



Promoting transparency in government

KEYNOTE ADDRESS – 23 MARCH 2020

## AUDITING – SPEAKING TRUTH TO POWER

K M Hayne<sup>1</sup>

My professional life, first as barrister and then as judge, has been spent considering whether there has been some departure from law and, if there has, what consequences can or should follow. These issues have always had to be considered in the context of a judicial system which places very high value on adjudication of disputes in public where judges are required to state their reasons for decision and publish those reasons. And resolution of the disputes has depended upon the generally applicable norms and standards of conduct that make up the body of the law. Those norms and standards are not always certain. But they are always external to the decision-maker.

Most of you have a much wider focus than I have had to have in my career. In the course of your work you will have to consider issues about the application of the law. You will have to consider whether the entities with which you are dealing have complied with the law. If you are considering their financial transactions and reporting, you will have to consider whether their reporting meets applicable general accounting standards and give a true and fair statement of their financial position. But more and more, and most especially in the course of performance audits, you are required to examine what has been or is being done against standards of community expectations. Those are standards that can, and do, change over time. And they are usually expressed very generally – seldom in a way that allows immediately direct application to a particular case at hand.

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<sup>1</sup> A Justice of the High Court of Australia 1997-2015, Commissioner, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* 2017-2019.

The central expectation the public has about the expenditure of public money and the provision of public resources is that money will be spent, and services provided, effectively, efficiently and economically. Hence, more and more you are required to examine what has been done, or is being done, in connection with either the expenditure of public money or the provision of public services against those very generally expressed standards: effective, efficient, economical. Unlike the lawyer or judge, you will often, even usually, have to examine these issues without someone first alleging that there has been an identified departure from the standards of “effective, efficient and economical” and without any prior more particular definition of what would constitute the effective, efficient and economical expenditure of public money or the effective, efficient and economical delivery of the relevant public service.

These are very challenging tasks. But the proper conduct of performance audits is critical to the health of the body politic. Their proper conduct requires the auditor to speak truth to power. Their proper conduct requires you to give practical content to those notions of “effective, efficient and economical”.

It has long been accepted that there must be external audit of public receipts and expenditures. That kind of audit is an essential element in the structures of government. But it is these same structural considerations that explain why performance audits are as important as they are. What are the structural considerations to which I refer?

The Constitution of the Commonwealth establishes a system of representative and responsible democracy. The constitutions of the States establish or assume that they too are each representative and responsible democracies – “representative” in the sense that the members of the lower house of the Parliament (or in Queensland the only chamber) are directly elected by the people; “responsible” in the sense that

Ministers who administer the departments of State are or must become members of the Parliament.

Consistent with long established British practice, the Commonwealth and the State constitutions give chief political control of the public purse to the chamber of the Parliament that is directly elected by the people. Consistent with that practice, the Commonwealth and the State constitutions provide for the review and audit of the receipt of revenue and the expenditure of money on account of the Commonwealth or relevant State by an independent officer of the Parliament.<sup>2</sup>

These constitutional provisions are intended to provide democratic control over taxation, public expenditure and public activity more generally. The audit provisions are intended to provide for an independent review of what has been done.

On their face, the provisions I have mentioned seem straightforward. There are, however, at least four relatively recent developments that may make their application harder.

First, review and audit of receipt of revenue and expenditure of money on account of the Commonwealth or a State may have been easier when government accounts were prepared on a cash rather than accruals basis. Accruals accounting can present difficult questions about the amounts that are to be taken to account in a particular accounting period. Large, long-tail, liabilities can be especially hard to value.

Second, and more importantly, outcomes-based appropriations can present nice questions about whether particular expenditures are or are not validly authorized. This is especially so when the outcomes are expressed at the level of

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<sup>2</sup> See, eg *Auditor-General Act 1997* (Cth).

abstract generality now so often found in Commonwealth Appropriation Acts. To take only one example, Outcome 1 for the Commonwealth Attorney-General's Department was described in the *Appropriation Act (No. 1) 2019-2020* as "A just and secure society through the maintenance and improvement of Australia's law, justice, security and integrity frameworks". Outcome 2 was "Facilitate jobs growth through policies and programs that promote fair, productive and safe workplaces". Together these items dealt with more than \$472 million of departmental and administered expenditure.

Third, the fiscal imbalance between Commonwealth and the States has seen the Commonwealth enter fields of activity it has not entered in the past. And that can generate disputes about the lawfulness of expenditures of the kind that were litigated in the High Court in the *Pape* and two *Williams* cases.<sup>3</sup>

Fourth, we have seen radical shifts in how services are made available to the public generally or particular sections of the public. Some services previously provided by government were corporatized and then wholly privatized. The role of government contracted. Recall, if you will, how utilities like gas and electricity were once government monopolies. As the Constitution itself recognizes, there were once State banks. No more.

But in addition to governments privatizing the provisions of some services to the public, there have been other equally significant changes in what governments do and how they do it. Especially at State level, governments now intersect with the private sector in ways that were unknown fifty years ago. Some facilities and services available to the public at large, or, in the case of so-called private prisons, a narrower section of the public, are now provided through public-private partnerships.

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<sup>3</sup> *Pape v Federal Commissioner of Taxation* ((2009) 238 CLR 1; *Williams v The Commonwealth* (2012) 248 CLR 156; *Williams v The Commonwealth [No 2]* (2014) 252 CLR 416.

Toll roads, court houses, convention centres, all sorts of publicly accessible assets and infrastructure have been built and then operated under arrangements of this kind.

Other public services are provided by private sector entities operating under contracts let by government. Some of those contracts will have terms that fix performance standards which, if met, attract financial reward and, if not met, attract financial penalty. But both the standards and the consequences that follow from meeting or failing to meet the standards are the product of negotiation between the parties.

More recently, so-called “unsolicited” or “market-led” proposals to government have become commonplace. A private sector entity may offer to acquire land or other assets from government in return for promises to provide particular functions such as waste or recycling facilities. And those proposals are often considered without seeking or having the benefit of any competing bid to provide the same or similar outcome.

All of these shifts in how services are provided to the public have been accompanied by increasing reliance on the expression “commercial-in-confidence” as a reason for not revealing what terms have been agreed between the private party and government.

All of these shifts in how services are provided to the public – outsourcing by privatization of what were government owned enterprises; the use of public-private partnerships; outsourcing by contracting out; and the rise of the market-led proposal – can be seen as public administration looking more and more to the corporation as its model. But the analogy cannot be complete. The purposes of a corporation differ from the purposes of a body politic. The governance of a corporation differs from public administration.

It may readily be accepted that public administration cannot and should not shut its eyes to developments in corporate governance any more than corporate governance should shut its eyes to what is happening in the public sector. Nothing I say should be understood as diminishing the importance of that observation. But I want to focus on three particular issues about corporate governance that may bear upon the work that you do. The issues can be described as objectives, measurement and culture.

We all know that the directors of a company are bound to act in the interests of the company. Their objective is to further the interests of the company.

In the case of publicly listed companies it is often said that directors must seek to maximize shareholder value. And some professional investors who seek public subscription to their investment funds seek to measure the performance of the board of a publicly listed company by measuring movements in share price and yield over time. Because the performance of those professional investors is measured by the yield they achieve, their focus is upon changes in corporate performance that affect their results, and thus, their capacity to attract further subscriptions. And they therefore see the primary, even exclusive, duty of the board of a publicly listed company as being to maximize profit in the current accounting period.

There are several points to make about this understanding of directors' duties that may have some immediate relevance to your work.

First, there is the question of time. When you are considering a board's performance, what period do you consider – the current or the next accounting period, or some longer time? The answers to those questions tend to be dictated by why you are assessing the board's performance. That is why the professional fund manager focuses on the present and immediate future. What happens in those periods affects the fund manager's business. A long-term investor may well take a

different view. So the more precise questions to ask become – What is, or has been, the board’s time-horizon? and What should be, or should have been, the board’s time-horizon?

Second, is performance one-dimensional? In the case of a company is annual profit the only measure of performance? It is obviously relevant and important, but are there other matters to consider when assessing a company’s performance?

Third, just as performance may have more than one dimension, a duty may require the office-holder to consider more than one factor. The office-holder may have to walk and chew gum. And most of us can, and do, hold more than one thought in our heads at any one time. So, does a director’s duty extend beyond considering the interests of shareholders? What about employees? What about third parties with which the company deals? What about more general issues affecting society at large such as the environment?

Put in this way, the questions suggest binary choice – between the interests of shareholders and the interests of others. But to analyse the issue in this way is to create a false dichotomy. It treats shareholder interests as opposed to the interests of employees and customers. They are not. How a company deals with its employees with its customers and with wider social issues may have very large effects on its reputation and on its ability to maintain and grow its existing customer base. Those are effects that are felt by the company and by its shareholders.

Fourth, even if shareholder-value is an important criterion to be considered (and it is), who are the shareholders whose interests are important – those who focus, for whatever reason, on the next accounting period, or those who hold the shares as a long-term investment? How are the interests of those groups to be determined? Do their interests diverge? If they do, how are they to be accommodated?

Describing the board's duty as "maximizing shareholder return" slides over all of the questions I have mentioned. The speed with which that slide is made is emphasized when a board's performance is expressed in one number – total shareholder return or some other measure.

More fundamentally, as public administration looks to the corporation as a model, how is account to be taken of the basic fact that the corporations being considered are organized for the pursuit of economic gain but public administration is directed to other ends. Selling public assets, either outright or for a term of years, may require consideration of many more criteria than the effect that the transaction may have on this year's public accounts or overall budget outlook.

The notion of measuring board performance by looking at some metric like total shareholder return brings me to the second of the three issues about corporate governance that may bear upon the work that you do – metrics and measurement.

It is very easy to be seduced into thinking that what matters can be measured, and what cannot be measured does not matter. The Board packs for any large and sophisticated entity now contain numerous graphs, dashboards and other presentations of metrics of the business. All of this information should be important. But is what is measured *all* that matters? What about issues that cannot be measured and reproduced as a graph, a table or a trendline?

The most important of those issues are issues about culture and compliance. Those aspects of a business cannot be readily measured in any meaningful way. Yet they are very important to the performance of any enterprise and to the reputation of that enterprise. How is a company's board to be kept abreast of these issues? How is a public sector body to stay abreast of them?



Culture and compliance will often intersect with employee compensation. It may do that directly through some variable remuneration scheme. But it will almost always intersect, even if only indirectly, with advancement within the enterprise.

Those who conform with the prevailing culture of the enterprise are more likely to be promoted than those who do not.

Often, however, metrics take over. In corporations, variable remuneration is often fixed by reference only to what can be measured – number of sales, value of sales, share price or the like. Focus on those metrics can affect, I go so far as to say will affect, how employees act. How employees act directly affects external reputation and compliance. And how employees act will both reflect and form the prevailing culture of the organization.

Culture, governance and remuneration march hand-in-hand. I have said elsewhere that each of these words can provoke a torrent of clichés and serious debates about definition. But we have no other vocabulary. How an entity governs itself determines what the entity values. What the entity values determines its culture. Its culture and governance directly affect who is paid what, regardless of whether there is any variable element in remuneration, because culture and governance determine who advances and who does not advance within the organization. Culture and governance directly affect regulatory compliance and overall performance.

The point of my mentioning these matters is to invite you to consider whether what lies behind these observations may be relevant to examining the performance of public entities and the delivery of public services. How important is culture to performance? How closely related is culture to the issues of effective, efficient and economical?

Behind the several points I have made about corporate governance and comparisons with public sector governance lies a more general issue. You will recall that I said that directors' duties are sometimes wrongly seen only through the lens of short-term financial results. That view depends on creating a false dichotomy between the interests of (some) shareholders and the interests of all other stakeholders in the enterprise. As I have said, the issue is more complex.

The example illustrates the need for you to consider whether the projects and entities with which you are concerned frame the sufficiency and efficiency of what they do by reference to a false dichotomy. Does the very simplicity of their statement of purpose slide over the need to take account of, and somehow balance, the different interests of more than one group of persons? In particular, does the way in which the statement of purpose is framed ignore some purposes that bear upon the effective, efficient and economical delivery of public services?

Do the performance measurements that the entity applies, or an external auditor adopts and applies, match its statement of purpose? Do the measurements that are made take account of all that should be considered? What about those criteria that cannot be measured? Most particularly, what about the culture of the organization? What does the organization value? How does it deal with those whom it serves? How is the auditor to assess these issues?

We know that failures of culture and governance contribute to misconduct. But culture and governance directly affect how well an organization performs. The root cause of failures in effective efficient and economical delivery of public services can often be traced to deficiencies in culture and governance. To put the point at its simplest, if the staff of an organization do not care about their work, their work is poor. In such a case there are evident management deficiencies, but the want of proper management may reflect a wider and deeper cultural malaise. Identifying

cultural defects is not easy. Proposing remedies for cultural deficiencies is even harder.

The matters I have mentioned are issues that can arise in commerce and in the public sector. There are some additional points to be made about the public sector.

Examining and reporting about whether public money and assets are being applied effectively, efficiently and economically requires those who do that work to tread on ground that is more and more being said to be the primary, even exclusive, province of the political branches of government. It is to be recalled in this regard that the role of ministerial policy advisers has been affirmed in the Government's response to the Thodey Review of the Australian Public Service<sup>4</sup> and emphasis given in that response to the public service's primary role being to implement the government's policies<sup>5</sup>. There are at least two consequences for auditors.

First, those who examine and report on politically sensitive programs must pay the closest attention to what legal constraints there are on the application of public moneys and whether those rules have been followed. Those who receive the money will not complain. Whether, and to what extent, there is any political check on what is done will depend on assessments by those elements of the political process that are not within government of short and long term political gain. Regardless of party, the political branches of government may see little or no

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<sup>4</sup> cf Department of Prime Minister and Cabinet, *Our Public Service, Our Future*. Independent Review of the Australian Public Service, 2019, Rec 11; Department of Prime Minister and Cabinet, *Delivering for Australians. A world-class Australian Public Service: The Government's APS Reform Agenda*, 2019, 16, Response to Rec 11.

<sup>5</sup> See, eg *Delivering for Australians. A world-class Australian Public Service: The Government's APS Reform Agenda*, 9 "Clear roles and priorities".

advantage in challenging the lawfulness, as distinct from wisdom, of particular expenditures. Hence the importance of external audit and report on these questions.

The second consequence I want to mention is that examination of, and report about politically sensitive projects and activities will inevitably have to deal directly with the ways in which the political branches of government choose to identify the desired ends and permissible means for the application of public resources.

I have said, elsewhere, that reasoned debate about contested policy issues has been affected, even supplanted, by resort to slogans and other marketing tools. Often those slogans mask much more than they reveal. So, to look beyond this country, “Get Brexit Done” suggested that Brexit was an event rather than a process – a process of disentangling connections with Europe that have been built up over many decades and deciding what new rules and arrangements should be made both internally and externally.

Closer to home, we are often told that opinions differ about human contribution to climate change and that we should not put our economic well-being at risk by responding to climate change. Well, opinions may differ but informed opinion points only one way. And the economy versus environment dichotomy is simply false. One need not look beyond what is said by the Governor of the Reserve Bank and the (now former) Governor of the Bank of England to see how closely connected the economy is to climate change.

But complaining about the way in which political discourse is conducted is nothing new. More than 70 years ago, George Orwell wrote, in his essay “Politics and the English Language”, that “political speech and writing are largely the defence of the indefensible” and that “[a]ll issues are political issues, and politics itself is a mass of lies, evasions, folly, hatred and schizophrenia.” The point of present relevance is that reviewing the expenditure of public money and the provision of

public services obliges the reviewer to look beyond the political rhetoric. Often, that entails cutting through the language the political branches of government have chosen to identify the desired ends and permissible means for the application of public resources. So, to take a recent example, the central question for the examiner may not be whether projects were eligible for assistance but whether a Minister had power to vary the list of recipients and amounts determined by the relevant statutory corporation.

Examining and reporting about politically sensitive expenditures and activities are not easy tasks. They are not easy because they require speaking truth to power. Speaking truth to power demands honesty and courage. And speaking truth to power, if it is to be effective, demands stating the truth clearly, directly and as simply as the subject permits. People will not absorb what is said unless it is said clearly, simply and directly. And even when the truth is stated in this way, it is increasingly difficult to show the wider community why what is said matters. More and more, people are minded to shrug, and move on to whatever may be the next point made in the never-ending and ever-accelerating news cycle.

Speaking truth to power, and stating it clearly, simply and directly, are not easy tasks. But they are essential to proper control of public spending and the proper delivery of public services. Their proper performance is essential to meeting what seems to be increasing cynicism about, even distrust of, the political branches of government. Proper performance of the tasks is, therefore, critical to the continuing health of our system of government.