also be promptly communicated to the appropriate staff.

Audit Findings

Whilst most executive groups and committees had determined the nature of their information needs and communicated their requirements to the appropriate line managers, a significant number of executive groups and committees had not formalised their information requirements.

In addition, most departments had a system for transmitting decisions of senior management to appropriate staff but Audit was unable to determine the effectiveness of this information flow at a number of departments where only informal processes were in place.

Recommendations

- **The information needs of executive groups and committees should be assessed in line with their specific requirements to clearly determine the type, quality, format and frequency of information that they require. Such information should include a risk management focus and be communicated to the appropriate line managers.**
- **The information system should also include processes for communicating information downwards and laterally to ensure that all staff are provided with timely information necessary for them to discharge their responsibilities.**

5.2.4 Self-Evaluation Processes

A self-evaluation process enables executive groups and committees to review the currency of their terms of reference and to determine whether their objectives are being met in a cost-effective manner.

Audit Findings

Generally, departments did not have evaluation processes in place to enable any performance assessment of the structure, operations and cost effectiveness of their executive group and supporting committees.

Recommendations

- **Executive groups and committees should undertake a balanced annual self-evaluation process to assess whether they are meeting their objectives in accordance with their terms of reference.**
- **Such evaluations should also review the overall governance framework for the department to provide assurance that accountability is being delivered in the most cost effective manner.**

5.2.5 External Membership

The presence of external members on executive groups and committees provides the opportunity to bring independent expertise to the decision-making process. However, before appointing external members to an executive group or committee, there is a need to consider confidentiality, the frequency of meetings and the nature of the independent expertise required *e.g.* the appointment to an audit committee should be based upon expertise in public sector accounting and auditing practices.

Audit Findings

Two of the departments reviewed had taken advantage of this opportunity and had appointed external members with relevant expertise to their executive groups.

This concept has considerable application to the composition of audit committees and QAO found that in the majority of cases, departments had appointed appropriately qualified external members to provide independence and transparency to the committee function and to complement the skills of audit committee members.

Audit committees can also benefit from having QAO representatives present at their meetings in an observer/advisor role. Such attendance can provide a transfer of relevant accounting and auditing information beneficial to both the department and QAO. Audit found that while the majority of audit committees invite QAO representatives to their full meetings, there were a significant number of departments where QAO had not been invited or were invited to attend only part of committee meetings. QAO nevertheless recognises that there are situations where the accountable officers may wish to deal with certain issues within the confines of their own staff.

Recommendations

- **When reviewing the appropriateness of the membership of their audit committees, departments should refer to the Guidelines on Audit Committees issued by Queensland Treasury as well as other best practice guides.**
- **In particular departments should give consideration to appointing suitably qualified, external members to their audit committees.**
- **Consideration should also be given to inviting QAO representatives to attend all audit committee meetings in an observer/advisor role to take advantage of their capacity to provide objective advice on matters relevant to the committee.**

5.3 Management Standards

The assignment of clear responsibilities, authorities and accountabilities in line with the goals and objectives of the strategic plan is a key governance function as demonstrated through the following elements —

- Policies at various levels provide support in achieving the organisation's goals and objectives and communicate management's expectations.
- Delegations provide the necessary authority.
- Codes of conduct define the behavioural standards expected of departmental officers.
- Organisation charts, position descriptions and performance planning and review processes provide further support by establishing clear roles and measures of conformance and performance.

5.3.1 Administrative Policy Development and Co-ordination

Administrative policies provide direction in the performance of consistent departmental administration. Periodic reviews of these policies are necessary to ensure that the policies continue to be relevant and that they do not present conflicting positions. Delegations should align authority with responsibilities.

Audit Findings

Processes associated with administrative policy development within many departments were not co-ordinated and generally received only limited central oversight.

Generally, departments had delegations in place which matched responsibilities. Such delegations were issued under an Instrument of Delegation signed by the accountable officer. QAO found that adequate processes were in place to provide for the timely review of delegations.

Compliance with delegations and policies was monitored by departments using several processes including internal control reviews by internal audit, managerial supervision and the performance planning and review process.

Recommendations

- **Departments should introduce a quality assurance process over administrative policy development to ensure relevance and consistency from a whole of department perspective.**
- **Existing policies should be regularly reviewed for alignment with legislation and the overall goals and objectives of the department.**

5.3.2 Codes of Conduct

Audit Findings

Codes of conduct defining the behavioural standards expected of departmental officers had been developed and issued by the majority of departments. With respect to the remaining departments, codes of conduct were in draft form awaiting formal approval.

QAO found that generally, external members of committees were not covered by the existing codes of conduct nor by any provision in the committee's terms of reference in respect to conflicts of interest and confidentiality issues.

Audit noted that a data collection and monitoring role for compliance with the code of conduct had been established in a small number of departments in association with their fraud prevention strategies. QAO supports the widespread adoption of such ongoing trend analysis and monitoring procedures.

Recommendation

- **Departments should review their code of conduct framework to ensure that —**
  - **external members of advisory groups and committees are covered with regard to expected ethical standards particularly in regard to conflicts of interest and confidentiality issues; and**
  - **trend analysis and monitoring procedures for compliance with the code of conduct are developed as part of the department's fraud prevention strategy.**

5.3.3 Communication of Management Standards

Effective communication of policies, delegations and codes of conduct ensures that employees receive up to date, quality information with respect to their expected obligations.

Audit Findings

QAO identified many positive departmental initiatives in developing employee commitment to management standards such as the provision of departmental induction courses and targeted training for new policy and procedural initiatives.

It was noted that with the exception of only one department, procedures and delegations had been converted into electronic format and made available to all staff, including those in regional areas, via their Intranet. The remaining department was in the process of converting its paper-based systems into electronic format at the time of the audit.

Audit found however, that there were instances where departments did not provide adequate guidance in regard to expected behavioural standards to their temporary and casual employees.

Recommendations

- **Departments should ensure that there is a mechanism in place for the induction of temporary and casual employees and external service providers in relation to expected management standards.**
- **Departments should assess the coverage and level of success in conjunction with the transition of their policies, delegations and codes of conduct to the new electronic format (Intranet) by monitoring the level of activity on their networks. Such monitoring may also be useful in identifying training opportunities with respect to particular policies, delegations and ethical standards.**

5.4 Control, Monitoring and Reporting

The control and monitoring of organisational activities is a critical role performed by all levels of management. In performing their monitoring and control functions, managers depend on access to accurate, timely and useful information in relation to the financial and non-financial performance of the organisation.

An effective control environment provides assurance that an organisation will achieve its goals and objectives. Internal audit through its internal control review and monitoring function has an important role in assuring effective corporate governance. The independence of internal audit, its reporting role to the audit committee and the accountable officer and its separation from day-to-day operations are important concepts.

Audit committees act as advisory bodies reporting directly to their respective accountable officer on accountability and audit-related matters. Their operations are independent of management and internal audit and external audit. Committee functions are focussed on an oversight of internal audit and the resolution of issues raised by external audit.

Other committees which may be established to assist in the monitoring and control over an organisation's functions include a Budget or Finance Committee, a Legislative Committee or a Risk Management Committee. The decision to establish such committees will depend upon the size and complexity of the organisation and on the nature of its business.

5.4.1 Internal Reporting

Executive groups and committees need to ensure that they are receiving complete, credible and unbiased information that satisfies their decision-making and governance requirements. Information also needs to be relevant and timely and reported to the governing body or committee at the appropriate level of detail or aggregation. The information flow needs to be provided within an efficient and cost effective monitoring and reporting system.

Internal reports to executive groups and committees need to cover all facets of the organisation's activities including controlled entities. These reports should also include reporting on financial and non-financial performance against established targets. Audit acknowledges that under the accrual output budgeting framework being introduced from 1 July 1999, there will be more balanced performance reporting available to management.

Audit Findings

QAO found that the current reporting focus at most departments was directed towards financial information with limited reporting of non-financial performance information. Audit also considers that generally the internal reporting processes could be enhanced through a periodic internal audit review of the quality control processes associated with the preparation of these reports.

Recommendation

Departments should ensure that —

- **the information being reported to executive groups provides a summary of all activities including balanced reporting of both financial and non-financial performance against targets; and**
- **there is independent scrutiny in relation to the completeness and accuracy of the information reported to executive groups and committees.**

5.4.2 Internal Audit Units and Audit Committees

Internal Audit Units

Under s.36 of the Financial Administration and Audit Act, every accountable officer is required to establish an adequate internal audit function to assist the officer in the performance or discharge of the functions and duties conferred or imposed on the officer under the Act.

The Act further prescribes that each internal audit unit is to perform the duties conferred upon it by the accountable officer and to regularly appraise financial administration and its effectiveness.

The officer in charge of the unit is to report at regular intervals to the accountable officer in relation to the result of any appraisal, inspection, investigation, examination or review made by the unit. Internal audit units are required under s.77 of the Financial Management Standard to operate under an appropriate Charter.

The roles and responsibilities of internal audit units therefore include the conduct of internal reviews of the key financial compliance and information systems and their operational effectiveness. Through these reviews the accountable officer can gain assurance that the internal control environment is operating as intended or is modified as required.

Audit Findings

All departments had established internal audit units and the reviews and investigations undertaken by those units covered a wide range of departmental operations. In each department reviewed, the internal audit unit operated independently under a Charter approved by the accountable officer. In almost all cases, the Charter complied with the provisions of s.77 of the Financial Management Standard. There were, however, instances where some matters prescribed in the Standard had not been addressed.

Most internal audit units carried out a balanced program of financial compliance, information systems and operational audits either with in-house staff or with contracted assistance depending upon the size of the department and the nature of the task. There were however, a small number of departments where financial and compliance matters received less than expected attention from their internal audit units, given the risk profile of those particular departments.

All departments had established procedures for internal quality assurance reviews of work performed by internal audit including that undertaken by contracted auditors. However, only a small number of internal audit units were subjected to periodic external peer reviews.

Audit Committees

Audit Committees exist as an advisory body to accountable officers and provide a quality assurance review as to the effectiveness of the department's financial management structures. This is achieved through the provision of advice on audit and audit-related matters and through the monitoring and review of the internal audit function by —

- ensuring that the internal audit unit is adequately resourced (staffing, skills, training) and its Charter remains relevant to the operations of the department;
- directing internal audit resources towards the coverage of high risk areas through the preparation and approval of internal audit work plans;
- monitoring the performance of the internal audit unit in completing the approved audit work plans;
- regularly reviewing internal audit reports and monitoring implementation of recommendations in those reports; and
- ensuring that internal audit issues and recommendations are reported to the executive group/accountable officer in a timely manner.

Audit Findings

All departments reviewed had established an audit committee and in most cases the committees were fulfilling their obligations to review internal audit plans and reports and to monitor the implementation of recommendations in reports by internal and external audit. However, QAO found that the absence of a structured review process by the Audit Committee at one department had resulted in the internal audit program not being aligned with the risk profile of the department.

Recommendations

- **In order to assist accountable officers in discharging their duties under the Financial Administration and Audit Act, audit committees should ensure that —**
  - **the internal audit charter complies with s.77 of the Financial Management Standard and is regularly reviewed to ensure continued compliance with the statutory requirements and relevance to the department's operations;**
  - **the internal audit unit is adequately resourced in terms of staffing and skills mix to enable a balanced work program to be undertaken;**
  - **the strategic and annual plans of the internal audit unit present a balance of financial compliance, information systems and operational audit matters aligned with the risk profile of the department;**
  - **the internal audit unit completes its work plans in a timely fashion;**
  - **recommendations by the internal audit unit are implemented by management in a timely fashion; and**
  - **the internal audit unit is subjected to an external peer review at least every five years.**

5.5 External Accountability

Public sector agencies are accountable to the Parliament for both the stewardship of funds allocated through the appropriation process and the performance of their operations. External reporting structures provide information that promotes the transparency of publicly funded operations as part of the accountability process.

5.5.1 Financial Stewardship

One of the significant components of an entity's external reporting process is the reporting of financial stewardship through the independent certification of annual financial statements by the Auditor-General.

A robust quality assurance framework is required to ensure the completeness and accuracy of the financial information being produced to enable the timely certification by the accountable officer and the Auditor-General.

Audit committees have an important monitoring role in this regard by ensuring that the financial statements provided to accountable officers for certification present a true and fair view of the transactions of the department and that they conform with the prescribed requirements.

Audit Findings

Audit noted that most agencies had planned and managed the annual financial statement preparation process in an organised and structured manner. However, in a small number of agencies where a structured project management framework had not been established, considerable difficulties were experienced with regard to the quality and timeliness of information presented for certification.

Audit found that only a minority of audit committees satisfactorily performed a monitoring and review function over the preparation of the annual financial statements.

Recommendations

- **Adequate systems and processes should be developed to manage the production of quality financial statements in a timely manner.**
- **The appointment and retention of appropriately qualified and experienced staff is paramount to the successful completion of this process and need to be addressed through the delivery of appropriate training programs and succession planning.**
- **Audit committees should adopt a monitoring role over the management of the annual financial statement preparation process in order to ensure the quality and timeliness of the statements presented to the accountable officer for certification.**

5.5.2 Corporate Governance Disclosure

QAO considers that all public sector agencies should disclose comprehensive information on their governance framework and practices in their annual reports. While there is no statutory requirement for such disclosure in the budget sector, this disclosure represents best practice and provides transparency and increased accountability to the operations of a department.

Audit Findings

Audit noted, that except for a small number of departments, more comprehensive corporate governance information could be provided in annual reports.

Recommendation

- **Departmental Annual Reports should clearly disclose all relevant corporate governance practices in operation during the year. Such disclosure should include as a minimum —**
  - **details on executive group and committee structures and operations;**
  - **the department's ethical procedures, values and practices;**
  - **the operations of the internal audit unit; and**
  - **detailed reference to the department's risk management philosophy and practical application.**

Ethical Disclosure

Under s.23 of the Public Sector Ethics Act, the chief executive of a public sector entity is to ensure that the annual report for the entity includes an implementation statement covering action taken to comply with the following sections of the Act during the reporting period —

- s.15 – preparation of the code of conduct;
- s.19 – access to ethics principles and obligations and code of conduct;
- s.20 – inspection of the code of conduct;
- s.21 – education and training; and
- s.22 – procedures and practices of public sector entities.

Audit Findings

Audit noted that almost all departments had a statement concerning their code of conduct in their annual reports, although the level of compliance with the requirements of the Public Sector Ethics Act varied considerably.

Recommendation

- **All departments should review their ethics disclosure in their annual reports to ensure compliance with the requirements of the Public Sector Ethics Act.**

Section 6.
Risk Management
— Results of Audit

6. Risk Management — Results of Audit

Risks relate to the uncertainty of outcomes across the full range of business or government operations involving financial, technical, management, marketing, policy, political, contractual, legal, environmental and the consequence of dependence on others.

Risks are dynamic and require continued monitoring and review not only over time but also in regard to their relative significance. The mechanisms and tools to manage specific risks may also change over time and also require monitoring and review to ensure that the most appropriate mechanisms and tools are employed.

A whole of entity approach to risk management is fundamental to an organisation achieving its goals and objectives. A risk management approach should be reflected in organisational strategies and plans, operational plans and individual projects and activities at all levels of an organisation. The development of a risk management culture is the responsibility of senior management who need to demonstrate through their management style that risk management is a critical component of modern management practices. The application of risk management principles to individual issues is the responsibility of all staff members.

The Australian/New Zealand Standard on Risk Management (AS/NZS 4360:1995) contains clear guidelines for the establishment of a risk management function. The commentary provided to s.84 of the Financial Management Standard refers to this Standard.

6.1 Management Support

The establishment of a risk management culture within an organisation is the responsibility of senior management and is facilitated by -

- the appointment of a risk management co-ordinator;
- the development and distribution of a risk management policy; and
- including appropriate modules in management development programs.

The risk management co-ordinator's role does not remove the responsibility from all staff to manage risks and is required at least in the first few years of implementation. In addition to other responsibilities, the Co-ordinator should act as a facilitator in relation to —

- promoting the acceptance of risk management techniques;
- providing advice and support;
- organising training;
- increasing awareness of the benefits of risk management; and
- developing risk management policies and procedures.

Such senior management support therefore assists in the development of an understanding amongst staff that the identification of risks, and the development and implementation of internal control systems and other strategies to manage those risks, are the responsibility of all staff.

Audit Findings

In the majority of departments reviewed, senior management had issued a statement to staff in support of risk management, appointed a risk management co-ordinator and provided training for staff. However, QAO found that the level of support varied between departments *e.g.* the training provided varied from a well-developed program to a once-only information session associated with the release of the policy.

Audit is of the opinion that the standard of support could have been higher and directed more towards management improvement rather than compliance with legislative requirements.

Recommendation

- **Departments should review their support procedures with respect to risk management to ensure that staff are committed to the identification of risks and the development and maintenance of internal control systems and other strategies to manage those risks.**

6.2 Risk Management Policy

A risk management policy clearly identifying the department's position and defining the roles and responsibilities of staff in respect of risk management is a key governance tool of senior management.

Audit Findings

Audit found that the majority of departments had issued a risk management policy and conducted staff information sessions. However, only one department had addressed all the elements of best practice principles as outlined in the AS/NZS 4360:1995 Standard. Some of the elements not addressed included —

- what is considered to be an acceptable level of risk;
- the links between risk management and the strategic plan;
- the plan for reviewing the department's performance in respect of the policy;
- the level of documentation required; and
- sources of support and expertise for those responsible for managing risks.

Recommendations

- **Departments should ensure that their risk management policy clearly sets out their position with respect to risk management and the roles and responsibilities of staff.**
- **This policy should provide detailed guidance on risk management practices to be adopted across the department including —**
  - **risk registers;**
  - **guidance as to what constitutes acceptable risks;**
  - **linkages between risk management and the strategic plan;**
  - **the level of documentation required; and**
  - **the reporting process.**

6.3 Manage, Monitor and Review Risks

The first step in managing risk is the identification process. This is followed by an analysis of the likelihood and consequences in order to assess the level of that risk.

The assessment process allows management to concentrate on those risks which are most likely to prevent the department from achieving its goals and objectives and to develop treatment plans to address these risks. Departments operate in a constantly changing environment which necessitates ongoing monitoring of their risk profiles and treatment plans.

This audit assessed the adequacy of management policies, procedures and action taken to address risks across all business activities and in all contexts from strategic to operational.

Audit Findings

QAO acknowledges that some departments are currently applying risk management practices in various key operational areas. However, Audit found that less than half of the departments had undertaken the comprehensive risk identification process associated with the development of an effective risk management system. Of these, only three departments had systematically applied the management procedures and practices of identification, analysis, assessment and treatment of risks across all business areas. Only one department had fully implemented risk monitoring procedures and practices.

Risk management committees were established in a majority of departments. Generally, the role of these committees is outlined in their terms of reference and includes functions such as —

- development and dissemination of the risk management policy;
- oversight of the development of a systematic and co-ordinated risk management framework linked to the department's planning processes;
- establishing management accountability for risk management;
- monitoring the impact of changes to the risk profile of the department; and
- monitoring and reporting on the continuing effectiveness of the department's risk management system.

Given the early stages of risk management implementation across the budget sector, Risk Management Committees are well placed to increase the profile of risk management within their departments and to ensure that a systematic and co-ordinated risk management framework is developed.

Recommendations

- **In accordance with the Financial Management Standard, departments should continue to develop and implement as a matter of urgency a systematic and co-ordinated risk management framework for both the department and entities responsible to the department in order to address and manage all their risks.**
- **This framework should include the identification, analysis, assessment, treatment and monitoring of risks in accordance with best practice principles outlined in the Australian/New Zealand Standard on Risk Management (AS/NZS 4360:1995).**

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L J Scanlan

Auditor-General of Queensland

Queensland Audit Office

Brisbane

4 June 1999

Appendices

Appendix A

Considerations for Corporate Governance in Departments

Introduction

Accountable officers are responsible for the efficient, effective and economical operation of their departments and this responsibility is set out in the following legislation —

- *Financial Administration and Audit Act 1977;*
- *Financial Management Standard 1997;*
- *Public Service Act 1996;*
- *Library and Archives Act 1988;* and
- *Public Sector Ethics Act 1994.*

A number of committees may be established to support accountable officers in the stewardship of their departments for example —

- Audit Committee;
- Risk Management Committee;
- Finance Committee;
- Legislative Committee; and
- Information Steering Committee.

The decision to establish such committees will depend upon the size and complexity of the organisation and on the nature of its business. Sections 82 and 85 of the Financial Management Standard provide that each department and statutory body may establish audit and risk management committees. The Standard also provides that if these committees are established, each accountable officer and statutory body must prepare a terms of reference setting out the role, responsibilities and membership of these committees. The requirement to prepare terms of reference represents best practice to be used when establishing any committee.

This Appendix provides guidance on the responsibilities and operational principles which should be considered in establishing a corporate governance framework in a Queensland government department. The responsibilities and elements identified are not meant to be all encompassing but present a broad overview of —

- the responsibilities of accountable officers, executive groups and committees;
- operational principles common to all committees; and
- operational principles relating specifically to internal audit units and audit committees.

RESPONSIBILITIES

ACCOUNTABLE OFFICER

- Promote the effective, efficient, economical and appropriate management of departmental resources.
- Establish an internal audit unit and approve its charter.
- Ensure compliance with the *Financial Management Standard 1997* in respect of –
  - strategic and operational planning – policies, procedures and delegations;
  - management of resources;
  - performance management;
  - corporate management which includes —
    - internal control structure;
    - systems appraisals;
    - internal audit function;
    - risk management;
    - financial delegations; and
    - ethical values and practices.
- Comply with guidelines and other documents issued by the Treasurer or published by the Treasury Department as detailed in Schedule 1 of the Financial Management Standard.
- Ensure complete and accurate public records are made and preserved.

EXECUTIVE GROUP

Acts as a group of senior executives with a corporate/strategic role in support of the accountable officer through carrying out functions as delegated by the accountable officer including —

- Reviewing and adopting —
  - strategic and operational plans;
  - policies, procedures and delegations;
  - codes of conduct;
  - the annual budget;
  - management information systems; and
  - the control environment.
- Monitoring and reviewing —
  - reports from other committees and operational areas to provide assurance on conformance and performance of the department against the corporate plan;
  - the control environment; and
  - its own performance.

RISK MANAGEMENT COMMITTEE

This committee should have a strategic outlook and not be focused towards solving operational issues. Its emphasis should be on –

- the development and dissemination of the risk management policy;
- oversight of the development of a systematic and co-ordinated risk management framework linked to the department's processes;
- establishing management accountability for risk management;
- monitoring the impact of changes to the risk profile of the department; and
- monitoring and reporting on the continuing effectiveness of the department's r isk management system.

AUDIT COMMITTEE

An Audit Committee acts as an advisory body independent of management and internal and external audit, and should report directly to the accountable officer on accountability and audit related matters. Its functions include an oversight of internal audit and the resolution of matters raised by external audit. In addition the Audit Committee should monitor and review —

- internal audit programs, functions and activities;
- the effectiveness of the internal control systems;
- fraud prevention;
- the implementation of recommendations within the reports of internal audit and external audit; and
- the accuracy, completeness and timeliness of departmental financial information and the financial statement preparation.

FINANCE COMMITTEE

The Finance Committee acts as a review body over the financial and budget documents of the department including the monitoring and review of the —

- departmental financial performance;
- departmental budget review process;
- internal departmental budget transfers;
- financing of significant projects; and
- significant financial transactions which are not part of normal departmental business.

LEGISLATION COMMITTEE

The Legislation Committee —

- acts as a body of review over the legislative program and legal compliance of the department including the monitoring and review of —
  - legislative compliance;
  - discharge of the department's legal and regulatory obligations;
  - subordinate legislation program; and
  - operational changes resulting from changes in legislation; and
- manages the development of new legislation.

COMMON PRINCIPLES — EXECUTIVE GROUPS AND COMMITTEES

TERMS OF REFERENCE

Terms of reference or charter approved by the accountable officer, should include —

- the title, roles and responsibilities of the executive group or committee with a description of any power being delegated;
- membership and selection processes;
- what constitutes a quorum;
- meeting frequency and the power to call a meeting at any time;
- minimum distribution time for agendas in advance of a meeting;
- the nature of reports the executive group or committee is to receive and produce;
- a process for annual reviews of the committee's performance; and
- appointment of an executive group or committee secretary and specification of the duties to be performed.

OPERATING PRINCIPLES

- Independent and/or specialised expertise appointed to the executive group or committee as required.
- A code of conduct for members, tailored to meet specific membership needs and communicated to the appropriate people.
- An induction process for new members which would include information sessions on corporate governance, the nature of the business of the executive group or committee and the strategic role intended for such bodies.
- Ongoing specialised training through a professional development program for members of the executive group or committee.
- Regular meetings of the group, with high attendance levels.
- An information plan for executive groups and committees which outlines —
  - the nature of briefings and reports it requires;
  - the form that these should take and the timing of such reports; and
  - the nature of briefings and reports to be provided to the accountable officer.
- Official executive group and committee minutes and supporting reports, submissions etc drawn up and filed in a manner to ensure that —
  - the proceedings of each meeting are accurately recorded;
  - responsibility and timelines for action items are assigned and monitored; and
  - original copies of minutes, supporting reports, submissions etc are readily available as records of its proceedings.
- A balanced annual self evaluation process for executive groups and key committees to assess whether such high level management groups are meeting their respective objectives in accordance with their terms of reference. Such evaluations would also review the overall governance framework for the department to provide assurance that accountability is being delivered in a cost effective manner.

OPERATING PRINCIPLES — INTERNAL AUDIT UNITS AND AUDIT COMMITTEES

INTERNAL AUDIT UNIT

- An internal audit charter, covering all departmental operations, approved by the Accountable Officer (refer s.77 *Financial Management Standard 1997*).
- Independence of the internal audit unit from operational activities within the department and a direct line of reporting from the internal audit unit to the accountable officer.
- Internal audit unit access to specialised expertise if required, with mechanisms in place to manage possible conflicts of interest, maintenance of confidentiality and other issues associated with the code of conduct.
- An internal audit program which includes a mix of the following roles —
    - reviewing and monitoring the system of internal control for financial and non financial systems and the provision of advice in regard to fraud control and prevention;
    - ensuring conformance by the department with required financial legislation, regulations and standards;
    - providing operational audit services to ensure efficient, effective and economical management of the departmental resources;
    - reviewing the accuracy and completeness of financial reports, including performance information, supplied to the accountable officer and executive groups and committees;
    - providing a level of assurance regarding the appropriateness of the design of current and proposed information systems;
    - addressing probity and propriety issues;
    - monitoring the risk management assessment process; and
    - maintaining a consultative relationship with external audit.
- Internal audit unit subject to an internal quality assurance process and at least every five years to an external quality assurance review.

AUDIT COMMITTEE

- Undertake monitoring and review of the internal audit function by -
    - ensuring that the internal audit unit is adequately resourced (staffing, skills, training) and its charter remains relevant to the operations of the department;
    - directing internal audit resources towards the coverage of high risk areas through the preparation and approval of internal audit work plans;
    - monitoring the performance of the internal audit unit in completing the approved audit work plans;
    - regularly reviewing internal audit reports and monitoring implementation of recommendations in those reports; and
    - ensuring that internal audit issues and recommendations are reported to the executive group/accountable officer in a timely manner.
- Act as a liaison between external audit and the accountable officer and monitor implementation of external audit recommendations.
- Review annual financial statements to ensure their completeness and accuracy and that they are presented to the accountable officer in a timely manner for certification.
- Report regularly to the executive group/accountable officer on matters which have been examined and the committee's opinion and recommendations with respect to those matters.

APPENDIX B

Best Practice Guidelines and Other Publications

In conducting this audit QAO had regard to the following Queensland Treasury publications —

- *Guidelines on Audit Committees*. Queensland Treasury, Brisbane, Australia, 1993: 13pp.
- *Guidelines on Risk Management and Insurance*. Queensland Treasury, Brisbane, Australia, 1994: 12pp.

QAO also made reference to a number of other publications including —

- *Applying Principles and Practice of Corporate Governance in Budget Funded Agencies*. Australian National Audit Office, Canberra, Australia, 1997: 14pp.
- *Audit Committees: Best Practice Guide*. Australian Accounting Research Foundation/Australian Institute of Company Directors/Institute of Internal Auditors – Australia, 1997: 28pp.
- *Australian Control Criteria*. Institute of Internal Auditors – Australia, Exposure Draft, March 1998, Sydney, Australia: 29pp.
- *Australian/New Zealand Standard 4360 on Risk Management*. Standards Australia, Homebush, Australia, 1995: 32pp.
- *Better Practice Guide – Audit Committees*. Australian National Audit Office, Canberra, Australia, 1997: 6pp.
- Boyd, J, 1998. *Risk Management's Role in Corporate Governance and Corruption Prevention*. Corporate Governance and Internal Control Journal, 2: 20-28.
- *Control and Governance, Number – 1. Guidance on Control*. Canadian Institute of Chartered Accountants, Ontario, Canada, 1995: 32pp.
- *Control and Governance Number – 2. Guidance for Directors – Governance Processes for Control*. Canadian Institute of Chartered Accountants, Ontario, Canada, 1995: 18pp.
- *Guidelines for Managing Risk in the Australian Public Service*. Management Advisory Board/Management Improvement Advisory Committee Report 22. Canberra, Australia, 1996: 53pp.
- *Information: the Currency of Corporate Governance: a Board Information Strategy*. Canadian Comprehensive Auditing Foundation, Ontario Canada, 1997: 25pp.
- Lang, A D, 1998. *Horsley's Meetings: Procedure, Law and Practice 4th Ed*. Butterworths, 1998: 336pp.
- Reports of Auditors-General in other jurisdictions on corporate governance and risk management including the 1997 Performance Audit Report on Corporate Governance by the New South Wales Audit Office.

Appendix C

Departments Reviewed

The following departments were reviewed as part of this review of corporate governance and risk management -

Department of Education

Department of Emergency Services

Department of Employment, Training and Industrial Relations

Department of Families, Youth and Community Care

Department of Health

Department of Main Roads

Department of Mines and Energy

Department of Natural Resources

Department of Police

Department of Primary Industries

Department of Public Works

Department of the Premier and Cabinet

Department of Transport

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Publications and Auditor-General's Reports

Publications

Publication	Date Released
'INFORM' Bulletin	Feb 99
Considerations for Better Management of General Procurement Practices	Jan 99
Best Practice Guidelines for the Sale of Material Public Sector Assets	Jan 99
Guidelines — AAS34/AASB 1036: Borrowing Costs	Dec 98
'INFORM' Bulletin	Oct 98
Guidelines — AAS33/AASB 1033: Presentation and Disclosure of Financial Instruments	July 98
Guidelines for the Implementation of New Generation QGFMS (SAP R/3)	June 98
Our Audit Process	Jan 98
Best Practice Guidelines — Information Systems (Revised)	Oct 97
Guidelines for Dealing with Reportable Gifts — Including Hospitality and Entertainment	Oct 97
Guidelines for Year 2000 Compliance	Sept 97
Guidelines on AAS29 — Financial Reporting by Government Departments	Nov 96
QAO Auditing Standards	July 96
Guidelines for the Conduct of Audits of Performance Management Systems	March 95

Copies of these publications are available by contacting QAO's Service Centre on (07) 3405 1100 or can be accessed at QAO's website.

QUEENSLAND AUDIT OFFICE

Auditor-General's Reports to Parliament 1998-99

Report No.	Subject	Date of Report	Date Tabled in the Legislative Assembly
1	Audits completed as at 9 September 1998	9 September 1998	18 September 1998
2	A Review of the Expo 2002 Bid and International Garden Festival 2000 Bid	10 November 1998	19 November 1998
3	Audits generally completed at 31 October 1998	4 December 1998	14 December 1998
4	Results of Audits of Local Governments (1997-98)	25 March 1999	14 April 1999
5	Audits generally completed at 31 March 1999	7 May 1999	18 May 1999
6	A Review of the Administration of Grants and Subsidies	17 May 1999	27 May 1999

Copies of these Reports are available from QAO's Service Centre on (07) 3405 1100
or can be accessed on the Internet at QAO's website.

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