

INTRODUCTION

Background

- 1.1 On 12 May 1999, the Joint Committee of Public Accounts and Audit (the Committee) resolved to conduct an inquiry into corporate governance and accountability arrangements for Commonwealth government business enterprises.
- 1.2 In December 1996, the then Minister for Finance, the Hon John Fahey, MP, requested Mr Richard Humphry, AO, to conduct an internal review of the governance arrangements for Commonwealth GBEs. In June 1997, the review report entitled, *Review of GBE Governance Arrangements* (the Humphry Report) was released.
- 1.3 The Humphry Report suggested that an appropriate framework for government business enterprises (GBEs) should be one where GBEs:
 - add to shareholder value;
 - are subject to normal business constraints and risks;
 - receive no competitive advantage from public sector ownership; and
 - adhere to the principles embodied in the Corporations Law and the *Listing Rules* for public companies.¹
- 1.4 One of the guiding principles influencing the findings and recommendations in the Humphry Report was the view that an adequate governance framework already exists. This includes the body of law applying to publicly listed companies and the business regulators such as the Australian Securities Commission, and the Australian Competition

¹ Humphry, R., *Review of GBE Governance Arrangements*, March 1997, p. 3.

and Consumer Commission. Humphry concluded that the 'GBE arrangements do not need to duplicate this existing commercial environment but should only enhance it, where necessary, to meet specific Government accountability requirements given its status as the 100% or at least substantial shareholder in these bodies.'²

- 1.5 Humphry made 27 recommendations seeking to improve governance arrangements for GBEs. A key proposal was the joint Ministerial shareholder model for overseeing the performance and accountability of GBEs. Under this arrangement the Minister for Finance would be responsible for focusing on financial performance of GBEs and the portfolio Minister would focus on non-financial aspects of GBE performance.³
- 1.6 In June 1997, the then Minister for Finance, the Hon John Fahey, MP, indicated that the Government had adopted most of the key recommendations in the Humphry Report.⁴ At the same time, Mr Fahey announced that new governance arrangements for Commonwealth GBEs would take effect from 1 July 1997. The new governance arrangements focused on reporting arrangements, the appointment and removal of board directors, board responsibilities, financial governance arrangements, and other matters relating to workplace relations, superannuation, partly owned GBEs and arrangements for GBEs being sold or restructured.
- 1.7 In March 1998, the Committee renewed its interest in corporate governance issues by receiving a private briefing from Mr Humphry on the matters raised in his report. The Committee had previously examined issues relating to GBEs in *Report 336, Public Business in the Public Interest*.⁵

Reasons for the inquiry

- 1.8 Effective corporate governance is an essential part of the modern corporate entity. Public and private sector organisations will ultimately be judged by how well they direct, control and deliver their corporate objectives. Public sector entities must also account to Parliament for their activities. Corporate failures during the 1980s and early 1990s, in

2 Humphry, R., *Review of GBE Governance Arrangements*, March 1997, p. 3.

3 Humphry, R., *Review of GBE Governance Arrangements*, March 1997, p. 22.

4 The Hon John Fahey, MP, Minister for Finance, *Government Business Enterprises – New Governance Arrangement, Media Release*, Canberra, 30 June 1997.

5 Joint Committee of Public Accounts, Report 336, *Public Business in the Public Interest, An Inquiry into Commercialisation in the Commonwealth Public Sector*, Canberra, AGPS, 1995.

particular, brought to the attention of the public the need for efficient, effective and responsible corporate governance. Shareholders and governments have had to pay dearly in cases where corporate entities have failed to apply effective corporate governance and accountability arrangements.

1.9 Further interest in corporate governance has been generated through the onset of the Asian financial crisis. Poor corporate governance, in the public and private sectors, is considered to be a contributor to the financial decline of some South East Asian economies during 1997. The issue of corporate governance was given prominence at the Asia Pacific Economic Cooperation (APEC) Finance Ministers Conference in Langkawi, Malaysia on 15–16 May 1999. Ministers endorsed the recommendations in the report, *Strengthening Corporate Governance in the APEC Region*.⁶ The recommendations focused on:

- safeguarding shareholder rights;
- increasing board independence and director training;
- encouraging shareholder activism; and
- the adoption of high quality accounting and auditing standards.

1.10 The focus on corporate governance is not just driven by the corporate failures of the past but also by the corporate challenges of the future. Corporations, both public and private, face challenges relating to globalisation, technological change and sustainable development.⁷ For example, the growing use of internet communications as a means of commerce is creating new opportunities and challenges for commercial entities.

1.11 From the perspective of the Australian Government, Commonwealth GBEs accounted for approximately 24.5% of the Commonwealth's total assets in 1998–99. The Department of Finance and Administration (DoFA), reported that in 1998–99, GBEs generated revenues of nearly \$25 billion, provided dividends of \$4.5 billion, and controlled assets of some \$40 billion. Given that GBEs are publicly controlled entities, the Parliament has a continuing interest in their governance, performance and accountability. GBE directors and Ministers responsible for GBEs are ultimately accountable to the Parliament for the strategic direction and performance of these business enterprises.

6 APEC: The Core Group of the Corporate Governance Initiative, Draft Report to APEC Finance Ministers, *Strengthening Corporate Governance in the APEC Region*, May 1999.

7 Mr I.T. Dunlop, CEO, Australian Institute of Company Directors, *Address to IIR Conference on Corporate Governance*, Sydney, 7 June 1999.

- 1.12 The range of services that Commonwealth GBEs provide to the Australian community includes communications, transport, employment and health services. DoFA commented that the performance of Commonwealth GBEs is 'critical, both from a public policy point of view and to the goal of achieving sustainable government finances.'⁸ Therefore, the method and effectiveness by which Commonwealth GBEs are directed, controlled and held to account is of particular importance to the Committee.
- 1.13 Possible confusion over the allocation of responsibility and accountability provisions applying to GBEs can be more of a problem than in the private sector. This is because Commonwealth GBEs work under the umbrella of the sometimes complicated relationships between Parliament, Ministers, Boards and CEOs. The Australian National Audit Office (ANAO) stated:
- ...Commonwealth authorities and companies have to satisfy a more complex range of political, economic and social objectives, and operate according to a quite different set of external constraints and influences than do private sector businesses. In addition, the former are subject to expectations and forms of accountability to their various stakeholders, who are more diverse and likely to be more contradictory in their demands than those of, say, a private sector corporation.⁹
- 1.14 The threat of corporate failure, an increasingly competitive environment, and the special responsibility and accountability arrangements applying to Commonwealth GBEs provide sufficient reasons to examine the corporate governance of Commonwealth GBEs.

Objectives, scope and focus

- 1.15 In view of the issues discussed above, the Committee has decided to review aspects of, and ask questions about, corporate governance and accountability arrangements applying to Commonwealth GBEs. The Committee commenced this inquiry about two years after the Government introduced new *Governance Arrangements for Commonwealth Government Business Enterprises* in June 1997. The broad objective of the inquiry is to assess the appropriateness and effectiveness of these arrangements.
- 1.16 The Committee wrote to all GBEs, relevant portfolio agencies, and a range of industry organisations seeking views on the governance arrangements. In addition, the majority of GBEs and portfolio agencies were questioned
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⁸ Ms Megan Coombs, Department of Finance and Administration, *Transcript*, p. 85.

⁹ Australian National Audit Office, Principles and Better Practices, *Corporate Governance in Commonwealth Authorities and Companies, Discussion Paper*, 1999, p. 4.

about corporate governance arrangements at public hearings. This process provided reasonable scope to examine a broad range of issues. These issues, reflected in the chapter outline, are discussed briefly in the sections that follow. Within each of these sections, the Committee identifies the objectives it sought to achieve.

The governance framework

- 1.17 The governance framework consists of the *Governance Arrangements for Commonwealth Government Business Enterprises*, Corporations Law, the *Commonwealth Authorities and Companies Act 1997* (the CAC Act), and relevant enabling legislation of individual GBEs such as the *Australian Postal Corporation Act 1989*. The ANAO commented that the 'current framework is quite robust and seems to be working quite well from our perspective.'¹⁰ Some groups, however, suggested that in view of market pressures, GBEs should simply be subject to Corporations Law. The Committee has sought to assess the effectiveness of the governance framework from the perspective of flexibility, reporting and accountability requirements.

Shareholder Ministers

- 1.18 The Commonwealth's ownership interests in GBEs are represented, in most cases, by two Shareholder Ministers, the portfolio Minister and the Minister for Finance and Administration. A key objective for the Committee is to test whether the joint shareholder arrangement is working effectively or whether a single shareholder Minister or some other arrangement is preferable.
- 1.19 Other matters that were examined include the quality of scrutiny and oversight by shareholder departments. The Committee's objective was to test whether shareholder departments have the necessary skills and financial expertise to assess GBE management strategy and performance.

Boards

- 1.20 Boards are a key part of the governance process. Boards of GBEs are responsible for governing and holding to account the CEO and management. In turn, Boards are responsible to relevant Ministers. The assessment and monitoring of Board performance is gaining more prominence. The Committee's objectives include examination of some aspects of selection and appointment, induction and training and, in particular, performance appraisal of boards and individual directors.

¹⁰ Mr Ian McPhee, Australian National Audit Office, *Transcript*, p. 28.

Reporting and accountability

- 1.21 The fact that GBEs are government entities, and have responsibilities to Ministers, the Parliament and the public, draws attention to the adequacy of the reporting and accountability arrangements. The Committee's objective is to assess the appropriateness of reporting and accountability arrangements. In particular, the Committee assesses claims that there is excessive Parliamentary scrutiny, namely the use of Senate Estimates to scrutinise financial aspects of performance. Some GBEs claim that the Senate Estimates process has the potential to compromise GBE corporate strategy through the release of commercially sensitive information.

Risk management

- 1.22 Risk management is the responsibility of the GBE board. Boards, with the support of relevant internal committees and management, are responsible for identifying key risks and developing appropriate management strategies to deal with those risks. The Committee's objective is to assess the adequacy of risk management arrangements, the use of internal audit committees, and the use of external risk review as additional mechanisms for managing risk.

Corporate governance

- 1.23 The focus on corporate governance in recent years has led to a number of statements which seek to explain corporate governance. Some relevant statements include:
- *Corporate governance is not about power, it is about finding ways to ensure that decisions are made effectively.*
 - *Monitoring and control mechanisms put in place with the objective of enhancing shareholder value.*
 - *The way corporate entities are governed, as distinct from the way they are managed.*
 - *Corporate governance is nothing more, nor less, than the system each country, or culture if you will, develops to balance the need for managerial risk-taking, entrepreneurial energy, and high capability, with the need for some form of monitoring.¹¹*

11 Blake Dawson Waldron, *Submission*, p. 141.

- 1.24 Some of the key themes that are evident from these statements include the focus on decision making, accountability, risk management, and monitoring and control. The ANAO has arrived at a definition of corporate governance which draws attention to the special circumstances of CAC bodies:

...corporate governance generally refers to the process by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organisation. For CAC bodies, key elements of corporate governance include transparency of corporate structures and operations; the implementation of effective risk management and internal control systems; the accountability of the Board to stakeholders through, for example, clear and timely disclosure; and responsibility to society.¹²

- 1.25 The Committee will draw on the various themes arising from these key statements as issues to be considered in this report.

Commonwealth GBEs

- 1.26 A government business enterprise (GBE) is a Commonwealth **authority** or **company** that is prescribed by the regulations under the *CAC Act*.

- A Commonwealth **authority** is a body corporate that is incorporated for a public purpose and holds money on its own account.
- A Commonwealth **company** is a Corporations Law company in which the Commonwealth has a controlling interest.

- 1.27 In general, GBEs should satisfy three criteria:

- they are commercial;
- they trade outside the public sector; and
- they are not primarily regulatory bodies.

Commonwealth GBEs by company and authority status

- 1.28 There are currently 14 GBEs. The ANAO indicated that the 'number of GBEs has decreased over the last few years, due largely to the privatisation policies of successive governments.'¹³ In 1995 there were 20

12 Australian National Audit Office, Principles and Better Practices, *Corporate Governance in Commonwealth Authorities and Companies, Discussion Paper*, 1999, p. 1.

13 Australian National Audit Office, *Submission*, p. S6.

GBEs, including Qantas, and the Commonwealth Bank which have been sold.

1.29 Most of the current GBEs are companies, reflecting a trend over recent years. Of the 14 GBEs, 10 are companies, two are being corporatised and two will remain statutory authorities. By comparison, in 1995, 11 of the 20 GBEs were statutory authorities.

1.30 The current GBEs, listed by portfolio with additional information as provided by DoFA, are as follows :

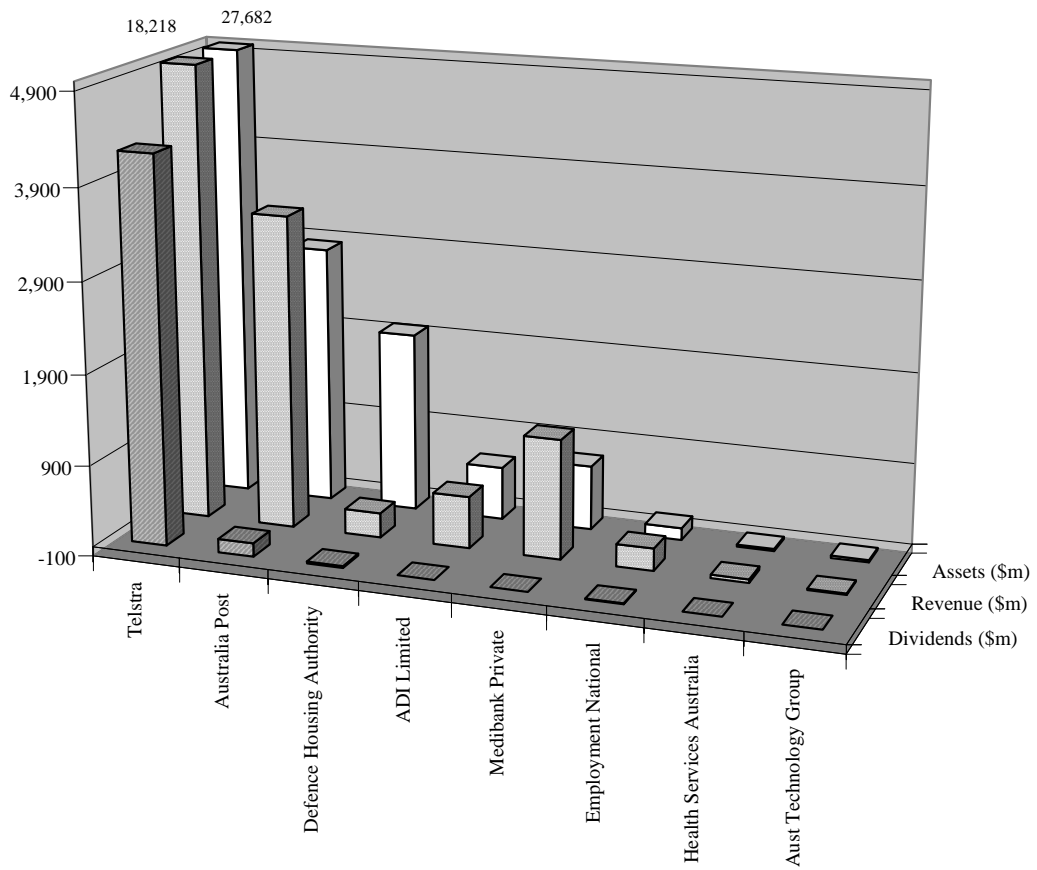
Portfolio	Company	Authority
Communications, Information Technology and the Arts	Telstra Corporation Limited ^{SP PP}	Australia Post (in the process of establishing as a company)
Defence	ADI Limited ^{SP}	Defence Housing Authority
Health and Aged Care	(a) Health Services Australia Limited (b) Medibank Private Limited	
Industry, Science and Resources	Australian Technology Group Limited ^{PP}	Snowy Mountains Hydro-Electric Authority ^{CC} (in process of corporatisation and dilution of Commonwealth ownership)
Transport and Regional Services	(a) Sydney Airports Corporation Limited ^{SS} (b) Essendon Airport Corporation Limited ^{SS} (c) Australian Rail Track Corporation Limited ^{CL}	
Employment, Workplace Relations and Small Business	Employment National Limited ^{SS}	
Attorney-General's		Australian Government Solicitor
Finance and Administration	Comland Ltd	

Notes

- PP partially privatised
- SS Minister for Finance and Administration sole shareholder
- SP subject to sale processes
- CC controlled by the Commonwealth for the interim – jointly owned with some States

1.31 The following graph and table (Figure 1.1) represents financial data for GBEs over the 1998-1999 financial period.

Figure 1.1 GBE Financial Data 1998-99



	Telstra	Australia Post	Defence Housing Authority	ADI Limited	Medibank Private	Employment National	Health Services Australia	Aust Technology Group
■ Dividends (\$m)	4,247	149	22	0	0	8	1.3	0
▣ Revenue (\$m)	18,218	3,449	271	572	1,313	247	38	16
□ Assets (\$m)	27,682	2,854	1,982	583	711	134	24	25

* not for profit organisation

(Source: Figures provided by DoFA)

Conduct of the inquiry

- 1.32 On 21 and 22 May 1999, the Committee advertised, in the *Weekend Australian* and the *Australian Financial Review*, terms of reference for an inquiry into corporate governance and accountability arrangements for Commonwealth GBEs and invited submissions from interested individuals and organisations. In addition, GBEs and portfolio agencies were requested to provide submissions addressing the terms of reference. The terms of reference were also sent to a range of industry organisations.
- 1.33 As with all inquiries in recent times, the terms of reference and other information about the inquiry were advertised on the Committee's internet homepage at:
- <http://www.aph.gov.au/house/committee/jpaa/index.htm>
- 1.34 Over 20 submissions were received which are listed at Appendix A. The Committee also received five exhibits which are listed at Appendix B.
- 1.35 Evidence was taken at public hearings held in Canberra and Melbourne during August, September and October 1999. A list of witnesses appearing at the hearings can be found at Appendix C.
- 1.36 Copies of the transcripts of evidence from the public hearings and the volume of submissions are available from the Committee secretariat and for inspection at the National Library of Australia. The transcripts of evidence are also available on the Hansard website at:
- <http://www.aph.gov.au/hansard/joint/commtee/comjoint.htm>

Report structure

- 1.37 The report structure reflects the key inquiry objectives. Chapter Two focuses on the appropriateness of the governance framework.
- 1.38 Chapter Three examines the existing model for shareholder control and the responsibilities of shareholder Ministers. In particular, this chapter will assess the adequacy of DoFA and other portfolio agencies in scrutinising and examining the performance of GBEs.
- 1.39 The fourth chapter links closely to the matters raised in Chapter Three by examining the responsibilities of GBE boards. A key part of this chapter is an assessment of performance appraisal systems for boards and individual board directors.

- 1.40 Chapter Five examines reporting and accountability arrangements applying to GBEs. A feature of this chapter is a review of the appropriateness of the Senate Estimates process in reviewing GBEs.
- 1.41 The final chapter addresses risk management and the obligations of boards in identifying risk and developing appropriate strategies to deal with risk. In addition, the use of internal audit and external risk review will be examined.