AUSTRALIAN RAIL TRACK CORPORATION LTD

21 March 2014

Mr David Brunoro
Committee Secretary
Joint Standing Committee of Public Accounts and Audit
House of Representatives
PO Box 6021
Parliament House
Canberra ACT 2600

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Dear Sir,

Public Governance, Performance and Accountability Rule 2014

1. Medibank Private Limited (***Medibank***), Australian Rail Track Corporation Limited (***ARTC***) and ASC Pty Ltd (***ASC***) welcome the opportunity to make a joint submission to the Joint Committee of Public Accounts and Audit (***Committee***) in the matter of the proposed Public Governance, Performance and Accountability Rule 2014 (***Rule***).

Modification to section 28 of the proposed Rule

2. Medibank, ARTC and ARC request that the Committee take steps to ensure that before the Rule comes into effect, section 28 thereof is amended so that paragraph 17(5)(a) of the Rule does not apply to a wholly-owned Commonwealth company that is declared to be a GBE. We set out below our reasons for recommending this amendment.

3. Section 17 imposes requirements with respect to audit committees. While it is expressed to apply in respect of "Commonwealth entities", section 28 requires that it also be adhered to by wholly-owned Commonwealth companies, and as though any reference in that provision to an "accountable authority" were a reference to the "governing body of the company".

4. The governing body of a company is its board of directors, and the prohibition expressed in paragraph 17(5)(a) of the Rule would, in application to a Commonwealth company, prevent the "head (however described) of the accountable authority" – which is to say, its Chair – from being a *member* of the company's audit committee.

Reasons for modifying section 28

The prohibition is unnecessarily restrictive

5. The prohibition on the Chair of the board sitting as a member of the audit committee is inconsistent with other widely adopted corporate governance standards. Two relevant examples, discussed in further detail below, are the standards issued by the ASX Corporate Governance Council and the standards issued by Private Health Insurance Administration Council. We query the necessity and desirability of creating an inconsistent standard to these commercial standards.

6. The highest standards that Medibank, ARTC and ASC are aware of applying in respect of Australian companies are such that the Chair of a company is prohibited from being the Chair of its audit committee *but permit that person to be a member of that committee*.

7. The *Corporations Act 2001* (Cth) imposes no requirements in relation to the composition of audit committees. The Listing Rules of the Australian Securities Exchange (***ASX***) make some provision in this regard: Listing Rule 12.7 requires listed entities in the S&P All Ordinaries Index to have an audit committee and, if such a company is in the S&P / ASX 300 Index it must comply with the ASX Corporate Governance Council's recommendations relating to audit committees.

8. The *Corporate Governance Principles and Recommendations with 2010 Amendments* (2nd edition) of the ASX Corporate Governance Council recommends under 'Principle 4 – Safeguard integrity in financial reporting' that: a board should have an audit committee; the committee should be structured so as to consist only of non-executive directors, the majority of whom are independent directors, that it be "chaired by an independent chair, who is not chair of the board" and have at least three members; that it should have a formal charter; and that the company should report the information referred to in the guide to reporting on this Principle 4. It does not prohibit the Chair of the board of directors of the company from being a member of the company's audit committee.

9. Private health insurers such as Medibank are required to comply with a vast range of regulatory requirements. One of these is the 'Governance Standard' set out in Schedule 1 to the Private Health Insurance (Insurer Obligations) Rules 2009.[1] Section 10 of the Governance Standard sets out a range of requirements for the audit committees of private health insurers, and subsection 10(6) says, "The chairperson of the board may sit on the board audit committee but must not chair the committee".

[1] These Rules are made by the Private Health Insurance Administration Council under the *Private Health Insurance Act 2007* (Cth).

10. This appears to be equivalent to paragraph 68 of Prudential Standard CPS 510 (Governance) applicable to APRA-regulated general insurers until 31 December 2014 and to paragraph 79 of the version applying after that date.

11. We have not been apprised of any justifications for imposing a higher standard on wholly-owned Commonwealth companies in respect of their audit committee composition than these other standards do. The *Draft Explanatory Statement to the Exposure Draft PGPA Rule 2014* included with the submission made to the Committee by the Department of Finance merely states what the effects of proposed paragraph 17(5)(a) and proposed section 28 are and does not clearly explain *why* it is necessary for effecting independence of an audit committee that its membership should not include the Chair of a Commonwealth company. In referencing and stating that it replaces regulation 6B Commonwealth Authorities and Companies Regulations 1997, the *Draft Explanatory Statement* overlooks the fact that there is no equivalent to proposed paragraph 17(5)(a) in regulation 6B and a reader may therefore infer – incorrectly – that proposed section 17 (in its application to a wholly-owned Commonwealth company via section 28) does no more than is currently provided for under the Commonwealth Authorities and Companies Regulations. In fact, it imposes a new requirement, and the necessity for this new requirement is not explained.

12. It is our view that regulation should not exceed the minimum that is reasonably required in order to achieve the particular policy effect (or adequately to counter a demonstrated mischief) desired. In the present situation, no convincing reason has been put forward as to why it is necessary to go further than other extant standards (such as those quoted above) and to prohibit the Chair of a wholly-owned Commonwealth company that is a GBE from participating as a member of that company's audit committee.

Efficiency of GBEs

13. Government business enterprises typically operate in markets where they are required to compete with private businesses, either in offering goods or services or as a buyer or acquirer of inputs (e.g., raw materials, employees, etc.). By establishing many of them as companies, it was intended that they should operate efficiently and without having to conform to the full range of regulation deemed necessary for operations of more "closely held" manifestations of the Commonwealth (such as Departments of State, "agencies", "commissions" and "authorities"). Established in this way, they ought also not have any advantages over their competitors due to a "Commonwealth connection", e.g., the "shield of the Crown" or exemption from taxation.

14. This was recognised in the case of Medibank by section 44 of the *Health Insurance Commission (Reform and Separation of Functions) Act 1997* pursuant to which the private health insurance business of the Health Insurance Commission was transferred to a company that was established under what is now the *Corporations Act*, which company was declared

not to be considered to have been established for a public purpose or to be an agency or instrumentality of the Crown or of the Commonwealth.

15. Medibank, ARTC and ASC are required to operate as businesses on commercially sound principles. We believe that, having regard to our function in operating government business enterprises, the corporate governance standards applicable to the audit committee should generally be consistent with corresponding standards that apply to private enterprises conducting similar commercial activities. Any additional regulation should clearly be demonstrated to be necessary and to be no more restrictive than the minimum that is necessary in order to ensure effective governance and oversight.

16. .We do not assert that there is no case for special governance or oversight arrangements of the activities of Commonwealth companies that are GBEs, and acknowledge the public interest benefits of having broad regimes in place such as the CAC Act and the PGPA Act. It is our view, though, that such regulation should be as light as is possible – meeting those objectives with minimum departure from the "establishing philosophy" that such entities are companies and should operate and be regulated exactly as other companies are. In effect this point merely emphasises the previous one: there is no adequate case for Commonwealth companies to be subjected to this higher standard in terms of audit committee composition than comparable privately owned companies are.

Competition policy

17. Insofar as any Commonwealth company is required to adhere to a regulatory regime that its competitors are not, there is a competitive disadvantage to the Commonwealth company. This therefore emphasises the point already made: the imposition of any additional obligation on a Commonwealth company should be justified by having regard to the benefits or policy outcome that it is designed to achieve, but weighed against the disadvantages, one of which is the interference in its ability to compete in the industry in which it operates.

18. The prohibition on the Chair of the board sitting on the audit committee would place Medibank, ARTC and ASC company at a competitive disadvantage to their private sector counterparts and other similar commercial enterprises. In the case of Medibank, it is clear that all of its competitors in the private health insurance industry are not subject to a similar requirement – for which see the Disclosure Standard referred to at paragraph 9 above.

19. Our view is that no Commonwealth company that is a GBE should be subject to the standard in proposed section 17(5)(a) of the PGPA Rule given that companies in the industries in which they compete as suppliers or purchasers are not subject to a similar prohibition. In the case of Medibank, this is made even clearer by the fact that the Private Health Insurance Administration Council has declared that it is *adequate* for private health

insurers to have audit committees among whose members is counted the Chair of the insurer itself provided that he or she does not also act as Chair of the committee.

Solution

20. The CAC Act recognises differences between Commonwealth authorities and Commonwealth companies. The PGPA Act does the same, recognising corporate and non-corporate Commonwealth entities as well as Commonwealth companies. The 'design principles'[2] for the PGPA Rule contemplate the possibility of differentiated application of rules if there is a clear case for them to apply to one group or type of entity.[3] Those same design principles state that such rules should be "necessary or convenient", minimise regulation and "red tape" and only apply where necessary to promote the objectives of the PGPA Act.[4] Moreover, paragraph 101(2)(b) of the PGPA Act contemplates different provisions under such rules for different Commonwealth entities or companies or classes thereof.

21. The regulatory context allows differentiation in the application of the rules that would permit section 28 of the PGPA Rule to be modified so that paragraph 17(5)(a) of that Rule did not apply to wholly-owned Commonwealth companies that are GBEs. In our view such a differentiated application is warranted. The reasons for this are as stated above.

22. We take the opportunity to acknowledge the breadth of the consultation process undertaken by members of the Department of Finance in development of proposed rules for the PGPA Act.

23. Medibank, in particular, has had involvement in that process and all interactions with members of the Department in this respect were welcomed and appreciated. Among other things, Medibank made a submission regarding a former version of the requirement now comprised in proposed subsection 17(3) of the PGPA Rule regarding the qualifications of members of an audit committee, and Medibank is gratified that this submission was considered and resulted in a revised form of that requirement that addressed the concerns that Madibank had had. At the time of making that submission Medibank had not quite appreciated the effect of proposed paragraph 17(5)(a), and so we are grateful for the present opportunity to remedy that oversight by seeking to have the Committee consider the appropriateness of that provision applying to wholly-owned Commonwealth companies that are GBEs.

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2 See Attachment B ('Public Governance, Performance and Accountability Rule Design Principles') to the submission dated 5 March 2014 from the Department of Finance to the Joint Committee of Public Accounts and Audit in this matter.

3 *Ibid*. item 6.

4 *Ibid*. items 1 and 3.

24. We thank the members of the Committee for giving their consideration to our submission.

Yours faithfully,

[redacted]

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