Corporate Code Of Conduct Bill 2000
Submission By The Australian Centre For Organisational Governance

1. About The Centre

The submission is by the Australian Centre for Organisational Governance, a volunteer run not for profit body. The Centre provides standards and publications for how organisations should be directed, managed, operated and audited (organisational governance). In contrast corporate governance is concerned purely with how organisations are directed.

The submission is authorised for release as a public document if required.

2. Overall Comments on Proposed Bill

The Centre supports cost effective directions that make directors and officers more accountable for the actions of their corporations and the impacts of activities in physical, social and human terms.

The Centre believes that the proposed Bill may enable directors and officers to be liable for breaches but may do little for preventing such risks materialising in the first place. Further direction is needed on how directors and officers should go about exercising and demonstrating effective governance and control.

3. Suggested Enhancements

Insert a provision that requires:

- directors and officers to establish and report upon a system for directing, managing, operating and auditing overseas activities and operations;

- the system should have, as one of its key outcomes the creation of a state of commitment and competency of directors and officers to exercise stewardship including supporting as far as practicable win-win relationships with shareholders and stakeholders.

4. Rationale for Win–Win Relationship Accountability

The notion of governance, control and due diligence by directors and officers has typically been taken to mean:

- setting direction in plans and performance targets;
- reviewing potential risks and impacts;
- developing policies and procedures;
- reviewing and auditing for compliance with plans and policies.

This thinking is reflected in the current Bill including in Section 7 (2). Many governance and control standards issued internationally and nationally also reflect this focus on process, inspection, paperwork and checking as the prime means of demonstrating governance and diligence.

This emphasis has arisen for a variety of reasons including dominance of the governance agenda by lawyers and accountants with a predominantly measurement and process mindset.

The thinking is fundamentally flawed. More plans and processes for increased scrutiny are not a substitute for having committed and competent people in the right positions with the right relationships to make informed judgements on stakeholder needs, opportunities, risks and capability.

The starting point for effective governance and control is not more process and paperwork. That may be the means but is not the outcomes that are to be achieved.

Effective governance creates a state of commitment and competency from the board room to front line employees to something the Centre defines as self committed stewardship. Self committed stewardship is a state of commitment and competency to act in the overall interests of shareholders and stakeholders. To think not just in terms of business but political, social, environmental and other outcomes. It goes beyond just corporate citizenship to being regarded as being trustworthy and acting with integrity.

Further details on the code of conduct for stewardship is found on the Centre's website www.stewardship.on.net. The Stewardship Code specifically requires supporting win-win relationships with stakeholders. **This is the key to preventing health, environment and human rights abuses.**

When there is win – win relationships between an organisation and its stakeholders including employees, customers, suppliers and the community in terms of the environment and employment then and only then do you have effective governance.

Examples of win-lose relationships that have resulted in failures and issues include:

- management by fear preventing employees speaking out on risks because they might be seen as disloyal. Risks in organisations can be known for some years before they finally show up in failures and issues;
- customer and supplier relationships based on lowest price with low returns causing the taking of shortcuts and risks including in employee and product safety and equipment maintenance;
- board and auditor relationships where auditors are reluctant to speak out on risks because management may not select them for consulting and other work.

Win-lose relationships are ultimately not sustainable and create risk. More inspection and checking is not a substitute for effective relationships based on win-win, trust and integrity.

Unfortunately corporate governance itself is typically a win lose relationship between directors and managers. More inspection and checking by directors turns managers and employees into information gathers and reporters distracting them from carrying out their jobs. Furthermore the information can be used against them if it provides adverse information on performance.

Is it any wonder that some major corporations have had major failures in performance, health and safety breaches, human rights abuses and environmental damage? And that directors were the last to know? This is bound to occur when you have win lose governance and legislation including the proposed Bill which promotes win lose governance through more plans, policies and checking!

The proposed Bill may be part of the problem rather than part of the solution if it promotes more inspection and checking (win-lose governance). There must be accountability and reporting on a governance system that supports win-win relationships both with internal and external stakeholders.

Anything less and Australia's reputation has little chance of being protected when the next round of problems occur. Comfort may be derived from being able to impose penalties. However only accountability for win–win relationships can prevent the problems from occurring.

5. Probability of Further Embarrassment

It is likely that Australia will continue to be embarrassed internationally. The results of surveys and self assessments indicate that some organisations are estimated to be about 30-50% effective in maintaining a governance system for exercising stewardship over performance, assets, resources and relationships. Appendix A provides further details.

These and other results show a significant number of directors, managers and internal auditors are simply not up to the task of maintaining and auditing a system for effective organisation wide governance. It may take another 10 years for stewardship competence to be fully developed Australia wide. There is currently little incentive or accountability for maintaining a system or demonstrating that system competency has achieved.

The Centre is willing to assist in enhancing the Bill to overcome these problems and progress the development of effective governance and diligence that has clear links to factors that cause success, prevent failure and demonstrate due diligence.

If Australia is to improve and sustain its standard of living there is a need for a co-ordinated effort to improve the governance of organisations in both the private and public sector.

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Results of Surveys
Governance System Effectiveness

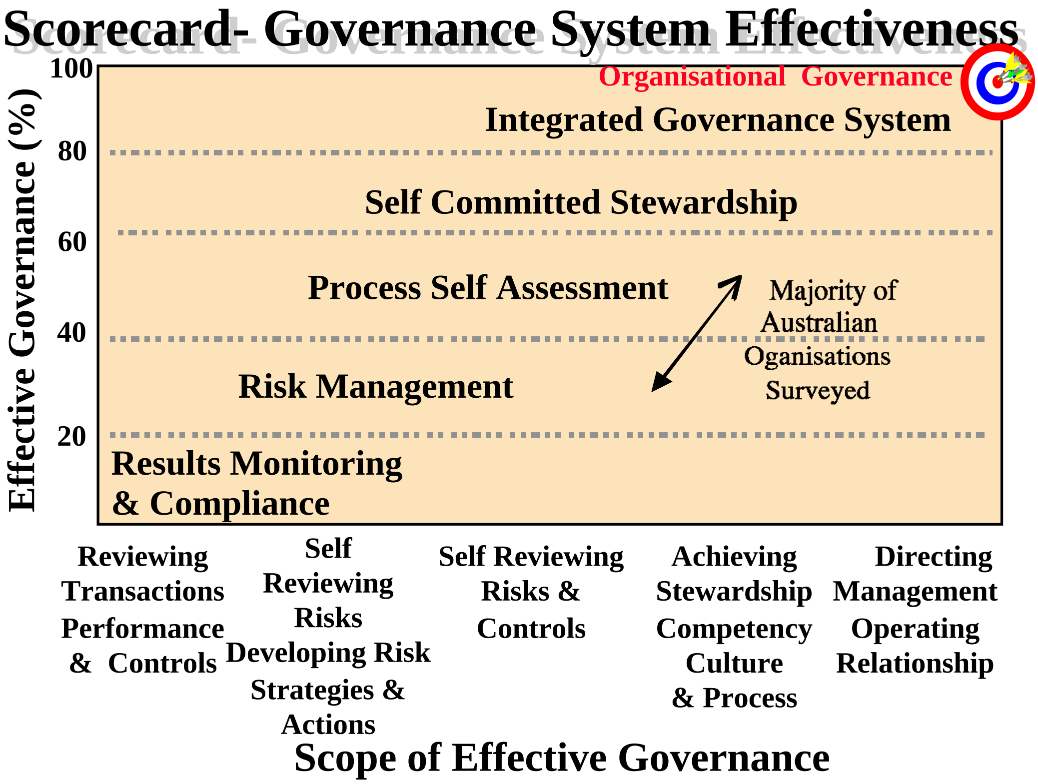
1. SCORECARD REPORTING

The Australian Centre for Organisational Governance has been conducting surveys with two leading professional associations over last two years. In addition workshops to enable directors, managers and internal auditors self assess their organisations have also been provided at major national conferences on governance, risk management and auditing.

Survey questions enable an estimate to be made of the effectiveness of a system established to direct, manage operate and audit an organisation (called a governance system).

The Centre has developed a framework and scorecard assessment (Figure 1) to strategically assess governance system effectiveness.

Figure 1



The framework and assessment is based on proven factors known to cause success, prevent failure and legal principles that enable directors and officers to demonstrate due diligence in leading and controlling. Frameworks and standards from Canada, US, UK and Australia are used in the assessment (see Section 3).

The system effectiveness reflects an evolution from a focus purely on plans, policies and procedures for governance to an emphasis on visioning, teamwork and a self improvement culture critical for innovation and creativity in the new economy.

Assessment is at 5 levels, each representing 20% governance system effectiveness. Effectiveness at each level means there is:

- periodic review of plans, budgets, policies, laws and regulations for compliance;
- assessment, management and reporting of risks at a strategic and operating level;
- self assessment of the design and operation of processes;
- committed and competent employees exercising stewardship over performance, resources, assets and relationships;
- a system which integrates and aligns directing, managing and operating responsibilities to enhance performance and optimise conformance supervision.

2. RESULTS OF SURVEYS AND AUDITS

The results of surveys and self assessments indicate that some organisations are estimated to be about 30-50% effective in maintaining a governance system for exercising stewardship over performance, assets, resources and relationships.

The estimate of 30-50% effectiveness takes into consideration that organisations in Australia in both the public and private sector are typically implementing formal processes for planning and risk management.

Larger organisations (eg those in the Australian public service, banks, manufacturing and oil companies) are also implementing control self assessment. In general, those organisations implementing control self assessment are using overseas frameworks and criteria including US (COSO) and Canada (CoCo).

Emphasis is placed on imposed plans and procedures with few organisations using organisational readiness assessments and commitment building processes. A characteristic of Australian management has been management by process.

Australian organisations have typically implemented a series of change programs with little thought being given as to the impact on trust and commitment and whether the changes come together as an integrated governance system. Employees in some organisations have become fatigued from being visioned, re-engineered, customer focused, quality assured, empowered, teamed, rightsized, performance managed and risk assessed.

These results are consistent with other surveys which, for example, have found:

- only 33% of employees trust management;
- between 1 in 3 and 1in 9 changes being successfully implemented;
- 70% of employees earning less than $20,000 and 48% of those earning over $100 000 believing they are in the wrong job.

This means that self committed stewardship has yet to be achieved for many organisations.

Few organisations have defined what is an effective governance system and associated performance and conformance competencies of managers, employees, advisers and assurance providers.

Many advisers and auditors are primarily conformance/ compliance focused on current risks and process effectiveness. Few have proven performance based roles and competencies including building self committed stewardship or facilitating governance system self assessment and conduct governance audits now required in international standards of professional practice issued by the Institute of Internal Auditors.

The results are not surprising. The Australian Institute of Company Directors has highlighted that performance versus conformance is a major issue for directors. More detailed studies by others also confirm these findings. For example:

- 60 percent of executives believe their organisation does not have a clear vision of where it is going and why;
- Australian management continue to be ranked out of the top ten countries (World Competitiveness Report);
- the top 30 companies in Australia are typically earning less than half the rates of return when compared to their counterparts in key western countries.