



# TOWARDS EFFECTIVE CORPORATE GOVERNANCE FROM SOURCE TO ENDPOINT

## Why businesses must understand their water 'products' from catchment to consumer to identify and manage risk

A Davison, B Burford, A Contos

### ABSTRACT

Water Journal has reported previously on the duties of directors and overarching corporate governance<sup>1</sup> management for state-owned corporations (SOCs) in the context of risk management (Davison et al., 2011). SOCs need to fully understand their operating context if they are to holistically understand and manage risks. The 'Frameworks' within contemporary Australian water cycle guidance, such as the *Australian Drinking Water Guidelines*, note that enterprises must understand their water 'products' from catchment to consumer to ensure that risks are properly identified and managed.

We suggest that an expanded framework approach from Source to Endpoint (S2E) could be used to help SOCs identify, understand and manage the risks to all the products and services that they deliver and, hence, provide for an improved approach to corporate governance. To help illustrate this point, we include information from a recent high-profile legal case, The Hasties Group, which helps to provide clarification on the responsibilities of management and directors, including the information that should be sought from management by directors, and when.

### INTRODUCTION

It is a contemporary expectation for a complex water organisation that they will have some sort of overarching risk management strategy in place, usually informed by a recognised industry or other standard (such as ISO 31000), and that this strategy will be embedded from 'corporate to coalface' across its operations. Underpinning this strategy is a simple concept of Authority, Responsibility and Accountability or ARA (Figure 1 and Table 1). ARA should

be understood by all, at their required level, in order to effect appropriate water organisation management and leadership.

In this paper we discuss a Source to Endpoint (S2E) risk identification and management approach utilising elements of the Frameworks, specifically focused on public water utilities. We also present potential information, which could be monitored by utilities to facilitate the analysis of trends and allow issues to be managed in a proactive manner as well as underpin reporting requirements up to the board.

### SOURCE TO ENDPOINT

The Framework for Management of Drinking Water Quality (ADWG, 2011) specifically requires utilities to have clear reporting in place, which explicitly means top-down bottom-up dissemination of

water quality information. While risk management plans are often developed and have to be endorsed by boards, the plans may 'sit on shelves' and then not be properly understood, monitored or implemented by boards. In some cases, executives specifically require water quality or critical control point exceedances or 'water quality near hits' to be notified directly to them; however, it is more normally the case that finished water quality is reported rather than barrier effectiveness.

The ADWG (2011) espouse the importance of understanding and managing the water supply chain from catchment to consumer. To ensure that all water products and services can be 'captured', it is important to widen the concept of a supply chain being from

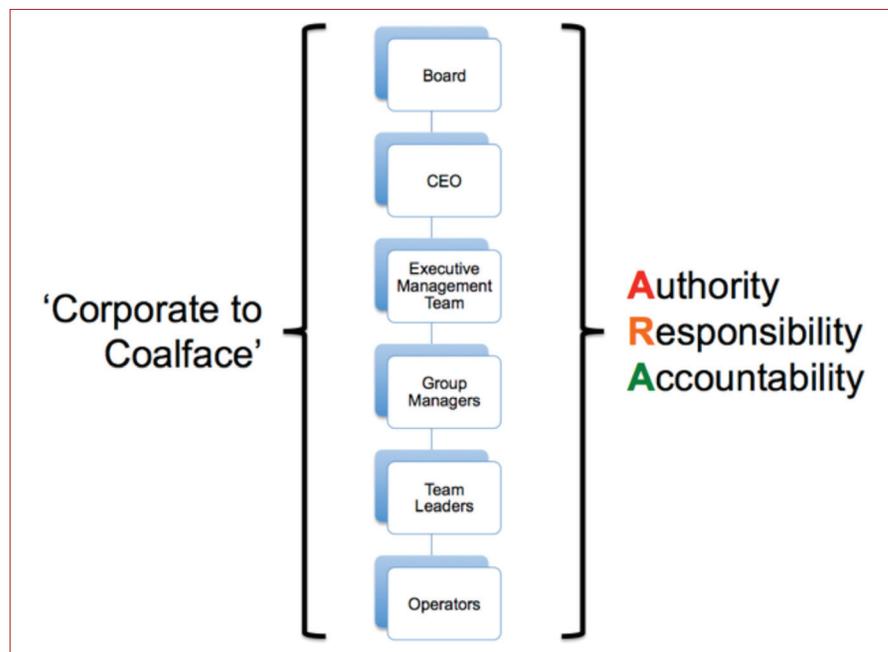


Figure 1. Authority, Responsibility and Accountability conceptualisation from 'corporate to coalface'.

<sup>1</sup> "The framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account." See ASX (2014) for more information.



**Table 1. Authority, responsibility and accountability.**

Area	Examples
<p><b>Authority</b></p> <p>Set by the legal and formal framework in which an organisation operates and provides a person or organisation with the power to conduct an act or act in a certain manner.</p>	<p>1. The <i>State Owned Corporations Act 1989</i> (NSW) provides that:</p> <p>a. "In the exercise of powers and the discharge of functions, an officer of a statutory SOC must exercise the degree of care and diligence that a reasonable person in a like position in a statutory SOC would exercise in the statutory SOC's circumstances." (Schedule 10, section 3(3)).</p> <p>2. The formal framework may also include internal documentation. For instance, many water utilities now have water quality and other policies in place in which their standard of duty is set out. It is important to read and understand your corporate documentation as this material may reflect the organisation's overarching authorities conferred by statute and other legal instruments, eg:</p> <p>a. Corporate objectives or values</p> <p>b. A drinking water quality policy may contain authoritative statements such as "Large Water Corp is committed to supplying drinking water which meets all of our required obligations."</p> <p>c. A policy will usually be signed off by the CEO and/or the chair of the organisation's board, to give further authority to its contents.</p>
<p><b>Responsibility</b></p> <p>Responsibilities are developed from the identified legal and formal authorities and are important in setting out the expected standard of duty of an individual working on behalf of an organisation. If an authority to conduct an act or act in a certain manner has been identified, there is a corresponding responsibility on the individual or organisation to do so.</p>	<p>1. A drinking water quality policy may contain responsibility statements, eg:</p> <p>a. "Large Water Corp is responsible for implementing a risk management plan for its drinking water supply under the <i>Safe Drinking Water Act 2003</i> (Vic) and its supporting regulations."</p> <p>2. A position description statement is based on setting out the responsibilities of an individual, eg:</p> <p>a. The Water Quality Manager is responsible for developing and implementing the <i>Drinking Water Quality Management System</i>.</p> <p>b. The Water Quality Officer is responsible for contributing to and implementing the requirements of the <i>Drinking Water Quality Management System</i>.</p> <p>c. The Water Quality Operator is responsible for the correct operation of the critical control points.</p>
<p><b>Accountability</b></p> <p>Once authority and responsibility have been established, an individual and an organisation will be held accountable for their actions. The degree of accountability will depend on what you should have known and when, what you should have done and when, and the provisions described in legislation or other formal documentation.</p>	<p>1. The repercussions of not complying with your responsibilities can vary depending on the degree of the non-compliance. In some cases, repercussions of non-compliance may incur severe punitive measures such as being sent to jail or a monetary penalty, depending on whether the non-compliance is viewed as a criminal or civil matter. Non-compliance repercussions within an organisation may include reprimand (on various levels), demotion or even job loss.</p>

'Source through to Enduse or Endpoint' (S2E). Understanding the S2E context for an organisation's products and services is fundamental to understanding how everything fits together and needs to be managed, from corporate to coalface.

In the past, the industry has been used to dealing with what it may have thought of as a typical drinking water supply system, generally where one utility has been responsible for harvesting and collection of raw water all the way through to delivery of the product to the customer. However, even in such systems it is important, but not always easy, to understand:

- Exactly what products and services the organisation produces and provides;

- Which 'parties' need to be identified as part of the system; and
- Who has obligations to whom, and what are they?

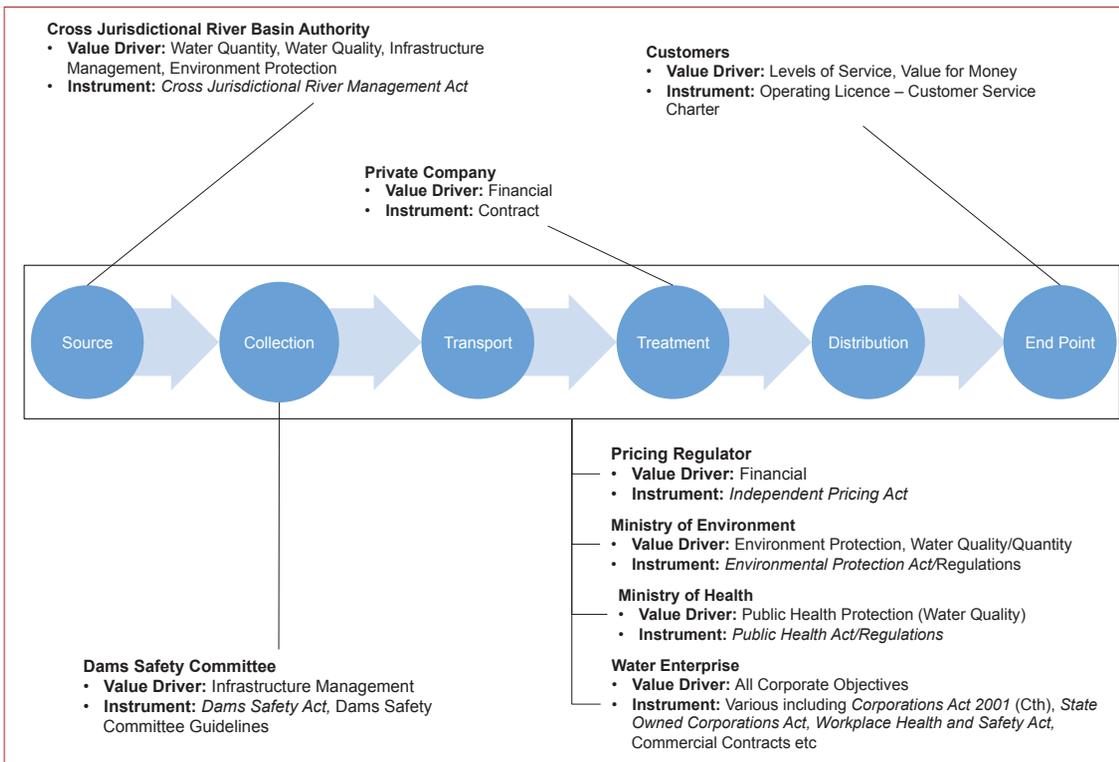
In considering fit-for-purpose products and services within your S2E delivery system, you will need to understand:

- The flow of water from S2E;
- The products, their quality specifications and requirements, and services provided by the organisation as part of the S2E chain;
- Responsibilities for management of the products and services offered by the organisation.

There are myriad water products and services, which an enterprise may have to deal with. Each of these water products and services will have its own set of stakeholders and stakeholder groups. Managers of enterprises need to balance the many competing demands of stakeholders across all water services and products.

Before one can engage with stakeholders, it is important to understand:

- Which 'parties' need to be identified as part of the S2E chain; and
- Who has obligations to whom, and what are they?



therefore these contexts require an increased complexity of understanding as well as a review of business opportunity/ risk against the enterprise’s risk appetite and tolerance.

In summary, there are several types of legal contexts about which enterprises need to be aware. While not intended to be exhaustive, some of the legal contextual issues are summarised in Table 2. However, it must be emphasised that an enterprise must understand its

Figure 2. Examples of S2E stakeholders, value drivers and instruments (not intended to be comprehensive).

In identifying key stakeholders, internal as well as external stakeholders should be considered.

Identifying key stakeholder value drivers is important as:

- At a corporate level:
  - They have a direct influence over an enterprise’s risk appetite and management framework.
  - They have a direct bearing on an enterprise’s compliance requirements.
- At a project level:
  - They have a direct bearing on the regulatory and formal framework within which a project is to be conducted.

An enterprise’s objectives, missions or values can be used as a starting point

for creating a group of value drivers. Objectives or functions of ‘enabling’ acts are also a useful source of information (and are often used to help set a state-owned corporation’s corporate objectives).

Once the stakeholders and their value drivers have been identified, the next step is to understand the formal and legal obligations that apply in the jurisdiction in which those stakeholders operate. Many water enterprises source their water from multiple jurisdictions and, therefore, must be aware of the broad range of their jurisdictional requirements. An overview of S2E analysis of stakeholders and their legal and formal requirements is provided in Figure 2. Modern water enterprises may also often offer consulting services, which can be provided not only in separate national jurisdictions but also international jurisdictions, and

own context not only in terms of identifying legal and formal requirements, but also in terms of keeping its information current.

**RECENT LEARNINGS<sup>2</sup>**

This section covers the failure of the Hastie Group with many of the findings related to the overall failure of governance and management processes.

Growing from a Sydney-based air-conditioning business, the Hastie Group became a provider of a wide range of services and was a leading international designer, installer and maintainer of technical services to the building and infrastructure sectors. The Hastie Group had established operations in Australasia, the UK and the Middle East. Its customers included construction companies, shopping malls, developers and various industrial corporations.

Table 2. Summary of legal ‘things to be aware of’.	
Impact	Example of Governing Instrument
Health	‘Protection of Health’ Acts, contracts, operating licences, operating requirements and reporting expectations
Environmental	‘Protection of Environment’ Acts, operating licences
Commercial	Contracts, ‘fair trading’ legislation
Staff	Work health and safety legislation
Physical Assets	‘Infrastructure Safety’ Acts, contracts, operating licences
Amenity	Common law
Process	Supply continuity contracts

<sup>2</sup> This section draws from information presented in PPB Advisory (2013).



**Table 3. 'Good Guy' and 'Bad Guy' approaches to corporate governance (WPW, 2012).**

Area	What the Good Guys Do	What the Bad Guys Do
Chief Executive Officers	Keep their egos in check, focus on the long term, demonstrate principled leadership, listen to the Board and to key stakeholders, are not also the Chairman of the Board.	Act like dictators, are often also the Chairman of the Board, ignore or collude with the Board, institute change of control bonuses or 'golden parachutes', pay themselves huge salaries, allow their egos to run riot, take reckless risks, focus on profits not principles.
Boards of Directors	Have sufficient relevant skills and understanding to review and challenge management performance, ask a lot of questions, vote against management as they see fit, rein in executive pay.	Golf with their pals (or worse, relatives) in management, vote the way management tells them, don't bother asking any questions.
Shareholders	Are vocal on corporate governance issues, exercise their voting rights, find out about the company they are invested in.	At worst, nothing. At best, rely too much on ratings agencies, fail to fulfil due diligence, don't bother voting.
Attitudes to Regulation	Satisfy or exceed regulatory requirements and demonstrate best practices in their industry by being as transparent as possible.	Look at regulation with contempt and analyse how they can best get around it.
Accounting Practices	Keep clear, simple, consistent and transparent accounts and pay their taxes.	Falsify results, overstate sales, inflate their stock price, hide losses, claim inappropriate expenses, evade taxes.

In 2012, the company was placed into administration and PPB Advisory was appointed to investigate. PPB Advisory notes the following as among the reasons for the Hastie Group's failure:

- Inadequate operational management processes;
- Inadequate management reporting systems;
- Inadequate Board reporting systems;
- Inadequate control exercised by the Board over management.

In addition, several issues were noted in terms of overall control deficiencies with the Hastie Group, including:

- Internal systems for project management were inadequate and not to industry standard;
- There appears to have been a general culture of ignoring bad news;
- The Audit and Risk Committee (ARC) was largely inactive;
- The Board appeared not to have 'an enquiring mind' as to reliability of financial statements and overall reporting.

### CONCLUSIONS

In their blog, investment managers Willauer Prosky Willaeur (WPW, 2012) note the big difference in the approaches taken by companies with and without good corporate governance in place (Table 3). WPW (2012) note that good corporate governance leads to higher returns, in one study as much as 8.5%

of shareholder value for companies in the highest decile of a governance index (Gompers, Ishii and Metrick, 2002). For public water utilities, high compliance is probably the bigger goal rather than financial returns in terms of corporate governance. However, key utility shareholders (government) would still be interested in returns on investment.

To conclude, it is worth reflecting on the WPW (2012) approaches in Table 3 and working out where you and your enterprise sit. Does your CEO keep his or her ego in check? Does your enterprise have a culture of disseminating bad as well as good news? Is your enterprise vocal about good corporate governance? Do you have a sufficiently representative dashboard to monitor your performance and act in a timely manner? Do people in your enterprise know what their responsibilities and accountabilities are?

### THE AUTHORS



**Dr Annette Davison** (email: [annette@riskedge.com.au](mailto:annette@riskedge.com.au)) is Principal and Director at Risk Edge Pty Ltd, Killara, NSW.



**Bob Burford** (email: [bob.burford5@gmail.com](mailto:bob.burford5@gmail.com)) is Principal, BBTech Consulting, Kingston Beach, Tasmania.



**Dr Annalisa Contos** (email: [annalisa@atom.com.au](mailto:annalisa@atom.com.au)) is Principal, Atom Consulting, NSW.

### REFERENCES

ASX Corporate Governance Council (ASX) (2014): Corporate Governance Principles and Recommendations. 3rd Edition ([www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf](http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf)).

Davison AD (2011): Enterprise Risk Management. Risk Appetite and Risk Tolerance: How Robust Are Yours? *Water Journal*, 38, 5, pp 65–68.

Davison, A., Burford, B. and Alden, S. (2011) Duties and obligations of directors in public utilities. How well do you understand water quality? *Water (Journal of the Australian Water Association)* Volume 38(7): 44-46.

Gompers PA, Ishii J & Metrick A (2002): Corporate Governance and Equity Prices. The Wharton Financial Institutions Center. Working Paper 02-032 ([fic.wharton.upenn.edu/fic/papers/02/0232.pdf](http://fic.wharton.upenn.edu/fic/papers/02/0232.pdf)).

ISO 31000:2009 Risk Management – Principles and Guidelines (adopted in Australia as AS/NZS ISO 31000:2009).

NHMRC/NRMMC (National Health and Medical Research Council and National Resource Ministers Ministerial Council) (2011): *Australian Drinking Water Guidelines*. ISBN Online: 1864965118.

PPB Advisory (2013): Hastie Group Limited and Specific Subsidiaries. Report by Administrators Pursuant to Section 439A of the *Corporations Act 2001*. January 2013 Joint and Several Administrators Ian Carson, Craig Crosbie and David McEvoy.

WPW (Willauer Prosky Willaeur) (2012): What is Corporate Governance and Why Should We Care? [wpwam.com/post.php?s=2012-08-17-what-is-corporate-governance-and-why-should-we-care](http://wpwam.com/post.php?s=2012-08-17-what-is-corporate-governance-and-why-should-we-care) (accessed 7 February 2013).