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24 March 2014

Dr Andrew Southcott MP
Chair
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

By email to: jcpaa@aph.gov.au

Dear Dr Southcott

Submission to the Inquiry into *Public Governance, Performance and Accountability Act 2013* Rules Development

Thank you for the opportunity to make a submission to the Committee's inquiry into the development of rules in support of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

The attached submission addresses a number of issues relevant to the process for the development of the rules, the impact of the rules, and the purpose of the rules in the context of the broader Public Management Reform Agenda.

We would be very happy to expand on the issues raised in our submission with the Committee or representatives of the Committee Secretariat. My mobile phone number is 04 1925 4006 and my email address is [REDACTED]

Yours sincerely

A large black rectangular redaction box covering the signature area of the letter.

Kevin Riley FCA FCPA CPFA
Managing Director

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Introduction

Capital Training Proprietary Limited (trading as Capital Training College) works extensively across Australian Commonwealth and State government departments and agencies. Our focus is on developing managers' financial literacy, risk management, planning and performance management skills and capabilities and providing advice on financial and performance frameworks.

We are a member of the Department of Finance's (Finance) panel of providers of the *Financial Management and Budget* (FMB) training program. Our Managing Director, Kevin Riley has contributed to a number of Institute of Chartered Accountants Australia public sector publications. Kevin Riley has had a long involvement in public sector finance and management reforms, including briefing the then Joint Committee of Public Accounts prior to publication of the Committee's Report No. 338 "*Accrual Accounting – A Cultural Change*" released in August 1995.

Our submission is based on our ongoing engagement with Australian Government departments and agencies and our experience working across a number of State government's financial frameworks.

Overview of the reform of the financial management framework

The *Public Governance, Performance and Accountability Act 2013* (PGPA Act) represents an evolution in public governance, performance and accountability arrangements for the Commonwealth. The PGPA Act continues the tradition of continuously improving the Australian Government's approach to the management of public money and public property.

We agree with the submission from Finance that the "new framework represents a shift from a prescriptive compliance-based approach to financial management towards a broad principles-based approach."¹ A key feature of this shift is the much stronger focus on risk oversight and management and appropriate internal controls.

We are very supportive of incorporating within the PGPA Act the requirement for the accountable authority to "establish and maintain:

- appropriate systems of risk oversight and management for the entity, and
- an appropriate system of internal control."²

While Commonwealth entities have previously applied better practice guidance on risk management³, this new legislative requirement will act to ensure a more comprehensive and whole-of-entity (or enterprise) approach to addressing risk oversight and management. We believe that this will provide opportunities for Commonwealth entities to realise improvements in efficiencies and streamlined activities, including a

¹ Department of Finance (2014) *Submission 1 to the Inquiry into the Public Governance, Performance and Accountability Act 2013 Rules Development*, p. 12.

² PGPA Act Sections 16 (a) and (b).

³ Comcover (2008) *Risk Management Better Practice Guide*.

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greater use of information systems and technology tools, without diminishing the overall control environment.

Our experience is that in many entities, risk is addressed at a program or activity level. This can lead to a distorted view of both the likelihood and consequence of risks. Without a whole-of-entity approach to risk oversight and management there is the possibility that internal controls do not adequately address the risks faced by the entity. More likely, a culture of risk aversion may result in internal controls that add to 'red-tape', slow service delivery, impede innovation and are too onerous and costly for the nature of the risks faced.⁴

The draft Commonwealth Risk Management Policy provides valuable guidance to Commonwealth entities working to achieve the requirements of Section 16 of the PGPA Act. A rule requiring accountable authorities to follow the Commonwealth Risk Management Policy, much like the requirement to follow the Commonwealth Procurement Rules (CPRs), may further strengthen the focus on risk oversight and management.

Consultation process

Throughout the Commonwealth Financial Accountability Review (CFAR) process, drafting of the PGPA Act, and the consultations on the draft rules we have considered that Finance's consultation process has been a comprehensive one.

While we believe the consultation process has been comprehensive, we are aware that the messages and associated cultural changes required within Commonwealth entities are not necessarily cutting through to decision-makers. Worryingly we have had conversations with officials who are unaware of the PGPA Act, or who have stated that the reforms have been 'put on hold' for a year. These acts of 'denial of change' are not new. Other reforms, including moving from the *Audit Act 1901* to the *Financial Management and Accountability Act 1997* and *Commonwealth Authorities and Companies Act 1997* and adopting accrual budgeting experienced similar denials by some officials.

We recommend that once the rules have been finalised, Finance implements a communication strategy designed to ensure that senior executives of Commonwealth entities are fully aware of the PGPA Act requirements, rules and other guidance. We note that Finance has already commenced work on updating the FMB training and Comcover's suite of risk management training to incorporate PGPA Act changes. We commend Finance on taking these actions. We encourage Finance to utilise as many communication channels as appropriate to inform officials, particularly senior executives, of the requirements of the PGPA Act reforms, rules and other guidance.

⁴ Advisory Group on Reform of Australian Government Administration (2010) *Ahead of the Game: Blueprint for the Reform of Australian Government Administration*, pp. 21, 30, 45, 50, and 66.

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Successful implementation of the PGPA Act and rules

We believe there are a number of key factors that will contribute to the successful implementation of the PGPA Act and rules. These key factors include:

- establishing a culture of actively engaging with risk
- encouraging a culture of continuous performance improvement
- reinforcing the 'proper use' test within the risk-based framework, and
- defining the financial sustainability of the entity.

Each of these key factors is addressed below.

Actively engaging with risk

Successfully achieving the objectives of the reform agenda will require Commonwealth entities to establish a culture of actively engaging with risk. The extent of public scrutiny of decisions, including parliamentary scrutiny, may be a factor that contributes to a culture of risk aversion. Overcoming this will require senior executives to positively contribute to addressing risk, and in modelling appropriate responses to risk issues and events. An enterprise approach to risk management can assist in communicating and documenting how risk is to be addressed within an entity.

Engaging with risk typically requires a clear and shared understanding of the nature and extent of possible risks and how risks are to be addressed, should they arise. Within a public company the governance arrangements for risk management will typically see the Board of Directors (under advice from the Audit and Risk Management sub-committee of the Board) approve the enterprise risk management approach proposed by the chief executive and management team. We note that the draft Commonwealth Risk Management Policy makes no reference to any ministerial or parliamentary oversight of an entity's risk management policy. The draft Resource Management Instruction on *Managing Risk and Internal Accountability* includes a point that requires the accountable authority to ensure "a process for the communication of risk, and an entity's ability to manage specific risks, with the responsible Minister."⁵

We recommend strengthening this requirements, making Ministerial approval of an entity's risk management policy a requirement of the Commonwealth Risk Management Policy. We believe an entity's risk management policy should be subject to parliamentary review, including review by the relevant Senate Legislation Committee and possibly the Joint Committee of Public Accounts and Audit.

Continuous performance improvement

Portfolio Budget Statements, Portfolio Additional Estimates Statements, Corporate Plans and Annual Reports contain significant information reported as planned or achieved performance. Unfortunately reviews of this performance information conducted by the Joint Committee of Public Accounts and Audit and the Australian National Audit Office have highlighted the significant shortcoming of this information. The requirement for reporting Key Performance Indicators (KPIs) has existed for some time. The

⁵ Department of Finance (2014) *Draft - The Model Resource Management Instructions*, p. 3.

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demonstrated shortcoming are not a failure of the requirements to report KPIs. It is our belief that the shortcoming are rooted in cultural issues which have more to do with avoiding blame for failure rather than focusing on continuous performance improvement.

Clear statements of the performance outcomes to be achieved by Government programs, including “key priorities and objectives”⁶ would assist in enabling Commonwealth entities to develop KPIs that demonstrate achievement (or at least improvements in achievement) of the entity’s purposes. We believe that until clear statements of performance outcomes are documented at the highest levels we will continue to see shortcoming in reported performance information.

Reinforcing the ‘proper use’ test

We agree that existing requirements relating the approval of proposals to spend public money can result in overly complex arrangements within Commonwealth entities. In some instances internal rules established by entities go beyond the requirement of the existing regulations, often because of confusion about the application of regulations.

We also appreciate that under a risk management framework entities will establish internal controls (delegations, approvals, and threshold for testing for ‘value-for-money’) that effectively replicate the requirements of existing regulations, but with the ability to tailor those internal controls to the risk profile of the entity, its operations and transactions. However, we believe the requirements to test for the ‘proper use’ of public money should be a requirement of the rule on the commitment of relevant money. We note that the most recent *Certificate of Compliance: Report to the Parliament* identified that 83.7 percent⁷ of reported non-compliance issues in the 2012-13 financial year related to the commitment of public money by agencies.

We recommend that the rule on approving commitments of relevant money reinforce that the approver documents that they are satisfied the proposal represents a ‘proper use’ of public money.

We also support the focus of the rule on “commitments of public money”. The language of the existing regulations focuses on “spending of public money” which pre-dates the introduction of accrual budgeting and management.

Defining financial sustainability

A significant enhancement of the PGPA Act over the existing framework is the requirement that the accountable authority “promotes the financial sustainability of the entity.”⁸

We believe that in order to hold the accountable authority of an entity to account for this requirement, the conditions that satisfy “financial sustainability” should be set out or defined. We do not believe there is only one test of financial sustainability. The testing of this condition will need to consider a range of factors, including non-financial

⁶ PGPA Act Section 34.

⁷ Department of Finance (2014) *2012–2013 Certificate of Compliance: Report to the Parliament*, p. 29.

⁸ PGPA Act Section 15 (c).

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factors and the environment the entity is operating within. The elements of a test of financial sustainability could include:

- references to relevant financial ratios (for example, the current ratio⁹)
- the ability of the entity to generate sufficient cash flows from operations and equity injections to meet asset replacements, and
- ensuring net cost of services before depreciation expense is within annual departmental appropriations.

While the focus on financial sustainability is likely to be on the departmental financial position and performance, it may also be useful to consider the costs of delivering administered programs as part of the financial sustainability tests.

We recommend that Finance documents the definition of financial sustainability, setting out the range of tests that the accountable authority of an entity is required to satisfy in order to comply with the requirements of Section 15 (c) of the PGPA Act.

Conclusion

We believe the direction of the reform agenda is an improvement on the existing financial framework for Commonwealth entities.

We believe that Finance has undertaken significant engagement with stakeholders throughout the CFAR and PGPA Act stages of the reform process.

Broadly the PGPA Act and proposed rules are in line with community expectations of the proper use of public money and public property. We have recommended suggested improvements to the rules and guidance, which do not add unnecessary administrative burden, and which we believe are consistent with the direction of the overall reforms.

We also recognise that the implementation process is just commencing and that for many entities the benefits of the new approaches will take some time to realise.

While the full benefits may take some time to realise, we agree with Finance that the new direction provides an opportunity for Commonwealth entities to improve the way they manage public money and public property and places the accountability requirements for realising these improvements appropriately on the accountable authority of the entity.

⁹ The current ratio is the comparison of current assets to current liabilities. This ratio is an indication of the ability of an entity to meet its liabilities from existing cash and cash-like assets. It is often used as a test of an entity's liquidity.