



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

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***Review of the Commonwealth Government Business
Enterprises Governance and Oversight Guidelines***

Chartered Secretaries Australia welcomes the opportunity to comment on the discussion paper, *Review of Commonwealth Government Business Enterprises Governance and Oversight Guidelines* (the discussion paper).

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency. CSA members are involved in governance, corporate administration and compliance with the *Commonwealth Authorities and Companies Act 1997* (the CAC Act) and the *Corporations Act 2001* (C'th) (the Corporations Act). Many of our members serve as officers within the wide array of commercialised government entities including government business enterprises (GBEs) and are experienced in the workings of various state and federal regimes. CSA has drawn upon the expertise of our members in these areas to provide comments on the discussion paper.

General comments

CSA welcomes the discussion paper concerning proposed amendments to the guidelines affecting GBE governance practice. The high levels of transparency and public expectation with respect to GBE operations require a solid governance framework to support them. This is particularly relevant to GBEs which undertake the dual functions of being commercially competitive within the business realm and achieving purely non-financial public goals.

In many instances, these public goals include the facilitation of access to major infrastructure, such as ports, electricity generators, railways, water entities and telecommunications. The role of the GBE, therefore, is not only as an efficient and accountable corporate entity, but also as a source of public service which would otherwise not have been made available by the private sector.

These combined expectations place emphasis on the governance framework which underpins the management of GBEs. Understanding how the GBE is run or governed, over and above its

basic legal obligations, requires an understanding of the four critical elements which underpin any good governance framework. These four elements are:

- **transparency**, which entails a true dialogue with a range of stakeholder groups. The starting point is transparency of purpose, clarifying why the organisation exists, what its objectives are and what the measures of achievement are. It also means transparency of process so that all stakeholders understand how things are done as well as why
- **accountability** — this means asking the questions: Who is responsible and to whom? What are they responsible for? What are the consequences if the rules are violated? It is a normal part of the exercise of responsibility. It is a reporting mechanism enabling those conferring responsibility to monitor its exercise
- **stewardship**, which involves a clarity in all organisational decision-making so that those controlling the destiny of an organisation do so not for their own benefit, but rather for the benefit of the range of individuals and groups who have an interest in the affairs of the organisation, that is, the stakeholders
- **integrity** — developing a culture committed to ethical behaviour. That culture should be about carrying out the responsibilities required by the charter, legislation or constitution in a manner open and apparent to all stakeholders; being accountable for those actions; acknowledging that the good of others overrides any benefit to oneself; and acting ethically.

The adoption and promotion of these values within a governance framework provides confidence to the stakeholders of the GBE that its operations are aligned with its values and objectives, and that the relevant processes are in place to manage the GBE.

However, the multiplicity of often complex stakeholder relations to consider, and the dual purpose obligations of many GBEs, also demand a level of flexibility and definition which addresses the key principles of: clarity of commercial and non-commercial objectives; management autonomy and authority; strict accountability for performance; and competitive neutrality through being subject to the same rules as any other business¹.

Within the business realm, governance principles are clearly defined through interpretation of the Corporations Act and incorporation of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (the ASX Corporate Governance Council's guidelines). CSA notes that many state-owned corporations adopt the ASX Corporate Governance Council's guidelines to ensure sound practice in governance and as a measure of achieving commercial competitive neutrality.

However, good governance for GBEs also requires further attention to these principles as well as the GBE governance and oversight guidelines as set out in the discussion paper. In particular, GBEs require a closer attention to some of the unique and complex issues that define their governance frameworks, including:

- the identities and roles of the key stakeholders (for example, Shareholder Minister, chairman, directors, chief executive (or equivalent) etc))
- the powers vested in each stakeholder and the basis upon which such powers rest (for example, do the powers arise from legislation, the constitution or other authorising documents?)
- the reporting responsibilities of each stakeholder and the identity of the stakeholder to whom those reporting obligations are owed (for example, does the chief executive report to the board or to the Shareholder Minister directly?)

¹ Jolly, R. (2000), 'Government owned corporations: Public Ownership, Accountability and the Courts', *AIAL Forum*, No 24, 2000 at p 16

- whether the relationships between stakeholders are formally based in a performance agreement and the frequency of review of any performance agreement, its nature and attendance
- the function of the board (it is advisory or governing?)
- the extent of the board's decision-making powers, and
- as between the board and the Shareholder Minister, who
 - sets the strategic direction of the business
 - appoints the chairman of the board
 - appoints the chief executive or managing director
 - determines the remuneration of the board and CEO.²

Implicit in these observations is the acknowledgement that the specific processes which GBEs are required to address differs from corporate practice. For example, the Queensland Office of Government Owned Corporations issues the *Corporate Governance Guidelines for Government Owned Corporations*, which draws upon the ASX Corporate Governance Council's guidelines; the Auditor-General's Report No. 2 2002-2003 — *Review of Corporate Governance and Risk Management at Government Owned Corporations*; the Auditor-General's Report No. 10 2002-2003 — *Review of Management's Assessment of Fraud Control Risks and Associated Plans and Procedures*; the *OECD Principles of Corporate Governance*; and the Crime and Misconduct Commission (Qld) and Independent Commission Against Corruption (NSW) — *Managing Conflicts of Interest in the Public Sector — Guidelines and Toolkit*.

CSA would strongly recommend that the federal governance guidelines review and consider the various state-owned commercialised government entities' frameworks and look to ensure consistency and harmonisation across obligations, reporting and administration.

Aligning the ideals of the state and federal regimes also serves as reassurance to the public that resources are being efficiently run and managed, as variations between frameworks suggest inconsistencies and inefficiencies in process.

With this in mind, CSA believes that the discussion paper broadly provides a descriptive and flexible model of governance. As such, CSA does not seek to comment or address all the proposed changes, but rather, provides detailed discussion about specific points, which CSA believes could be amended to provide better consistency and impact and lead to sound governance practice within the federal regime.

Yours sincerely



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² Chartered Secretaries Australia, Good Governance Guide: Government businesses — governance arrangements, June 2009

1 Managing the GBE board

The specifics of board responsibilities and conduct

CSA notes paragraph 2.3 of the discussion paper which provides a summary of the fiduciary and other duties which directors are required to fully understand before accepting appointment to the board. Among these responsibilities are details concerning what could be loosely defined as 'independence'.

Within the corporate sphere, obligations relating to independence are specifically set out in the ASX Corporate Governance Council's guidelines. The notion of conflicts of interest is framed with reference to associations and materiality. However, in the GBE realm, this distinction is less well defined and the governance and oversight guidelines express only a reference to 'conflict of interest' matters.

CSA believes that the governance and oversight guidelines would benefit from incorporating more details in their exploration of matters dealing with the independence of directors, particularly as this is a key element of maintaining the transparency of the GBE. For example, CSA suggests that there be a requirement for a director's register of interests subject to annual review, or an expansion of the current direction about the practical implementation of s 27G of the CAC Act dealing with the standing notice of an interest.

Board tenure and composition

CSA agrees that the injection of fresh thinking and innovation inherent in the appointment of a new director can provide the GBE with the best chance of commercial development (within the context of its need to provide the requisite non-financial public good or service). However, CSA also notes that in some instances there needs to be consideration given to the retention of knowledgeable and experienced directors who can provide significant value to GBE operations.

CSA notes that the guidelines propose board tenure of a maximum of six years for a director. The comments provided in paragraph 2.5.5 of the discussion paper suggest that longer tenures should only be available where there are highly specialised markets and difficulties in attracting suitably qualified candidates, and that this scenario is not relevant in the Australian situation.

However, CSA does not agree with this conclusion. CSA is of the view that board renewal, with its attendant issue of board tenure, is best left to the board itself, as boards are best placed to take into account the financial and operational circumstances of the company, which over time may demand different skills in directors. A board is best placed to undertake a skills gap analysis and board matrix setting out the required skills at any particular time and to assess the length of time for director service to ensure that the director's term adds value to the GBE. It may be that a particular director could add value to the GBE by serving on the board for longer than six years and the board is best placed to form a view on this issue.

CSA recommends that further flexibility be embedded within the guidelines to enable GBEs to make considered determinations as to board tenure relevant to their specific operational needs. These may be necessitated by particular circumstances, operating environments, or regulatory control processes. For example, electricity network providers are subject to regulatory determination of allowed fees or revenues, with a major submission to be made once every five years to the external regulatory body in order to continue operations. These submissions require in-depth experience and a detailed understanding of the business. The restriction on the tenure of board directors would, in that instance, restrict the passing of knowledge developed through the submission process as directors may only be present for one cycle of the submission process.

The increase in workload required of new directors in developing the requisite knowledge to build and develop those submissions would use up valuable resources of both the director and the GBE. For reasons such as this, CSA does not believe that limits on the number of terms allowed supports the specific governance requirements of particular GBE services.

CSA also notes that in the listed company sector, ensuring a suitable mix of directors with experience of the business and those bringing fresh ideas and perspectives to board decision-making is dealt with through the ASX Listing Rules requirement that directors of public listed companies submit themselves to re-election at the annual general meeting of shareholders every three years (Listing Rule 14.4). Rather than setting fixed three-year terms, CSA is of the view that the GBE governance guidelines could require the board to:

- disclose its board renewal policy to the Shareholding Minister, and
- subject director reappointments to scrutiny by the Shareholding Minister at three-year intervals, thus providing the board with the opportunity to explain to the Shareholding Minister why a particular director should be reappointed after more than two three-year terms, should the board have determined that the individual director continues to add value.

CSA also notes that paragraph 2.9 provides that: ‘The Shareholder Minister(s) may elect to appoint a candidate not proposed by the Committee Chair.’

CSA also has reservations about this, as we are of the view that it is a poor governance outcome for the Shareholder Minister to be able to appoint a candidate who may not have the appropriate skill set required by the board, and who may be appointed for political purposes rather than fit for purpose reasons.

CSA understands that the government wishes to ensure that its interests are represented. However, CSA is of the view that a better governance outcome is assured if any candidate proposed by the Shareholder Minister is discussed with the chair of the board, so that the candidate’s skills and experience can be evaluated within the context of the skills gap analysis undertaken by the board.

Recommendation 1: That paragraph 2.13 be amended to require the GBE to disclose their Board appointment and renewal policy to remove the restriction on the tenure of directors and implement a requirement for the GBE to:

- disclose the board renewal policy, and
- subject director reappointments to scrutiny by the Shareholding Minister at three-year intervals.

Recommendation 2: That paragraph 2.9 be amended to state that the ‘The Shareholder Minister(s) may elect to appoint a candidate not proposed by the Committee Chair, subject to discussion of the recommended candidate with the Committee Chair’.

Acting in the best interests of the GBE

One of the key components of a directorship lies in the ability of an officer of a company to be able to exercise their due care, skill and diligence in the best interests of the organisation. For a GBE, this fiduciary duty is central to the adoption of the corporate form as the means of achieving government policy. The corporate form is intended to provide a separation between government and the enterprises it creates, to distance government and allow management of the enterprise to focus on the business of the particular enterprise.

CSA holds reservations with respect to the potential for interference which is allowed by paragraph 2.15, in particular, paragraph 2.15b which allows for the unfettered removal of a director who 'embarrasses' the Shareholder Minister or GBE.

While there will be legitimate conditions under which this power should be exercised, the ambit of the discretion being provided to the Shareholder Minister in the opening sentence of paragraph 2.15 allows for the dismissal of a director who is acting in the best interests of the GBE, but not the Shareholder Minister.

CSA suggests that this situation is not an example of best practice governance and that it would likely affect the quality of candidates who would consider becoming a director for a GBE. CSA is of the view that disclosure is the best means of ensuring that there is transparency and accountability in relation to the dismissal of a director. CSA therefore recommends that the dismissal of a director by the Shareholder Minister should be subject to a requirement to disclose the reasons for the dismissal.

Recommendation 2: That paragraph 2.15 be amended to require the Shareholder Minister to disclose their reasons for dismissal of a director.

Board induction, training and evaluation

CSA believes that flexibility within the guidelines should be demonstrated in the evaluation and review measures implemented with respect to board performance. CSA notes the application of paragraphs 2.17 and 2.18 and is of the view that further flexibility be written into the proposed controls to allow for the diversity of review and assessment procedures that GBEs may seek to implement.

CSA notes that many GBEs adopt different review regimes in assessing the performance of their directors. It is not uncommon, therefore, for annual assessments to be fairly straightforward and efficient processes, where appropriate, which may involve an interview between the chair and a particular director or the board filling out a questionnaire that is then assessed by the chair. The resulting statement confirms the director's satisfactory performance, and the board as whole is then assessed against predetermined performance targets which might include attendance at meetings, or involvement in various board committees. The GBE may also engage an external consultant to facilitate a board evaluation on a less frequent basis which provides in-depth feedback and a thorough review of board performance.

CSA notes that the ASX Corporate Governance Council's guidelines require, in Recommendation 2.5, that: 'Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.' The commentary providing guidance on this Recommendation states that: 'The performance of the board should be reviewed regularly against appropriate measures.'

That is, the Council's guidelines do not specify either the measures that are to be utilised in the board review, or the exact periods in which board reviews should take place, but do require disclosure of the board evaluation process undertaken. CSA agrees with the approach taken in the Council's guidelines, which provides flexibility to boards to decide the best process and timeframe for its board evaluations, subject to disclosure to shareholders as to the board's decision-making.

CSA strongly advocates for reporting flexibility for GBEs and harmonisation with the state regimes, which often require the corporate governance section of the GBE's annual report to disclose the details of board evaluation processes, that is, what evaluation has occurred during

the particular reporting period, and how the review was conducted. CSA believes that this approach would better support good governance procedures and also align the governance guidelines with the ASX Corporate Governance Council guidelines on board evaluation.

Recommendation 3: That paragraphs 2.17 and 2.18 be amended to provide that the boards of GBEs disclose the details of whether a performance evaluation for the board, its committees and directors has taken place in the reporting period and whether it was in accordance with the process disclosed.

2 Planning and reporting

Corporate plans and annual reports

Disclosure from the board of the GBE to the Shareholder Minister is an important stakeholder relationship which is unique to GBE operations. There should be strong communications lines established which recognise the areas of responsibility and the timely delivery of information.

CSA notes that it is often the case that there is disclosure occurring to the Shareholder Minister on an ongoing basis, particularly during the relevant reporting periods detailed in the 'Best Practice' timetable. This requirement is, in most instances, above and beyond the requirements of continuous disclosure applicable to the corporate sector.

CSA Members have noted, however, that across the state regimes, timings for the delivery of GBE reports and dividends varies. For example, regulation 49 of the *Government Owned Corporations Regulation 2004* (Qld) states:

- (1) An annual report of a GOC or prescribed GOC subsidiary must be given in paper form to its shareholding Ministers within the period starting immediately after the end of the financial year to which the report relates and ending on 15 September (the preparation period).

CSA notes that the 'Best Practice Timetable for GBE Reports and Dividends' requires submission of the annual report by 1 September of each year to the Shareholder Minister.

While discrepancies in timetabling and reporting are unlikely to have a disastrous impacts on the processes of the GBE, CSA would again highlight the importance of establishing better consistency and harmonisation across the state and federal regimes.

CSA is strongly of the view that recommendations which exemplify the flexibility embodied in the state regimes provide better governance outcomes, because the GBE is able to demonstrate transparency and accountability measures which are tuned to the size and scope of the business activities and their internal and external environment.

Weighted Average Cost of Capital (WACC)

As a specific example of the need for flexibility, the requirements on WACC and financial targets provides demonstration that the needs of each individual GBE should be taken into account.

While WACC has traditionally been a commercial tool for evaluating financial targets in non-government organisations, the cost of capital poses unique problems for GBEs. This complexity is embodied by understanding the diversity of industry and capital requirements which some GBEs must consider. For example, the GBE's interaction with its relevant external regulator will often require that capital be contrasted with their public obligations. This might include the

provision of goods or services in remote areas which otherwise would not have adequate access to resources, but which commercially represents a capital loss.

CSA believes that reporting in this regard needs to account for public obligations which are above and beyond simple commercial decision-making, that is, the obligations created in paragraph 4.8 which detail goods and service efficiency and competitive neutrality.

In considering WACC, CSA would advocate that the idea of adding shareholder value to the GBE's operations be construed broadly with financial and public targets incorporated into the considerations. Whereas a GBE would be considered to have not achieved the minimum return acceptable to the shareholder upon not reaching the WACC target, flexibility in the reporting provisions should be expanded to consider the achievement of a relevant principal with other financial targets over the medium term.