



CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

30 July 2010

The Honourable Colin Barnett
Premier; Treasurer; Minister for State Development
Government of Western Australia
24th Floor
Governor Stirling Tower
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PERTH WA 6000

By email: wa-government@dpc.wa.gov.au

Dear Mr Barnett

***Putting the Public First: Partnering with
the Community and Business to Deliver Outcomes:
Final Report of the
Economic Audit Committee***

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance in Australia. 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.

Background

CSA commends the Western Australian Government for commissioning the Economic Audit Committee report (EACR) to provide recommendations on ongoing improvement in the outcomes achieved by the Western Australian public sector. CSA provides governance education for the public sector through our Graduate Diploma of Applied Corporate Governance. It is a postgraduate program, fully accredited by all relevant higher education authorities, providing comprehensive knowledge and skills in the essential elements of good governance principles. It is the industry standard qualification that provides a platform for a senior career in governance and it contains specialist public sector modules.

Due to our leadership role in governance education for the public sector, and our ongoing mission of promoting and advancing the effective governance and administration of organisations in the private and public sectors through the continued development and application of governance and administrative best practice, we are writing to offer some

comments on the recommendations of the EACR that refer to government trading enterprises (GTEs), specifically in chapter five of the report.

Our knowledge of governance frameworks in GTEs has been enhanced by the inaugural survey that we undertook in 2009 of governance practice in Australian government commercialised entities, that is, government-owned corporations (GOCs), government business enterprises (GBEs), state-owned corporations (SOCs) and GTEs. The high levels of public accountability that apply to GTEs as a result of their public ownership make their corporate governance very important. Entities at both the Commonwealth and State levels were surveyed. There was a 66 per cent response rate. I have attached a copy of the survey report for your reference.

Comments on the recommendations in the EAR

Recommendation 28: Introduce umbrella legislation to:

- **standardise, strengthen and clarify governance arrangements for all GTEs; and**
- **establish a remuneration policy for GTE board members and their executives, administered by the Salaries and Allowances Tribunal**

Standardise governance arrangements

CSA welcomes the recommendation to standardise and clarify governance arrangements for all GTEs. The main finding of our survey of governance practice in Australian commercialised government entities is that adoption of the corporate form has not resulted in the clarity that this form is intended to provide in relation to the roles of the various parties in the governance framework, that is, the shareholder (government); the board of directors (governing body); and management.

Representatives of the owner on boards and role of Minister in dismissing the CEO

In relation to the recommendation that any umbrella legislation for GTE governance should address the creation of legal rights for government to include a representative on the board to represent the owner; and remove any board member (including the managing director) where it is warranted under the circumstances, CSA notes that:

- The existing statutory framework that applies to many GTEs in Western Australia already provides for directors to be appointed by the Governor on recommendation of the responsible Minister. Given the framework, the Government is already in a position to appoint a representative on the boards of its GTEs. Having made that observation, however, having such stakeholder representatives on boards can conflict with good governance outcomes, as all directors have a fiduciary duty to act in the best interests of the company. Such interests may not always align with those of the stakeholder group they are representing. This creates conflicts of interest, requiring such directors to leave the boardroom during discussions and decision making relating to their stakeholder group.
- A central role of any board of directors is to appoint, monitor and, if necessary, dismiss the chief executive officer (CEO). CSA notes that all GTEs have a CEO who is not necessarily a managing director. The CEO may be appointed as a managing director, but it is also possible that the board is comprised solely of non-executive directors. CSA understands that it is common practice that the Minister (Government) has the capacity to dismiss the CEO *in his or her capacity as a managing director* (executive director), but it would be a very poor governance outcome for the Minister to usurp the board's role and have the capacity to dismiss the CEO if that CEO is not the managing director. CSA observes that the existing legislative framework that applies to many GTEs in Western Australia already empowers the Governor to remove any director, including the Managing Director, without giving reasons.

The role of the shareholder Minister in approving finance for GTE investment

In relation to the recommendation that any umbrella legislation should formally set out, in the legislation and associated regulations, the role of the shareholder Minister and wider government in approving financing for a GTE's planned investment, CSA notes that a central role of the board is to have oversight of the strategic direction of the company, including its investment decisions.

CSA is of the view that it is extremely important to differentiate between the Government's role in approving any funding for investment decisions of GTEs and approving investment decisions of GTEs. Any governance framework needs to provide for the board to be free to make its investment decisions without Treasury approval, as this is part of its fiduciary duty to act in the best interests of the company. CSA is very strongly of the view that it is not for Treasury to second-guess the commercial decisions of a board. For example, CSA notes that in the private sector a financing institution would not be involved in approving an investment decision as this could place the financier in the role of shadow director.

CSA notes that checks and balances already exist, with many GTEs required to seek the Minister's approval for transactions above a certain amount, which provides for the opportunity for the Minister to assess the due diligence undertaken by the board. This could be standardised across the sector.

Establish a remuneration policy for GTE board members and their executives, administered by the Salaries and Allowances Tribunal

CSA notes that there is a distinction between board member remuneration and executive remuneration which is somewhat blurred in this recommendation. There is a clear role for the Government to play in being involved in non-executive director remuneration, which should be subject to shareholder approval (as it is in the private sector). However, CSA is strongly of the view that directors should have the responsibility to determine executive remuneration, as boards are best placed to take into account the financial and operational circumstances of the company, which may shift year to year, when assessing remuneration structures. That is, CSA is of the view that boards should retain the discretion to determine the quantum, short-term incentives, long-term incentives, performance hurdles and other parameters used in determining remuneration structures. Equally, CSA believes boards should have accountability to the Government shareholder for those decisions.

CSA also notes that the industry expertise and market knowledge for which non-executive directors are sought by the Government to sit on GTE boards cannot be assumed to be found on the Salaries and Allowances Tribunal (SAT). The SAT has knowledge of remuneration within the markets it controls and understands but will not be as knowledgeable of private sector remuneration frameworks, which are applicable to executive remuneration within GTEs, given the movement of personnel from the private sector in relation to these corporatised entities.

CSA is of the view that the SAT can add value and assist boards as requested or appropriate, but is equally of the view that it is not appropriate for the SAT to be determining executive remuneration when it lacks knowledge of the financial and operational circumstances of the company and cannot assess how to leverage remuneration in order to drive company performance. For example, in the private sector, boards seek advice from remuneration consultants but the ultimate decisions concerning remuneration rest with the board of directors.

CSA therefore recommends that it is appropriate for the SAT to review the process of setting remuneration in GTEs, but it should not be involved in setting the quantum of executive remuneration.

On the issue of non-executive director remuneration, while CSA supports the governance process of such remuneration being subject to government approval, CSA also notes that the Government seeks to attract senior people on private sector boards to sit on GTE boards. This in turn raises questions about the capacity of the SAT to make sufficiently informed decisions concerning non-executive director remuneration. CSA recommends that the GTE board itself is probably best placed to set the quantum of non-executive director remuneration, with the SAT reviewing the process undertaken by the board on behalf of the government.

Recommendation 29: Establish a Government Trading Enterprises advisory and monitoring unit

CSA welcomes the recommendation to establish a GTE advisory and monitoring unit. CSA is of the view that such a unit develops expertise in and knowledge of the particular context in which GTEs operate, and the development of this expertise should provide opportunities for significant improvements in the governance frameworks applying to GTEs. In particular, CSA is of the view that such a unit can assist in developing understanding within government of the respective roles of the government shareholder, the board of directors and executive management, which is central to a good governance framework.

CSA notes that at least one other state has a dedicated government-owned corporation unit and that it has proved to add value.

Developing, in consultation with shareholder Ministers, selection criteria for board members, maintaining a pool of suitably qualified potential candidates for board membership and undertaking board performance reviews

CSA believes that such a unit could provide guidance and better practice facilitation to a number of corporatised entities. However, CSA notes that any such unit's role should be confined to guidance and advice and should not usurp the role of the board of a GTE.

CSA also sees a strong role for such a unit in identifying a pool of potential directors for GTEs, but strongly recommends that determining the selection criteria for board composition should remain a matter for the board. Only the board is sufficiently informed as to the necessary and desirable competencies of any directors it is seeking to add value to the performance of the GTE.

Not only board succession plans, but also decisions concerning the form of board evaluations should also sit with the board. Such reviews provide the opportunity for boards to identify the skills they need. Having a government unit control the composition of the board and board evaluations means that there is potential for the government to mistake the governing role of the boards of GTEs as an advisory role.

Recommendation 30: Review Government Trading Enterprises (GTEs) to ensure that the governance and ownership of each business is appropriate for delivering Government's policy objectives

CSA welcomes the recommendation that GTEs be reviewed to ensure that the governance and ownership of each corporatised entity is appropriate for delivering the government's policy objectives.

In our attached research report we note that the corporate form was chosen for GTEs as it best provides a separation on an 'arms-length' basis 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. Yet our report asks whether there is a sufficient break between government and the entity it creates.

The key governance issues that need to be considered in order to understand if a governance framework is in place for a GTE are as follows:

- the identities and roles of the key stakeholders (for example, board of directors, members, executive management)
- the powers vested in each stakeholder and the basis on which such powers rest (for example, do the powers arise from legislation, the constitution or other authorising document?)
- the reporting responsibilities of each stakeholder and the identity of the stakeholder to whom those reporting obligations are owed (for example, the chief executive reports to the board, the board reports to the shareholding Ministers)
- the extent of the board's decision-making powers, the members' decision-making powers, and executive management's decision-making powers.

Reflecting on these, some of the questions that arise are as follows.

- Are the boards of commercialised government entities able to act as governing boards, with full power to act in the best interests of each company to achieve economic efficiency?
- Are the role and functions of boards ambiguous, in that their roles, functions, responsibilities and public accountability may overlap with those of Ministers?

If the identities and roles of the key stakeholders are confused, then the governance framework is in question and it is difficult to see how the corporate form can provide the economic advantage it is meant to.

Conclusion

CSA's mission is to promote and advance the effective governance and administration of organisations in the private and public sectors through the continued development and application of governance and administrative best practice.

Our comments in this letter are tendered with a view to contributing to the ongoing improvement of governance in a key part of the public sector, that is, GTEs.

In preparing this letter, CSA has drawn in particular on the experiences of its Members, including those working in GTEs.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

cc Timothy Marney (Administrative Chair), on behalf of the Economic Audit Committee