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Project Governance

– a board responsibility

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Are board members adequately equipped to oversee the company's capital projects and programmes?

Introduction

"Things can, and do go wrong" - This is an all too familiar phrase understood by the boards of many companies which undertake significant capital projects. But they are not alone. A recent article in the Business Day newspaper indicated that the "megaproject market is worth about $9trillion each year, and globally big builds are in a mess. It is rare to have one completed on time and on budget"[1] .

The key question though for many boards is how to extract the maximum value out of these projects. A recent McKinsey[2] report identified several barriers that could hamper the delivery of the planned infrastructure investments. One of the factors was 'a pattern of cost and schedule overruns in key projects'.

The report further suggests that in order to make the country's infrastructure spending as productive as possible, one of the solutions to explore is streamlining the delivery of projects by adopting more effective management approaches and practices.

There are a number of reasons which could cause a project to be ineffective or to fail. Governance challenges range from a lack of oversight to excessive involvement of the board in the day-to-day operations of the company.

Boards of companies undertaking significant capital projects face challenges regularly. Capital projects differ from other projects in that that the product is materialising over time and may change, the price may also change and in many instances cannot be fixed and the remedies on breach are at times limited.

The reputational risk associated with disastrous project governance is as unpleasant as the cost of overruns and significant project delays.

There is a need to carefully select projects based on their alignment with strategy; to carefully develop the project planning in a manner that improves certainty and lastly to control execution in a manner that will minimise the risk of failure. If this is not done, planned business benefits and stakeholder value can be rapidly eroded by delays and cost overruns, even to the extent that the continued sustainability of the enterprise can be placed at risk.

Properly overseen projects require the board to step back and holistically assess how capital projects support the corporate strategy. This can be achieved by a sound governance framework which guides effective decision making and lays the foundation for achieving project success.

The above then raises the question – what are the obligations and responsibilities of a board in respect of the entity's capital project portfolio; what skill and expertise is required and are boards adequately equipped to oversee the entity's capital projects?

This paper aims to provide guidance on project governance for the board by defining what is project governance and setting out the three typical components of a project governance framework. These components are an oversight framework, controls over the project through its life cycle phases and independent project assurance. The approach adopted by the board may be altered depending on the size, duration and costs of the project. The approach should be assessed taking both financial and reputational risks into account.

Board responsibilities

Mega projects are generally high risk investments given the significant amounts of cash, complexity and duration that they span for. As a result of these challenges, project level risks can easily become enterprise level risks. A PwC analysis[3] of project failure has shown that projects seldom fail due to technical aspects. It found that managerial aspects were the root cause of failure in 92% of instances, which brings the matter into the ambit of the board and its governance and oversight role over projects.

Boards and individual directors have a responsibility to exercise the necessary due care and diligence in discharging their duties. It is the responsibility of the board to oversee the company by providing direction and guidance. However, striking the right balance between exercising oversight and managing a project can be challenging.

The board has the overall responsibility for the governance of project management. This responsibility is concerned with ensuring that the project is aligned with the organisation's objectives and strategy.

The Centro case[4] highlighted that the board has the responsibility for controlling the flow of information to it and the manner in which the information is provided to it. The Centro case also highlighted that 'directors cannot substitute reliance upon the advice of management for their own attention and examination of an important matter that falls specifically within the Board's responsibilities...' It is not expected that the director is a subject matter expert on all matters, but rather that he or she should be sufficiently informed to interrogate the matter as indicated in the Centro case.

1 Business Day, 31 August 2015, 'Mega disasters in the making'; Tom Nevin
2 McKinsey Global Institute, September 2015, South Africa's Big Five: Bold priorities for inclusive growth

3 Capital projects: Is your board doing enough?
4 Australian Security and Investments Commission V Healy, a case concluded in Australia and not part of South African case law.

What is Project Governance?

Project governance is the extension of corporate governance into the capital project environment. Project governance may be defined as a collective business framework used to plan and deliver all commercial and technical aspects of the capital project. It includes the systematic and structured processes of control, oversight and assurance over the selection, development and execution of capital projects to ensure a transparent, accountable and auditable project delivery environment. This in turn supports informed decisions, underpinned by strategic insight and effective risk management.

Application of these principles of good project governance will lead to increased levels of confidence that the right projects are selected and planned in a manner that will deliver those projects on time, within budget and with the intended benefits.

The board's duties in respect of capital project oversight

The board must adopt and take ownership of the capital project oversight framework. Typically this is an eight-step process, where the board should:

1. **Consider** the importance of the project to the company; the industry delivery capability; the company's own delivery and oversight capability and the risks associated with these. Boards should invest time in understanding reasons for undertaking a project and the expectations of the project at the outset. The return on the investment together with a timeframe over which returns will be generated should be understood. Projects should be supported by a detailed financial analysis supported by a strong business case, with key milestones and associated risks. Best and worst case scenariosfrom an operational, financial and reputational perspective should be considered. These assumptions should be challenged by the board.

2. **Agree** on its approach to oversight for the project. Items to consider are whether the entire board, a committee, or others are given the oversight task.

   a. The board should consider the backgrounds and experience of existing directors to assess if they have the skills necessary to oversee capital projects. If not, the board will need to ask the question as to whether the skills of the board need to be augmented with additional capital project expertise through bringing capital project experience onto the board or by the use of outside experts. This will be true for companies that have assessed capital projects as a strategic priority or for those that have identified current or planned capital project activity to represent an enterprise level risk.

   b. The board should consider if key individuals outside the project team, with the necessary professional scepticism have input into the risk identification and management process.

   c. The next item to consider is how often directors should discuss capital projects. The amount of time spent is correlated to the importance and assessed riskiness of capital projects to the company. Quarterly reporting is a minimum guideline for high-risk ormega-projects, with an increased frequency in instances where complex or significant projects are undertaken or when major problems arise. Reporting associated with smaller or more routine programmes should be provided in the normal course of business.

3. **Identify** the level of board involvement in key capital project activities such as: capital investment planning (CIP); project development; risk and control environment alignment; contracting strategies; project reporting and fraud prevention and detection.

4. **Align** capital project activities with strategy oversight – defining the business objectives to be accomplished through the project and the associated investment strategies and aligning the capital investment plan when strategies change.

5. **Embed** capital project delivery into risk management oversight - capital project risks need to be included in the company's enterprise risk management plan, especially as the size and complexity of the capital programme increases.

6. **Adopt** a continuous process of assessing the feasibility of the project in light of the overall strategy of the business and measure results. Boards should have the ability to change or withdraw existing capital projects if not longer aligned to the overall strategy of the business. By defining and implementing a monitoring process that corresponds with project objectives and to the size and scope of a particular company's capital program, the board can best oversee capital projects over the long term. Key performance indicators are an effective way of tracking the progress of the project and provide earlywarning signs of a project going off course. Failure to meet one KPI may indicate problems in other areas which will enable the board to challenge the assumptions of the business case and delve deeper into the issue.

On-going monitoring of the effectiveness of the company's capital project activities should be supplemented by a continuous evaluation of the board's oversight process. Not only do the strategy and economic conditions evolve, but the composition of the board and its level of capital project expertise also fluctuate. Periodic checks of the framework will provide directors with the confidence they need to oversee their company's capital program.

7. **Ensure** that the company's assurance policies and frameworks include and adequately cover the risks of its capital projects and programmes. All relevant reports on independent and technical reviews of its capital projects should be brought to the attention of the audit committee in accordance with a combined assurance framework. Such reports should be used to independently verify and confirm the results reported by the project team and by management.

8. **Review** the project execution and governance following the implementation thereof.

A project life-cycle control framework

The oversight framework discussed above is supported by a control framework consisting of two sub-components, namely a stage–gate process that focuses more on the selection and development phases and an integrated project controls environment to ensure control over execution of the project. It is important to note that this control framework can be applied regardless of the type of project management methodology used.

A stage-gate approval process for project selection and development

Many companies have a "stage-gate" approach to project approval, requiring an incrementally refined level of scope and estimate detail for each successive tranche of funding or approval to the next stage. Depending on a company's delegation of financial authority guidelines and the size of a proposed investment, these activities may require board level approval and should be conducted in the normal course of board activity.

The objectives in respect of the project approvals are different during the selection and the development life-cycle phases. During the selection phase the focus is on prioritising those projects that are best aligned to, and best placed to implement, strategy. The objective during the development phase is to reduce uncertainty through increased up-front planning and design to an extent where the scope, schedule, cost and risks base-lines can be fixed. This approach is known to significantly reduce execution phase uncertainty and risk.

Integrated project controls over execution

An integrated project controls environment ensures that changes to the scope, cost schedule and risk base lines are controlled through an integrated process. This allows progress to be measured and reported against realistic base lines and allows accurate determination of value earned during construction. Project performance information is analysed and trends are identified early on. This integrated process provides strategic insight, informed and timely decision support, and forward-looking indicators to management and the board.

Independent assurance

Independent assurance is the third leg of project governance. It ensures transparency and improves accountability. It provides:

- **Assurance** to the board that the project and programme management of its capital projects is conforming to required processes and standards.
- **Early warning** of potential project issues and risks which might affect project success; and
- **Considered recommendations** on what to do to address specific and generic issues and concerns identified.

An integrated capital project assurance framework, with at least three lines of defence, is a necessity for companies with large programmes of capital projects. Such a framework combines and integrates the assurance practices across divisions and reduces the risk of unexpected project failure. Its purpose is to provide independent verification of project performance and risks, which will lead to improved transparency and accountability.

Conclusion

Capital projects have enormous potential to enhance shareholder value if delivered properly. However if project governance fails, project level risks can as easily ratchet into enterprise level risks with the potential to seriously erode or destroy stakeholder value.

The board's oversight role is a critical component of good project governance. Boards have tough questions to ask about their own ability, background, skills and experience necessary to oversee capital projects. If not, the board must act quickly to acquire such skills before it is too late.

Simply put, project governance is the extension of corporate governance over projects and is based on the principles of oversight and assurance over the control of projects through their life-cycle from selection to execution.

Appendix A – Questions the board should be asking

Why this project?

- Why is this project being undertaken?
- How will the project affect the company's competitive position in the marketplace?
- What business objective of the overall strategy is the capital project addressing?
- Are there clear benefits that will be derived and in what time frame are these benefits expected?
- What major risks could impede progress and how does it link into the risk appetite of the company?
- What is the forecast for return on investment in both the best and worst case scenarios?
- How has the project manager delivered historically in terms of other capital projects?
- Were other alternatives considered?
- What are the hurdle rates milestones required?
- What are the consequences of not undertaking the project?

Do we have the right skills and governance processes in place?

- Do the risks, size and complexity of the project warrant a board committee?
- Is the board equipped with the necessary skills and expertise to exercise effective project governance?
- Should more experience be brought on the board or would experts engaged on an ad-hoc basis suffice?
- How often should capital projects feature on board agendas?
- What governance processes are in place to ensure the board is properly notified when issues surface?
- Is there need to seek an independent third party opinion?
- Is there a need to reassess skills on the board?

What if something goes wrong?

- What is the probability of a negative event occurring?
- What is the impact if a negative event had to occur?
- Are there contingency procedures in place?
- How does the project link into the risk appetite of the company?
- Can the board pull the plug on projects that incur risk above its appetite threshold?
- Does the company have the necessary resources (financial and other capitals) to see the project through to completion?
- Are the projected returns from the project still attainable?
- Can the board suspend or terminate the project without material financial or other consequences?

Notes

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