EFFECTIVE PROJECT GOVERNANCE
A CULTURAL SEA CHANGE

Presented at

PMI Global Congress
ASIA PACIFIC 2005

21-23 February 2005
Swissôtel (The Stamford)
Singapore

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INTRODUCTION – THE IMPACT OF SOX

The culture of corporate governance is being irreversibly changed by legislation similar to SOX[1] that has been (or is being) introduced around the world. The hypothesis central to this paper, is that:

- The changes in legislation impacting corporate governance…….
- Will force changes the behaviours of organisations…….
- Which will over time, alter the culture of those organisations and the way they do business.

Organisations and businesses based in countries that have not enacted legislative changes similar to the SOX Act in the USA may be able to escape the heavy hand of legislative enforcement (for now anyway). However, if the hypothesis is proven that: 'significant change in an organisation's internal culture will inevitably alter its expectations of appropriate behaviours in its suppliers, trading partners and customers'. The consequences will be that any business that has an involvement with global trade will find it almost impossible to avoid the impact of the changes that will become manifest over the next few years (within organisations operating in the USA, Europe, Australia and similar jurisdictions) and will need to implement similar changes simply to stay competitive.

The key change this paper will address is the requirement for robust, reproducible and auditable control systems that deliver accurate forecasts of future business outcomes. For most organisations this translates directly into the need for robust, reproducible and auditable project, program and portfolio management systems because most of the significant changes within an organisation are created by projects!

In 1997, John Maclay, General Manager, 3M Australia Pty Limited said:- "*In getting a product to market, a blow-out in budget of 50% will lead to a reduction in revenue of 4%, whereas a schedule overrun of 50% will lead to a revenue reduction of 33%.*" If these ratios hold true for most businesses, the critical role project governance will start to play in corporate governance becomes obvious when you consider:

- One of the key requirements of SOX is for corporations to project ***future*** cash flows
  (outlays, inflows and profits).
- Introducing a 'new product' into the market normally generates significant changes in cash flows.
- New products are typically created by projects and programs.
- Changes to the launch date for the new product will change the future cash flows and profits.
- Changes in product launch dates are usually directly aligned to changes in project or program completion dates.
- Under SOX a corporations CEO, CFO and auditors all need to sign off on the accuracy of the projected future cash flows and the effectiveness of the systems used to generate the projections.

This paper will not attempt to provide a legal view of the various legislative changes being enacted around the world. The purpose of this paper is to offer a personal view of the future of project governance based on the author's assessment of the likely consequences of the changes in the behaviours and attitudes of corporate managers generated by their response to SOX (and similar legislation elsewhere). However, as any project planner will tell you, all attempts to predict the future are fraught with difficulty (particularly when there is no previous history to provide a reference), prone to error and requires regular monitoring and updating to retain relevance.

THE LEGISLATIVE FRAMEWORK DRIVING CHANGE

In most (if not all) of the major trading economies around the world, there has been a legal framework in place for at least the last century that directs and governs the behaviours of corporations, their Directors and their managers. Until recently, these regulatory frameworks have tended to act retrospectively. By way of example auditors were only required to report on the accuracy of a company's accounts up to a point in time and to identify any irregularities that had occurred in the past. All of the major corporate scandals of the last decade have been, or are being, dealt with under this type of retrospective legislation.

The legislation was relatively effective in punishing wrong doers many years after the investors and trading partners suffered their losses but this type of legislation has generally proved ineffective in recovering those losses. As a consequence of a number of high profile corporate collapses in recent years (USA: Enron, WorldCom; Australia: HIH, One.Tel; Europe: Parmalat, etc), a new breed of corporate legislation has been enacted that seeks to be more proactive. The two key components of this new type of legislation this paper seeks to address are:

- The proactive need to 'keep the market informed' with legal requirements to:
  - Project future cash flows, profitability, etc.
  - Advise the relevant share markets and investors of any changes to these projections immediately they occur or are ***foreseen***. Corporations can no longer wait for losses to crystallise, if a business expects it will lose money on a project at some time in the future, the market must be informed today!
- The trend to make corporate management more personally accountable for their actions and the performance of the corporation.

Key legislative changes:

The United States of America (USA).

The Sarbanes-Oxley Act of 2002 (SOX), and the resulting Securities and Exchange Commission (SEC) rules, have created new standards for corporate governance in the United States. Key elements of the Act include:

- Requirements for the CEO and CFO to personally certify the accuracy of a business's financial reports.
- The requirement for businesses to establish and maintain 'adequate internal control structure and procedures for financial reporting'.
- Auditors to approve these systems and procedures.
- Requirements to forecast the timing and certainty of future cash flows and future profits.

Australia.
Corporate Law Economic Reform Program (CLERP 9). CLERP 9 is part of the reform program initiated by the Australian Government that allows for the changing environment in which business operates, while at the same time providing clear guidance on appropriate corporate behaviour and effective enforcement when breaches occur. The modifications made to the Australian Corporations Act and other Acts by the CLERP program of legislation include requirements for companies listed on the stock exchange:

- To forecast future profits and cash flows.
- Inform the market in an expeditious manner of any changes to those forecasts. Breaches of this 'continuous disclosure' provision can attract fines of up to $1million.
- CEO and CFO (or equivalent) to give a declaration to the Board of Directors that the financial statements give a fair and true view of the company's financial position.
- The Directors to include in their report, that the declaration has been made and that the company reports are fair and true.
- The Auditors to report any suspected breaches of the Corporations Act that are 'significant' and/or any attempt to interfere with the audit process.
- Change in the way reports are prepared to align with the International Financial Reporting Standard (IFRS). IFRS require reports on the timing and certainty of future cash flows.

United Kingdom (UK) and Europe.

Changes to the European regulatory framework (Directives) and a tightening of the Combined Code on Corporate Governance issued by the Financial Reporting Council in the UK are being backed up with legislative changes including a new statutory 'Operating and Financial Review' (OFR) requirement. The effect of OFR and provisions in the 'Accounts Modernisation Directive' require the directors of quoted companies (ie listed on the stock exchange) to 'report on a company's objectives, strategies and key drivers of the business, focusing on…. more forward looking information'[2].

Impact of the Legislative Changes:

The ability of an enterprise to generate cash and/or cash equivalents and of the timing

and certainty of those future cash flows is fundamental to its value on the share market and at a more basic level its ability to continue trading. The primary driving force behind the international changes has been to provide better information to investors and trading partners, to increase the predicability of an organisation's ***future*** financial performance and to keep the markets informed of changes as they occur. However, at the same time as the regulatory framework is tightening, shareholders and other corporate stakeholders are becoming less tolerant of errors of judgement and loss of control. This lack of tolerance has forced numerous high profile resignations when unexpected losses became public (even when there was no strict legal liability).

Based on these trends, it will not be long before a high profile CEO in the USA is personally sued for losses incurred by shareholders who claim they relied on information contained in incorrect company forecasts personally signed by that CEO in compliance with the SOX legislation. Already ten former directors of WorldCom have agreed to pay $US 18 million of their own money to settle a class-action lawsuit brought by disgruntled investors who lost money in the World.Com crash.

This trend is not unique. In the UK Scott VC in a judgement dealing with aspects of the Barings collapse stated *"The higher the office within an organisation held by an individual, the greater the responsibilities that fall upon him……and those responsibilities require diligent attention from time to time to the question whether the system that has been put in place and over which the individuals presiding is operating efficiently."* [3]

Similarly, in Australia, John Greaves, the former chairman of One.Tel was disqualified from further office following court actions by the Australian Securities and Investment Corporation. Greaves effectively acknowledged his responsibility as Chairman of the Board of Directors for the failure of One.Tel's management to keep the Board properly informed as to the parlous state of that business' cash flows prior to the business being declared insolvent.

Project reports have changed from being an academic process undertaken by relatively junior managers to being of direct personal interest to most businesses CEOs, CFOs and Directors! After all it's the projects undertaken by organisations that create the new products, or implement the new systems, that generate the future sales and savings that in turn underpin the financial forecasts of the business. And the CEO is now personally liable for the accuracy of that information.

When the requirements of the regulatory changes outlined above are combined with the enhanced expectations of stakeholders a significant requirement for robust, predictable and auditable corporate project management processes is emerging around the globe. These pressures may not be obvious at all levels of all affected organisations yet. Many businesses are still struggling to come to grips with developing systems to implement the mechanics of the changes, but it will not be long before the full implications start to be realised at the project level.

Implications of SOX

Some of the key implications flowing from SOX and other similar legislation are:

- The delivery time for projects will need to be accurately predicted (they impact the timing, and potentially the value, of future cash flows). This means developing achievable and realistic schedules based on the availability of adequate resources to undertake the work, balanced across all of the projects an organisation commits to. Setting arbitrary and unachievable delivery times to fit the requirements of a 'business case' places the CEO's personal wealth at risk!
- The cost of projects will need to be accurately estimated (they impact the amount of cash out-flows). This means achievable and realistic costs based on accurate data are essential. Setting arbitrary and unachievable budgets to 'get a project approved' is unacceptable.
- Proper risk assessments will be required (and adequate reserves and contingencies created) to manage normal fluctuations in project performance.
- Effective monitoring and control systems will need to be in place to identify and predict trends and variances and to help implement corrective actions as soon as they are needed. (Earned Value)
- Far more honesty and openness will be needed at all levels of the project planning and control systems. The best real estimate of cost and time needs to be in front of management, acknowledged and acted upon.
- Organisations will need to recognise and accept performance that does not conform to plan at all times. Provided issues are acknowledged openly and honestly, support and resources to assist in applying effective corrective actions need to be developed. The 'blame culture' inherent in many organisations is counterproductive and works to ensure critical information is suppressed for as long as possible, under SOX and CLERP9, this is probably illegal if the project variance impacts future cash flows or profits.
- Internal systems including effective Project Offices, supported by tools such as Enterprise Project Management will need to be developed, and develop a high degree of sophistication. Project data is the foundation of much of the corporate reporting now mandated by legislation.

Organisations in countries that do not have SOX-style legislation in place cannot ignore these changes. There are three key influences that will drive change:

- Organisations supplying goods and services to businesses operating under a SOX style legal regime will progressively find their clients requiring similar levels of compliance from them. The purchasing organisation's ability to deliver its projects and programs 'on time and on budget' is directly linked to the performance of their suppliers and its SOX style reporting requirements will need accurate data from those suppliers.
- Competition in the global market place will drive improved performance. One of the demonstrated advantages of effective project management is improved business performance. As the focus in businesses subject to SOX-style legislation shifts from a scramble to comply fully to one that makes use of the systems and data now available, a noticeable improvement in performance can

be expected. Other businesses, irrespective of their location, will need to match this improvement to stay competitive.

- The expectations of owners, investors, customers and other stakeholders will shift to the new benchmark. Substandard and ad hoc project delivery will rapidly become as unacceptable as substandard and ad hoc quality management is today.

Why is SOX and similar legislation predicted to cause so much change? The view of this author is that because SOX potentially places the personal wealth of every CEO and CFO at risk, the focus on developing effective governance systems will be far greater than any change in project governance to date (and it will be driven from the top). We have yet to see the first class-action lawsuit against a CEO for losses allegedly caused by inaccurate data in a company's forecasts; however, it is unlikely to be long in coming. The associated headlines in the business press will focus senior management's attention on effective project governance in a way not seen before.

Whilst the initial reaction of many business managers may be risk averse (don't do projects, don't report expected income, etc), this reaction is unsustainable. Businesses need to compete, need to maintain their share price, need to grow, etc. But businesses cannot compete, grow and generate wealth by doing nothing, they have to introduce new products, take managed risks and innovate; ie they have to do projects and deliver their projects is a consistent, predictable and efficient manner. The second wave of the SOX induced reform within business will be focused on successfully achieving these outcomes.

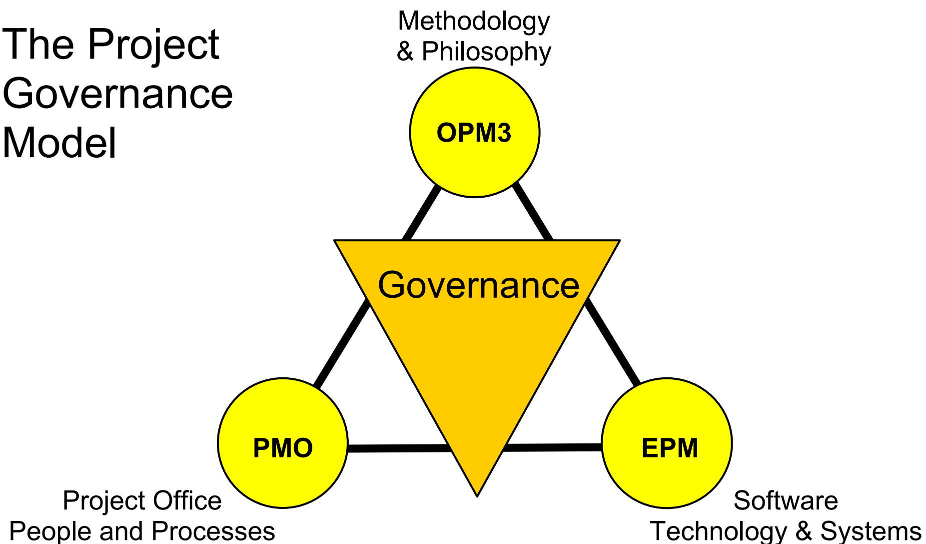
THE BUSINESS FRAMEWORK FOR PROJECT SUCCESS

Project governance is a sub-set of overall corporate governance. The aim should not be the blind conformance to the minimum requirements of the legislation. The objective should be to leverage the minimums of good governance imposed by regulation and legislation to create a system that can generate real benefits. The tools needed to deliver accurate and robust project analysis have been around for years (Primavera, Open Plan, Microsoft, etc). These tools are supported by effective techniques that accurately predict overall project performance and are reinforced by recognised Standards (Earned Value, ITIL, *PMBOK® Guide*, PRINCE2, etc)[4]. However, on their own these tools and techniques are insufficient.

More recent developments in project management have seen the move from a focus on the effective management of individual projects in isolation (as described in the PMBOK) to viewing individual projects as part of a larger strategic picture and a focus on delivering benefits to the organisation. This trend has seen the evolution of Program and Portfolio Management, supported by project offices, collaboration tools, enterprise project management software (EPM) and a more holistic view of risk assessment and risk management.

More recently, the release of OPM3[5] by PMI has delivered a robust international standard for the implementation of best practices at all levels of an organisation and

has given businesses the opportunity to improve and benchmark their portfolio, program and project management performance. All of these trends need to be brought together if an organisation is going to achieve effective project governance.



Meeting the requirements of the legislation may be achieved in isolation but effective project governance is made easier by having a holistic corporate project management system in place.

Methodology and Philosophy

Until recently there was very little guidance generally available to describe best practice in the sphere of portfolio, program and project management and as a consequence, many businesses fail to align their projects, programs, portfolios, strategies and vision/mission. The Organizational Project Management Maturity Model (OPM3) developed by PMI describes a range of 'best practices' in these interlinked areas and is designed to assist organisations in assessing and understanding their current level of maturity, and if they choose, help them plan an improvement path to become more mature.

OPM3 has been designed to meet the needs of organisations of all types and sizes. Its primary functions are:

- To be the international standard for Organisational Project Management.
- To provide a framework for assessing organisational project management maturity.
- To deliver a methodology to enhance an organisation's overall ability to select and manage projects in a way that supports achieving its strategic goals and overall vision.

The key focus within OPM3 from a project governance perspective is implementing processes that align project activities with corporate strategies (via programs and portfolios) to achieve the organisations overall vision and as a result, meet its forecast cash flows, profitability, etc.

OPM3 defines portfolios as a collection of projects, programs and other work grouped together to facilitate effective management of that work to meet strategic business objectives.

- Every organisation has at least one 'portfolio' of projects and programs (most have several).
- Portfolios are aligned with achieving strategic objectives, these strategic objectives in combination create the vision the organisation exists to achieve.
- Portfolios tend to be on-going and may involve operational aspects (functional management).

Programs are a group of related projects that are managed in a coordinated way to achieve benefits and control not available from managing them individually.

- Programs may include other non project work.
- Programs tend to be temporary and end when their goal is achieved.

Projects are temporary endeavours undertaken to create a unique product, service or result. Projects may form part of a program or have been created as a stand alone endeavour within a portfolio.

If these objectives and relationships are not clearly defined, projects that have no real purpose can be undertaken at the expense of more beneficial projects with a detrimental impact on future cash flows. The essence of good corporate governance is to move from a parochial view of making sure 'my project' gets the go-ahead; to a view that the best projects to undertake are those that directly support the achievement of the organisation's vision.

Enterprise Project Management (EPM)

Enterprise Project Management delivers the technical capability to build integrated project management systems. All of the major software vendors in the 'project

management' space have EPM solutions. This paper recognises the vital role these tools play in enabling effective project governance. However, time and space limitations prevent a detailed discussion on the technology. A few of the key vendors with EPM offerings (in no particular order) include Primavera (www.primavera.com), Welcom (www.wst.com), and Microsoft (www.microsoft.com).

People and Skills - the PMO

An effective Project/Program Management Office (PMO) is a critical component of any governance system. Surveys undertaken by KPMG[6] across all industries, around the world have consistently demonstrated that a 'mature' PMO is a 'must have' investment. The KPMG Programme Management Survey 2002 found:

- 98% of projects in organisations with 'mature' project offices are successful.
- 53% of projects in organisations with 'new' project offices are successful.
- Other project success rates are generally below 50%.

The survey's cost/benefit analysis showed the average cost of each 'failed' project was £8 Million (Approx. AU$19.5 Million) whilst the cost of running the PMO was less than 3% of project value. Its conclusion was that a mature PMO with effective systems makes a major contribution to overall project success rates and improves the business bottom line. The 2003 survey supported the 2002 findings but showed the Asia Pacific region lagging the rest of the world in implementing effective PMOs!

Good PMOs should provide far more than a simple policing / data gathering role. Some key benefits that can be delivered by the PMO include:

- Developing, maintaining and propagating project management processes and standards for the organisation, supporting the evolution of 'communities of interest'.
- Training and mentoring project staff.
- Operating and supporting the EPM software and systems.
- Consolidating and managing data flows from 'projects' into the overall corporate compliance systems (and highlighting critical trends and issues requiring management attention early).
- Providing input to estimating and pre-project planning.
- Providing resources to assist with project set up, corrective action implementation and closure.
- Providing input to time and cost risk assessments and monitoring or controlling the relevant reserves and contingencies.

There is a significant and expanding body of work freely available on the various roles and forms a project office may adopt. The 'correct' PMO for each business will be strongly influenced by that business' internal structure and culture and will need to be an integral part of both. However, the KPMG reports have shown beyond doubt that not having a PMO is a guaranteed way to lose money.

CONCLUSIONS

This paper has demonstrated the key linkages in delivering effective project governance between methodology (OPM3), technology (EPM) and the people that manage the systems and processes (the PMO). Establishing or implementing any one of these components will deliver significant benefits, when implemented as a holistic system the sum of the benefits can be significantly greater than the individual parts. The question facing senior management in many (if not most) organisations is how long poor, erratic and uncoordinated project performance will continue to be tolerated by their owners, shareholders, clients and other stakeholders (not to mention the corporate regulators)?

The challenge facing every organisation that relies on projects to instigate change and grow value is to move from an ad hoc system of 'doing a project' to one that is integrated, robust, repeatable and auditable and meets the organisations legal and ethical reporting obligations. This transition requires the active involvement and understanding of senior management, supported by properly trained and qualified project personnel who have the authority and capability to implement best practice processes and systems.

The profession of Project Management has largely addressed the challenge of training and qualifying individuals (PMP, IPMA Certification, etc) and has developed a broadly agreed set of competencies expected of a Project Manager and project team members. However, few businesses actually insist on their project managers being qualified!

Similarly, EPM systems offer senior managers and directors ready access to the tools and techniques needed to meet the challenges of predictability, accountability and effective project risk management and to contribute significantly to the growth of their organisations. However, at the moment very few senior managers are trained in these skills, or appear willing to make effective use of the tools and information.

Therefore we would suggest the real challenge of implementing best practice project governance system is neither the legislation nor the technology. It lays far closer to the corporate heart; it's in changing cultures to embrace openness and accountability, educating and qualifying key people from project managers upwards and accepting the challenge of implementing world best practice processes and procedures such as OPM3. Organisations that accept these challenges are the ones that will succeed and lead in the 21st Century.

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