



REVIEW OF THE  
CORPORATE GOVERNANCE  
OF STATUTORY AUTHORITIES  
AND OFFICE HOLDERS

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OF STATUTORY AUTHORITIES  
AND OFFICE HOLDERS

June 2003

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# Review of Corporate Governance of Statutory Authorities and Office Holders

The Hon John Howard MP  
Prime Minister  
Parliament House  
CANBERRA ACT 2600

Senator the Hon Nick Minchin  
Minister for Finance and Administration  
Parliament House  
CANBERRA ACT 2600

Dear Prime Minister and Minister

In accordance with the terms of reference, I am pleased to present the report  
of the review of the corporate governance of statutory authorities and office holders.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Uhrig'.

John Uhrig

27 June 2003



# TABLE OF CONTENTS

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<b>Letter of transmittal</b> .....	<b>.iii</b>
<b>Executive summary</b> .....	<b>1</b>
Background to the review .....	1
Terms of reference .....	1
The review process .....	1
Governance .....	2
Developing good governance for the public sector .....	3
What the review found .....	5
Good governance going forward .....	7
The principles .....	10
The templates .....	10
Summary of recommendations .....	11
Summary of better practice guidance for boards .....	13
<b>Chapter 1 – Introduction</b> .....	<b>15</b>
Background to the review .....	15
Terms of reference .....	15
What are statutory authorities and who are office holders? .....	16
What is corporate governance? .....	17
The review process .....	18
<b>Chapter 2 – Governance</b> .....	<b>21</b>
What is meant by the term ‘governance’? .....	21
Why we should look to see what the private sector has to offer .....	26
Governance of statutory authorities .....	30
The appropriate structures for statutory authorities .....	34
<b>Chapter 3 – What the review found</b> .....	<b>37</b>
Clarity of purpose .....	37
Performance of boards .....	40
Structures .....	44
Purchaser/provider arrangements .....	46
The sharing, exercise and appropriate limitation of internal authority .....	47

How statutory authorities relate to outsiders .....	49
Accountability and disclosure .....	52
<b>Chapter 4 – Governance going forward .....</b>	<b>.57</b>
Creating statutory authorities .....	57
Understanding success .....	58
Organising for success .....	61
Achieving success .....	76
<b>Chapter 5 – The templates .....</b>	<b>.79</b>
Applying the templates .....	79
Board Template .....	80
Executive Management Template .....	85
Additional mechanisms of governance .....	89
<b>Chapter 6 – Getting the best from governance boards .....</b>	<b>.95</b>
Board size .....	96
Board committees .....	96
Appointment of directors .....	97
Board tenure .....	100
Development of the board .....	102
Performance .....	102
<b>Appendix A – Terms of reference .....</b>	<b>105</b>
<b>Appendix B – Structures of the eight entities .....</b>	<b>108</b>
<b>Appendix C – Board composition of the five entities having boards .....</b>	<b>110</b>
<b>Appendix D – Consultations .....</b>	<b>111</b>
<b>Appendix E – Bibliography .....</b>	<b>115</b>
<b>Appendix F – Review Secretariat .....</b>	<b>119</b>
<b>Definitions .....</b>	<b>121</b>
<b>Abbreviations .....</b>	<b>125</b>

# Executive summary

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## Background to the review

Governments have significant interaction with the community, with a significant proportion of this conducted through statutory authorities and office holders. This is particularly so in the areas of taxation, regulation and the provision of services. The community has a right to expect that these functions will be carried out in a manner that is efficient, effective, objective and transparent.

The Government commissioned the review of the corporate governance of statutory authorities and office holders to identify reforms that might assist in improving the performance of these bodies, without compromising their statutory duties.<sup>1</sup>

## Terms of reference

In November 2002 the Prime Minister announced the review. The terms of reference required an examination of structures for good governance, including relationships between statutory authorities and the responsible Minister, the Parliament and the public, including business.

A key task was to develop a broad template of governance principles that, subject to consideration by government, might be extended to all statutory authorities and office holders. As part of the process of developing that broad template, the review was asked to consider the governance structures of a number of specific statutory authorities and best practice corporate governance structures in both the public and private sectors.

## The review process

As the terms of reference focused the review on identifying best practice in the private and public sectors, a targeted consultative approach was chosen in preference to a general invitation for public submissions.

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1. The Prime Minister's Press Release, 14 November 2002 and The Howard Government, *Securing Australia's Prosperity*, 2001, p 15.



The review took a practical rather than theoretical approach, thinking from ‘first principles’, in considering issues revealed in the course of its work and in identifying appropriate governance mechanisms. The core of the review and its conclusions, however, stem from the outcome of consultations with key participants, including the government and business sector. In particular, it draws on the knowledge and wisdom in the private sector, which comes from the accumulation of its practical experience of when there are robust governance arrangements in place and when there are not.

Because the review approached its task from ‘first principles’, the report aims to have broad applicability and a timeless quality, not only providing insights and solutions to governance issues confronting authorities today, but being useful also for future governments when considering these issues.

## **Governance**

Corporate governance encompasses the arrangements by which the power of those in control of the strategy and direction of an entity is both delegated and limited to enhance prospects for the entity’s long-term success, taking into account risk and the environment in which it is operating. While this definition is employed for the review it is noted that there is no universally accepted definition of corporate governance, or agreement on the structures and practices that are required to achieve good governance.

A well-governed organisation will clearly understand what it is required to achieve, will be organised to achieve it through the success of its executive management and will focus on ensuring it achieves its goals. In other words, by ensuring that the effort of an organisation is well directed, a well-governed organisation will be more efficient and more likely to produce effective outcomes. Governance should be enduring, not an instrument that is exercised from time to time depending on circumstances. A good governance framework should guide the actions of individuals by providing clarity of direction as to appropriate behaviour and decision-making. When working well, a governance framework produces better outcomes simply because it exists.

The review identified a number of elements that are central to the governance of entities, irrespective of whether they operate in the public or private sector.

- **Understanding success:** Those in control of an entity need to be clear about what the entity is to achieve and communicate that effectively to management. This involves the establishment of a clear sense of purpose and the development of clear expectations of performance.

- **Organising for success:** Once an entity has developed an understanding of what it needs to achieve, it should be organised appropriately.
  - *Implementing the right organisational structures:* Structuring an organisation in a way that is most likely to assist it to achieve its objectives is a commonly accepted proposition. The right structure will depend on many factors, including the nature of the entity's functions. A key question to consider in getting the structure right is whether it is designed so as to support (rather than impede) the operation of governance.
  - *Power must be: in existence, delegated, limited and exercised:* In order for an entity to achieve its purpose, power must be given to executives to develop strategy and direction for higher level approval. Power will need to be further delegated as it is not feasible for a small number of individuals to make all decisions. Delegated power needs to be limited to manage risk associated with decision-making and to limit the opportunity for non-alignment with the interests of those granting power. Finally, parties in receipt of power must exercise it and do so in a responsible manner.
  - *Clarity of roles:* In organising for success all parties within the governance framework must have a clear understanding of their roles and responsibilities, including their personal accountability.
- **Making sure success is achieved:** Governance is about ensuring individuals responsible for performance understand what outcomes they are required to achieve and are provided with the capacity to achieve them.
  - *With responsibility there needs to be accountability:* A robust governance framework should, through transparency and accountability mechanisms, link power and responsibility to performance and review.

## Developing good governance for the public sector

In developing a view of governance for the public sector, the lessons and developments in the private sector have been considered. The threat of commercial failure provides an incentive for the private sector, constantly, to develop and improve governance practices.

Private sector governance models will vary, depending on the ownership characteristics of the entity. In the case of large listed public companies in Australia, ownership is widely dispersed and it is impractical for shareholders to be involved, personally, in the direct oversight and/or management of the enterprise. In these circumstances the main

mechanism for achieving good governance in the shareholders' interests is a board of directors. A key characteristic of a board in a public company is its full power to act and its responsibility to do so. This includes the approval of strategy and direction for the business and important company policies, as well as overseeing the performance of management. A critical element of the board's power is the ability to appoint and terminate the chief executive officer (CEO). In carrying out its responsibilities the board is expected to apply objectivity, wisdom gained through appropriate experience, authority and judgement. Private sector lessons confirm that these attributes are the essential primary attributes for board membership, rather than specific professional skills or representation of particular interests.

As with a public company, the issue of ownership has great influence on the governance structures and practices of closely held companies. A closely held company generally consists of a single owner, or a small number of owners, who have the ability to impact directly on the operations of the company, including its strategy and direction, defining its purpose and management appointments. The owners have the power to oversee and provide direction to management. While the owners may elect to have a board of independent directors to oversee the performance of the entity, the establishment of a board, in itself, may not lead to good governance.

In circumstances where the board functions under the influence of the known views of a small number of owners, it cannot operate with the same entrepreneurial freedom and power to act as a public company board. In this context, it is unlikely that good governance will prevail due to the board's limited ability to act. The board may also have difficulty in defining its role and fully applying objectivity, wisdom, authority and judgement.

The role of the Minister for a statutory authority will be established by its legislative framework, including whether or not the authority is a body corporate separate to the Commonwealth. At the very least, Ministers have a general power to require authorities to provide them with the information necessary for them to meet their accountabilities and to fulfil their duties to uphold the laws of the Commonwealth. Where a statutory authority is not created as a separate body corporate, the Minister generally has the same powers in respect of the authority as he or she has in respect of a department of state except for those matters for which the authority has independent statutory responsibilities. Where a statutory authority is a separate body corporate the powers available to a Minister will ordinarily be reflected through its enabling legislation.

In the public sector, the characteristics of ownership, control and the extent of power to act should also inform the identification of appropriate governance arrangements. Statutory authorities undertake a number of roles including commercial operations, regulation and the provision of Commonwealth services, with their delegated authority largely established through their enabling legislation. The opportunity for ministerial involvement in the governance arrangements of statutory authorities varies greatly.

The role of government is itself a defining factor in establishing appropriate governance arrangements for statutory authorities. Governments are held accountable by the electorate for the performance of government as a whole. Where statutory authorities are failing to perform adequately, the electorate will expect governments to act. Inevitably, therefore, there is a role for Ministers in the governance of statutory authorities.

There are a number of circumstances in which Parliament and government may choose not to provide a wide-ranging power to act, instead, establishing a narrow set of outputs to be delivered by a statutory authority. In these circumstances a parallel can be drawn to closely held companies where a limited delegation of power, and the influence of a limited number of parties controlling the entity, indicate that an independent board may not provide the best governance. In circumstances where government is not providing a broad delegation it is likely that holding either chief executives or commissioners directly accountable for performance will produce better governance.

In circumstances where government is able to provide a wide delegation and the authority can operate with 'entrepreneurial' freedom, a board will be the optimal mechanism for governance.

## **What the review found**

The review considered the existing governance arrangements for statutory authorities, finding a number of opportunities for improvements.

There is a lack of effective governance for several of the authorities considered by the review due to several factors including unclear boundaries in their delegation, a lack of clarity in their relationships with Ministers and portfolio departments, and a lack of accountability for the exercise of their power. This lack of governance arises primarily due to a 'hands off' attitude assumed by many when dealing with statutory authorities. This situation is often further complicated by the presence of a board, particularly those where it is impractical for government to provide the full governing powers required to be effective.

Statutory authorities develop an understanding of their purpose through both their legislative framework and interactions with the relevant Minister. However, it is the assessment of the review that this does not always provide sufficient clarity for all parties. Consequently, there is scope for improvement.

After reviewing a number of boards and considering processes for board appointments, it is apparent that the public sector experiences difficulties similar to those of the private sector in recruiting appropriately experienced directors. This is particularly so in cases of larger Commonwealth authorities due to the limited pool from which potential directors may be drawn and because government is competing with the private sector for suitable candidates. Consequently, a range of other skills and backgrounds is being sought when considering potential directors. However, the lack of experience in governing enterprises of the size of many public sector organisations and the potential for conflicts of interests are impediments to good performance.

Where a board has limited power to act, its ability to provide governance is reduced and its existence adds another layer, potentially clouding accountabilities. Given the nature of government, the circumstances in which a board can be given full power to act are going to be rare and are most likely to be limited to those authorities which are commercial in nature.

A significant source of power for any board is the power to appoint and remove the CEO. For several of the authorities considered by the review where a board exists, these powers do not rest with the board. The ability of boards in these circumstances to influence decisions about appointment, termination or reappointment of a CEO is dependent on the extent to which the board is able to influence the Minister. An ability to influence the Minister will be dependent on the level of trust and confidence between the Minister and the CEO. In an authority where the day-to-day relationship with government is primarily between the CEO and the Minister (rather than between the chairman and the Minister) the board's ability to influence is lessened. Conversely, the influence of the CEO with the board and the Minister is increased, creating the potential for a CEO to use the support of one to exert pressure on the other.

There are a number of existing intra-government agency purchaser/provider arrangements (an agreement to provide services on behalf of another Commonwealth entity for a fee) in place in Commonwealth service delivery agencies that are intended to assist in governance. It is difficult to identify the benefit to the Commonwealth of such arrangements where services to the public are 'purchased' and delivered by entities that are both part of government and accountable to the same Minister, particularly given

limitations on the capacity of the purchasing entity to use its purchasing power to drive performance improvement.

The review found that entities undertaking similar functions do not necessarily have comparable governance arrangements. For example, one entity may have a board while another may not. Similarly, one may be subject to the resource management requirements of the *Financial Management and Accountability Act 1997* and another may be subject to the *Commonwealth Authorities and Companies Act 1997*. Given the significant differences between these Acts in terms of accountability for the use of Commonwealth resources, and the significant differences in accountability where a board is present or not present, a consistent approach to application would assist clarity and alignment of governance structures.

## **Good governance going forward**

In comparison to the direct relationship between a Minister and the portfolio department, statutory authorities often operate with a greater level of separation. It is this separation, or 'independence', that creates the need for robust governance structures. The need for governance increases when independence is combined with power. Consequently, statutory authorities should be created only where there is sufficient need for:

- efficiency: that is, a clear purpose is required to achieve objectives and it is considered beneficial to undertake functions outside the portfolio department, or
- independence: when functions require a level of separation from government to ensure objectivity.

A number of initiatives and policy opportunities were identified by the review for the Government to consider with a view to improving the performance of statutory authorities.

In a number of cases statutory authorities would benefit from greater clarity in the definition of their purpose, direction and objectives. This could be achieved through the relationship between government, portfolio departments and statutory authorities, including through regular enunciation of expectations.

To assist this process, it is recommended that each Minister issue a Statement of Expectations to statutory authorities within their portfolio where the Minister has a role in providing direction. This document would outline relevant government policies, including the Government's current objectives relevant to the authority and any expectations the

Government may have on how the authority should conduct its operations. Statements would need to be framed carefully, respecting the areas of necessary independence provided for in the statutory authority's enabling legislation. Each statutory authority would then respond by outlining how it proposes to meet the expectations of government in a Statement of Intent, including the identification of key performance indicators agreed with the relevant Minister. Key performance indicators should be limited in number to those crucial to the success of the authority and include both financial and non-financial measures. The exchange of statements would need to be updated from time to time as government policies develop and the operational environment changes.

These documents should be made public, allowing the Parliament and the community to be aware of the government's expectations and the responses by statutory authorities.

The proposal envisages these statements being issued to authorities where the Minister has a role in providing direction. Where government does not have a role in providing direction, a Statement of Expectations will not be appropriate. For example, a Statement of Expectations would not be appropriate in respect of the Auditor-General. The Auditor-General has been established with statutory independence reporting directly to the Parliament and is not subject to direction by a Minister.

Statements may not be necessary where a statutory authority is subject to the governance arrangements for government business enterprises and, as a consequence, prepares an annual corporate plan for endorsement by the Minister and subsequently issues a Statement of Corporate Intent.

Statutory authorities whose major activities are commercial in nature will generally be better suited to operate under a board. To be effective, such a board would need to have powers similar to those of the board of a publicly listed corporation. A board is seen as having the ability to add value to the governance arrangements of such commercial statutory authorities through the application of entrepreneurial skill, objectivity and wisdom gained through appropriate experience, including in exercising authority and judgement.

Where statutory authorities undertake a narrow set of functions, delegation to an executive group, coupled with an appropriate framework of governance (not a board) will be the most practical and effective arrangement to achieve alignment between operations and the priorities of government.

A board does not provide an appropriate governance structure for statutory authorities operating in the fields of Commonwealth service provision or regulation, as it is unlikely

that such a board can be delegated full power to act. In these types of authorities government typically retains, and is expected to retain, control of policy and approval of strategy. Creativity by the statutory authority is limited to achieving the most efficient methods of executing the service provision or regulatory function. A board in these circumstances is likely to struggle with establishing an effective role for itself and may dilute accountability by adding a layer between Ministers and management.

The operations of regulatory authorities can have significant impact on the community including business. To preserve necessary areas of independence, the scope for ministerial direction of such authorities is limited by their enabling legislation. A perhaps unintended consequence is that regulatory agencies are not subject to the same degree of accountability for the way in which they exercise their statutory powers as service provision authorities. It is proposed that an Inspector-General of Regulation be established to review, independently, a regulatory authority's systems and procedures for the administration of legislation.

To achieve greater consistency on the application of governance arrangements and frameworks the Government should consider allocating an advisory function on consistency to a central agency. This function might include development of guidance on better practice and liaison with departments on issues surrounding the governance arrangements of new statutory authorities or where existing authorities may be under review or subject to proposed legislative amendment.

Ministers need to be supported in executing their governance responsibilities for statutory authorities. In addition to statutory authorities themselves, the relevant Minister's department is an important source of advice. Indeed, as a Minister's most senior departmental representative, the portfolio secretary needs to be in a position to provide advice in relation to all matters within the relevant Minister's portfolio. There would be considerable value in removing the current uncertainties among Ministers, secretaries and statutory authorities about the extent to which they are each able to engage in relation to the activities of statutory authorities. Reinforcing the role of portfolio secretaries as the principal source of advice to Ministers in relation to all matters within the portfolio would be the best way of achieving this. It will be important that departments and statutory authorities maintain effective communication channels to ensure that the department is well placed to provide timely advice to the responsible Minister.

Finally, the report includes guidance on better practices in managing boards where they are deemed to be appropriate. Key points include discussion on appointments and tenure.



## The principles

- *Owners, or their representatives, need to establish, clearly, an understanding of success for the activity, including their expectations of performance.*
  - Owners of an organisation need to set its purpose clearly and state their expectations of performance.
- *Governance should be present and the arrangements should be appropriate for the entity given the nature of ownership and its functions.*
  - The appropriate organisational structure will vary from entity to entity and will depend on functions, complexity of operations, ownership characteristics and objectives.
- *To be successful, power must be: in existence; delegated; limited and exercised.*
  - Power frameworks will influence the efficiency and effectiveness of decision-making and the capacity of decision-makers to produce quality outcomes.
- *There should be clarity of roles within the governance arrangements of organisations to ensure that efforts are directed towards success and that responsibilities are performed in an efficient manner.*
  - Those who own, govern and manage an organisation should have a clear understanding of their roles and responsibilities.
- *With responsibility there needs to be accountability.*
  - Individuals should understand what they are required to achieve, have the capacity to achieve and be held accountable for their performance.
- *For a board of directors to be effective, it must have the full power to act, including the ability to appoint, supervise and remove senior management as well as approve strategy.*

## The templates

Two templates have been developed incorporating these governance principles. A 'Board Template' is proposed where government takes the decision to delegate full powers to act to a board, or where the Commonwealth itself does not fully own the assets or equity of a statutory authority (that is, there are multiple accountabilities). The 'Executive Management Template' is proposed in other cases.

The benefits of the proposed templates are:

- Improving the transparency and accountability of statutory authorities through:
  - clear and transparent lines of accountability
  - clear understanding of roles
  - clearly articulated and publicly available objectives and strategies
  - an Inspector-General of Regulation reporting to Ministers and through them to the Parliament.
- Improving efficiency of statutory authorities by ensuring:
  - there is effective supervision of management
  - management is accountable for its performance
  - the effort of authorities is directed towards the achievement of well-understood objectives.
- Improving the effectiveness of statutory authorities through developing a sound understanding of what they are required to achieve resulting in:
  - higher quality services
  - better regulation.

## **Summary of recommendations**

1. The Government should clarify expectations of statutory authorities by Ministers issuing Statements of Expectations to statutory authorities; by statutory authorities responding with Statements of Intent for approval by Ministers; and by Ministers making public Statements of Expectations and Intent.
  - Statements of Expectations would need to take into account the nature of the independence of each statutory authority and may not be necessary where the existing governance framework provides for a comparable arrangement (for example, as is the case in respect of government business enterprises).
2. The role of portfolio departments as the principal source of advice to Ministers, should be reinforced by requiring statutory authorities and office holders to provide relevant information to portfolio secretaries in parallel to that information being provided by statutory authorities and office holders to Ministers.

3. Governance boards should be utilised in statutory authorities only where they can be given the full power to act.
4. The Government establish an Inspector-General of Regulation to investigate, where necessary, the systems and procedures used by regulatory authorities in administering regulation.
5. The Government should allocate a function to a centrally located group to advise on the application of appropriate governance and legislative structures when establishing or reviewing statutory authorities.
6. Financial frameworks generally be applied based on the governance characteristics of a statutory authority, that is:
  - The *Financial Management and Accountability Act 1997* be applied to statutory authorities where it is appropriate they be legally and financially part of the Commonwealth and do not need to own assets. (Typically, this would mean Budget-funded authorities.)
  - The *Commonwealth Authorities and Companies Act 1997* be applied to statutory authorities where it is appropriate they be legally and financially separate from the Commonwealth and are best governed by a board.
7. Statements of Expectations and Intent should include those values central to the success of the authority, including those relating to its relationships with outsiders.

### **Summary of better practice guidance for boards**

1. Board size should be developed taking into consideration factors such as an entity's size, complexity, risk of operations and the needs of the board.
2. Committees are a useful mechanism for the board to enhance its effectiveness through further detailed oversight and supervision of the management of risks that are critical to the success of the entity. Committees should be used only for this purpose.
3. In getting the best from boards, appropriately experienced directors are critical to good governance.
4. Representational appointments to boards have the potential to place the success of the entity at risk.

5. Responsible Ministers should issue appointment letters detailing government expectations of directors.
6. Maximum board service periods allow for a structured rotation of directors.
7. All boards should have orientation programs and directors should have the opportunity for ongoing professional development.
8. Annual assessments of the board need to occur to ensure government gets the best from the board.



# Chapter 1 – Introduction

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## Background to the review

On 14 November 2002 the Government announced a review of the governance practices of statutory authorities and office holders, with a particular emphasis on those which impact on the business community. The objective of the review was to identify issues surrounding existing governance arrangements and to provide policy options for Government to get the best from statutory authorities and office holders and their accountability frameworks. In doing so, the Government noted the impact the performance of statutory authorities and office holders has on business and the overall health of the Australian economy. In particular, the review was to focus on the areas of taxation and regulation, where businesses have the right to expect the highest levels of efficiency, fairness and transparency in their dealings with government.

## Terms of reference

The terms of reference, reproduced at Appendix A, required an examination of structures for good governance, including relationships between statutory authorities, the responsible Minister, the Parliament and the public, including business.

There were a number of factors the terms of reference required the review to take into consideration. These included the unique status of the Commonwealth as owner or shareholder, as the sovereign government and the source of regulatory authority.

A key task was to develop a broad template of governance principles that, subject to consideration by government, might be extended to all statutory authorities and office holders.

As part of the process of developing a broad template, the review was asked to consider the governance structures of a number of statutory authorities and office holders with critical relationships with business and to consider best practice corporate governance structures in both the public and private sectors. In considering the existing relationship structures statutory authorities have with Ministers and departments, the review was also asked to consider the implications of intra government purchaser/provider arrangements for governance outcomes generally.

## What are statutory authorities and who are office holders?

A statutory authority in the Commonwealth sphere is a public sector entity created by legislation, that is, a specific law of the Commonwealth. The characteristics of statutory authorities, of which there are over 160<sup>2</sup>, are not common to all. Differences include the extent to which powers are conferred on Ministers, governance structures, whether the authority is established as a legal entity separate to the Commonwealth and the financial management legislation that is applicable.

When examining the governance arrangements of a statutory authority consideration needs to be given to the individual elements of its legislative framework. For example, in relation to the Australian Taxation Office (ATO), office holders are created by the *Taxation Administration Act 1953* and the Commissioner of Taxation together with staff of the ATO constitute a statutory agency for the purposes of the *Public Service Act 1999* (PS Act). For the purposes of this report a statutory authority includes a statutory agency having statutory office holders.

An authority's governing structure may comprise one or more of the following: one or more commissioners, a CEO or a board of directors. Where a board exists: if the portfolio secretary is a member, he or she may or may not have full voting rights; directors may be or may not be representational; and the mix of executive and non-executive directors will vary from authority to authority. Tables showing the differing characteristics of authorities considered by the review are at Appendices B and C.

The office holders considered by the review are those persons appointed to statutory positions in the governing structure of a statutory authority. Depending on an authority's particular structure, these positions include the CEO or managing director, commissioners and members of a board of directors. The scope of the review did not extend to other persons who may be office holders in the sense of that term as it may be used more broadly in the Commonwealth public sector.<sup>3</sup>

The existence of statutory authorities reflects decisions by government over time, and legislated for by Parliament, where it has been deemed desirable for particular activities to operate outside a traditional departmental structure. Statutory authorities generally have a single or primary role (albeit comprising many parts) that they are established to carry out, subject to varying degrees of ministerial control specified in legislation. The

2. Source: Department of Finance and Administration ([www.finance.gov.au/finframework](http://www.finance.gov.au/finframework))

3. 'Office holder' has a very broad meaning for the purposes of determinations made under the *Remuneration Tribunal Act 1973*.

boundaries of a statutory authority's separation from direct ministerial control are drawn by the legislative framework. This framework includes the authority's enabling legislation, financial management legislation and, with some exceptions, the full range of administrative law provisions (for example, freedom of information and processes for appeal or review of decisions). In pursuing their legislated functions, statutory authorities (like departments) are subject to scrutiny by Ministers, the Parliament and the Auditor-General. More informally, there are other sources of scrutiny including analysis by academics and the media, as well as by sections of the community affected by the authority.

That government can engage in conduct through statutory authorities is a long and well-established concept. It follows that government, through Ministers, is accountable for statutory authorities. The accountability of specific Ministers is recognised through the Administrative Arrangements Order (AAO), issued from time to time by the Governor-General, which specifies the legislation administered by Ministers, including the enabling legislation of statutory authorities.<sup>4</sup> Constitutionally, Ministers have a governance role and responsibility in respect of statutory authorities within their portfolios.

## **What is corporate governance?**

In general terms, corporate governance encompasses the arrangements by which the power of those who implement the strategy and direction of an organisation is both delegated and limited to ensure the organisation's success, taking into account the environment in which the organisation is operating. While this description has been employed for the purposes of the review, it is not surprising that there is no universally agreed definition of corporate governance, just as there are no universally accepted structures and practices that constitute good governance. There are a number of structures employed, dependent on a range of variables, including the type of organisation, its ownership characteristics and the nature and breadth of the function.

Governance is relevant to the performance of both private and public sector organisations and in considering what constitutes good governance, the lessons available from both sectors have been explored. Many of the concepts of governance are similar across the private and public sectors, for example, clarity of purpose and accountability. The

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4. Referred to by Aitken G and Orr R, 2002, *Sawyer's The Australian Constitution*, Third Edition, Canberra, Australian Government Solicitor. 'Section 64 of the Constitution allows the Governor-General to appoint Ministers to administer 'such departments of State as the Governor-General in Council may wish to establish. ... Although section 64 only mentions 'departments of State' it has always been accepted that the government can engage in conduct through statutory offices and authorities.' pp 109–111.



rationale for establishing governance practices is also comparable, in particular, to the focus on achieving success and managing risk.

Generally, governance arrangements for statutory authorities should strike a balance between providing flexibility to enable authorities to undertake their legislated functions and the policies of the government of the day. As described earlier, the ability of an authority to act independently of government is drawn by the authority's legislative framework. The greater an organisation's independence, the greater is the need for robust governance mechanisms as a means of ensuring that it is discharging its delegation appropriately. To the extent that independence is combined with power, that need is heightened. Given the independence of statutory authorities, this is a critical factor for the public sector. Robust governance provides assurance, not only to government, but also to the Parliament and the public, that those in the community affected by the activities of an authority are protected from the inappropriate exercise of power.

Governance should establish appropriate structures and behaviour to enhance the capacity of government and statutory authorities to achieve greater clarity in their relationship and in aligning expectations with performance. Good governance structures also establish appropriate processes to resolve any tensions which may emerge between the manner in which authorities perform their legislated functions and the policies of the Government of the day. They should also provide a mechanism for that part of the community upon which an authority has impact to have input through consultation of some kind. The benefits include greater openness in decision-making and consequentially greater clarity for Parliament and the public regarding government priorities and expectations and the performance of statutory authorities.

## **The review process**

To identify key governance issues from the perspectives of those with responsibility for governing statutory authorities, the review met with relevant Ministers, secretaries of their departments, the heads of the authorities and where appropriate, the chairman of the board in relation to the following authorities: the Australian Taxation Office (ATO), the Australian Competition and Consumer Commission (ACCC), the Australian Prudential Regulation Authority (APRA), the Reserve Bank of Australia (RBA), the Australian Securities and Investments Commission (ASIC), the Health Insurance Commission (HIC), Centrelink and the Australian Postal Corporation. Collectively, these authorities represent a high proportion of the relationship between government and business and between government and individuals, especially in the areas of taxation, regulation and the

provision of services. To gain the private sector perspective, the review met with peak business and consumer bodies relevant to the above authorities and with other organisations, which sought a meeting. A list of persons and organisations with whom the review consulted is at Appendix D.

As the terms of reference focused the review on best practice corporate governance structures existing in the private and public sectors, a targeted consultative approach was chosen. The review had a preference for meeting directly with interested stakeholders wherever possible and decided not to call for public submissions. Some members of the public did offer comments to the review by way of correspondence. Those organisations and persons who wrote to the review with comments are also listed in Appendix D.

The terms of reference called for the identification of governance principles and the development of templates the Government might apply to all statutory authorities and office holders and more broadly to a wide range of public sector bodies. As the templates developed by the review are based on established principles of governance, they lend themselves to wide applicability. However, notwithstanding the fact that the principles on which the templates are based are broadly applicable, some authorities involve considerations which take them outside the scope of matters examined by the review. For example, although Commonwealth courts and tribunals are established by legislation and included in the AAO in a Minister's portfolio responsibilities, they are covered by the principle of judicial or quasi-judicial separation of powers and consequently require different governance arrangements to those applying to government generally. Similarly, the Auditor-General has statutory independence, reporting directly to the Parliament and consequently is not subject to direction by a Minister. Nevertheless, principles of governance are by their nature broadly applicable and will be relevant to the wider public sector.

The review took a practical rather than theoretical approach, thinking from 'first principles', in considering issues that emerged and in identifying appropriate governance mechanisms. This is not to diminish the current and emerging body of valuable research, debate and literature on this topic to which the review had regard (a bibliography is at Appendix E). The core part of the review and its conclusions, however, stem from the outcome of consultations with key participants, including the business sector. The review draws heavily on the knowledge and experience gained as a result of the accumulation of practical experience in the private sector by the reviewer. This private sector experience provides insights into the full spectrum of private sector outcomes to be considered.

Because the review approached its task from ‘first principles’, the report aims to have broad applicability and a timeless quality, not only providing insights and solutions to governance issues confronting authorities today, but also being useful to governments when considering these issues in the future.

The review was required to develop governance principles and broad templates to apply to Commonwealth statutory authorities. It did not require review of structures of specific entities, or of the performance of their functions. Consequently, the report does not seek to make recommendations on the individual structures or functions of any of the identified authorities.

# Chapter 2 – Governance

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This chapter identifies principles of governance, many of which will inform the development of the governance templates for statutory authorities discussed in Chapter 5. In developing principles that are appropriate for the public sector, a number of factors which influence governance in statutory authorities are explored. These include:

- general principles of governance
- governance arrangements and practices in the private sector
- applicability of private sector governance models for statutory authorities
- analysis of governance issues in the public sector, paying specific attention to government and ministerial responsibilities
- the need for governance mechanisms specifically suited to statutory authorities.

## **What is meant by the term ‘governance’?**

### **What is governance?**

*Governance is about ensuring the success of an activity.*

It encompasses the arrangements by which owners, or their representatives, delegate and limit power to enhance the entity’s prospects for long-term success.

### **Why is governance necessary?**

*The need for governance increases with separation and independence from owners.*

As separation or independence increases, the ability of owners to rely on the activity being undertaken in a manner consistent with their interests decreases. Some simple examples can demonstrate this to be the case. In closely held companies, where an owner can ensure its interests are protected through direct supervision of an activity, governance is not an issue. However, in the case of a public company with diverse ownership, it is the separation and consequent independence from the owners that creates the need for

governance arrangements to enhance the prospects that those with day-to-day decision-making power will act in the interests of the owners.

### **What is good governance?**

*Good governance is the presence of governance in the most appropriate form.*

The question of what constitutes good governance is less meaningful than the question of whether or not governance is present and is in the most appropriate form for the organisation. Although it is difficult to measure the impact of governance on performance, governance is essential for an organisation to respond quickly and effectively in crisis. Consequently, it is often easier to identify the lack of governance through failure than the presence of effective governance mechanisms through success.

Currently emerging views of non-practitioners on what is essential to good governance are not always consistent with achieving the best outcomes. For example, there are cases of high levels of success being achieved through the presence on a board of an executive chairman and/or significant executive representation, although some would argue against such a proposition under all circumstances. Governance solutions need to be considered on a case-by-case basis, taking into account the quality and professionalism of the people available to be involved in the governance framework as well as other factors.

Governance should be an enduring element in the structure of an organisation, and not something that is exercised from time to time. A governance framework should guide the actions of individuals by providing direction as to appropriate decision-making and behaviour. As a result, the framework should require less formal use, as people begin to behave consistently with the standards set. In this regard, governance arrangements often work well to produce better outcomes simply because they exist.

### **What is success?**

*Success is meeting the expectations of the owners.*

Success depends on the nature of the activity. In the private sector, success for the owners is maximising the return on their investment over the long term. Consequently, governance has a key role to play in supervising decisions relating to strategy and direction and, importantly, to determining appropriate risk for expected reward. Generally, the higher the reward being sought, the higher will be the acceptable level of risk to be supervised. In the public sector, the reward for the owners, that is the

community through the Parliament and government, is a well-executed low risk implementation of government policy with minimum negative impact. In all cases critical risks must be managed specifically and their management supervised through governance arrangements.

### **How does governance ensure success?**

*Governance ensures the success of an entity through the success of its executive management.*

A well-governed organisation will clearly understand that success can only be achieved through its executive team. This requires those responsible for governance to ensure the executive has a clear understanding of what is to be achieved, operates in a supportive and encouraging environment and through accountability, will successfully attain the entity's goals.

### **Understanding success**

*Owners, or their representatives, need to establish, clearly, an understanding of success for the activity, including their expectations of performance.*

An important principle of good governance is the requirement for owners or their representatives to be clear about what they want to be achieved. This requires establishing an unambiguous purpose for the entity and developing clear expectations of the meaning of success.

It is of equal importance that these requirements are conveyed by owners to key decision-makers. When there is a lack of clarity on these issues, it is difficult for management to pursue the interests of owners with certainty. Purpose and expectations should be established and re-affirmed as necessary.

Once the purpose of an entity and the expectations of its achievement have been established, it is essential for management to formulate strategies, for approval, that aim to accomplish the goals of the owners. These approved strategies will assist decision-makers to implement the activities necessary to be successful.

## **Organising for success**

*Governance should be present and the arrangements should be appropriate for the entity given the nature of ownership and its functions.*

With a clear understanding of what is to be achieved, owners should ensure the establishment of the governance arrangements most likely to focus on their interests. The most appropriate governance arrangements will depend on the nature of ownership and consequently the extent of separation and independence of the activity from the owner. The range of solutions in the 'governance tool kit' include the use of boards of directors, the mix of independent and executive directors, whether or not the chief executive chairs the board, the use of executive management in lieu of a board, whether or not the owner manages the activity or whether the situation demands the use of other mechanisms. Such arrangements will constitute a framework built from an array of elements of governance chosen collectively to suit the circumstances surrounding a given organisation. Effective governance arrangements will ensure the entity is equipped to confront challenges and achieve goals.

## **Appropriate power structures are essential to efficiency and effectiveness**

*To be successful, power must be: in existence; delegated; limited and exercised.*

Where the provision or use of power does not allow the organisation to function effectively, the capacity to make good decisions and deliver high quality outcomes may be compromised. Governance requires power. Delegation cannot be carried out without it. However, governance is not solely about the exercise of power, if it were it would be likely to result in authoritarianism, which would be likely to lead to failure.

Governance should ensure there is a system to delegate power to appropriately skilled individuals, and the system is subject to regular review to ensure performance meets the requirements of the delegation. In most organisations it is unlikely that all decisions will need to be, or can be, taken by a single individual (as a function of issues such as physical capacity and the need for objective review). There may also be a number of issues that require multiple decision-makers including efficiency, technical capacity, risk management and obtaining the best from individuals through appropriate empowerment.

Good governance will impose an appropriate limitation on power and ensure that decision-makers do not carry out actions that are in excess of the powers delegated.

It will ensure there is not a concentration of power vested in a single individual, allowing actions to be taken other than in the interests of the entity itself and its owners. An appropriate limitation of power restricts the ability of decision-makers to pursue activities inconsistent with the requirements of those who are granting power.

As all activities involve an element of risk, a well-governed organisation will recognise that not all decisions will lead to successful outcomes. However, an appropriate provision and limitation of power should ensure that the impact of poor decisions will not cause serious damage. In this regard, governance should have a strong focus on the management and oversight of risk, particularly in areas that are essential to the success of the entity. An organisation operating within a sound governance framework with appropriate power structures will be equipped to manage risk and deal with crisis.

Governance should ensure that power is exercised responsibly, taking into consideration the interest of those granting power and to an appropriate extent other stakeholders. To achieve this, governance frameworks should include oversight mechanisms linking the exercise of power to accountability. Governance should also be directed at ensuring that power is exercised appropriately. Poor outcomes can also result from individuals failing to act as well as individuals acting inappropriately or unethically.

### **Clarity of roles**

*There should be clarity of roles within the governance arrangements of organisations to ensure that efforts are directed towards success and that responsibilities are performed in an efficient manner.*

For an entity to succeed, all relevant parties must have a clear understanding of their roles and responsibilities in the governance framework. This assists in ensuring effort is directed towards the goals of the organisation and that individuals carry out their responsibilities in an efficient manner, and in accordance with the expectations of those delegating power. A lack of clarity, resulting from individuals being unsure or unclear about their responsibilities, will have detrimental effects on an organisation, including inefficiency through duplication of effort or critical tasks not being undertaken.

For roles and responsibilities to be fully understood it is important for those involved in governance and management to have a clear understanding of their individual roles and relationships with one another.



## **Making sure success is achieved**

*With responsibility there needs to be accountability.*

Accountability is a core principle of governance as it clearly links power and responsibility for performance. Governance requires individuals responsible for performance to understand what outcomes they are to achieve and that they are provided with the capacity to achieve them. It is crucial for owners to be able to hold those individuals to account.

The system for oversight should include objective and critical judgement in relation to performance and standards against which decision-makers can be assessed. When decision-makers deliver outcomes that do not align with expectations, there should be adequate oversight processes to hold them accountable. This requires relevant, verifiable and timely financial and non-financial data to be available to those delegating power.

## **Why we should look to see what the private sector has to offer**

There are benefits in looking to developments and lessons learnt in the private sector when considering appropriate governance frameworks for the public sector. The environment in which the private sector operates creates significant challenges for companies. The consequences of failure and threat of takeover provide incentives for the private sector to constantly strive to improve governance practices. In dealing with the challenges of the market, the private sector has gained considerable experience in applying the core elements of governance. The experience of the private sector has provided the review with valuable insights into the full spectrum of governance arrangements and the corresponding impact on outcomes.

## **Governance in listed public companies**

Listed public companies require the support of a large number of investors. As ownership is widely dispersed, it is generally impractical for shareholders to oversee personally the operation and performance of their investment. A board provides a mechanism that enables shareholders to delegate authority and consequently responsibility, for the performance of the company. In delegating this authority to a board, it is the right of shareholders to expect that directors will work solely in their collective interest.

In a public company, boards are the most effective governance mechanism because shareholders also delegate full power to act. The power to act is essential to a board's ability to govern effectively. This enables it to act on its judgements and to apply the full breadth of the experience and wisdom of its membership to drive the interests of the company. The power to act derives from the ability to operate with entrepreneurial freedom, to set strategy and direction and to appoint and remove the CEO.

Currently there is much debate about how the board should best fulfil its role. The information outlined below summarises the review's consideration of the full range of powers available to, and exercised by, boards generally found in Australian public companies leading in the field of governance.

A board provides the opportunity for shareholders to be represented by a group of people with the ability for critical thought, objectivity, wisdom gained through appropriate experience, authority and the ability to exercise judgement. A group with these skills is most likely to have the competence to guide a large enterprise to success. A board can also serve to limit the power concentrated in a single individual, such as a CEO, and ensure the interests of the company as a whole.

As an additional measure to ensure the power of management is appropriately limited, Australian public companies generally consist of a majority of independent, non-executive directors with a non-executive chairman. In most cases a strong independent presence on the board increases objectivity in decision-making, provides an appropriate balance of power and increases accountability.

The board is accountable to shareholders for the responsibilities delegated to it, including the financial success of the company. The board is responsible for:

- approving the strategic goals developed by management
- ensuring management achieves its strategic and other goals
- providing the company with a strong sense of purpose
- influencing the culture and standards of the company
- appointing and removing the CEO
- ensuring management institutes adequate reporting systems, internal controls and systems for managing risk

- ensuring management delivers appropriate product quality
- ensuring operations of the company take into account the expectations of customers, employees and the community to the extent that they are limited to the interests of the owners
- approving matters of major capital allocation.

By electing the directors to run the business on their behalf and holding them accountable for its performance, shareholders play a basic role in the governance of public companies. To ensure the board is capable of continuously fulfilling its delegation it is responsible for the appointment of new directors who are subsequently subject to shareholder approval and plays a role in supporting, or not supporting, its members for re-election.

The relationship between the board and management is crucial to the success of the enterprise. There should be a clear distinction between their roles and responsibilities. The board needs to be supportive of management with the chairman ideally performing a mentoring role to the CEO. At the same time the board must retain objectivity to enable it to remove the CEO should that be appropriate. These roles and obligations make governance a more complicated responsibility than is commonly believed to be the case.

The board is responsible for supervising the activities of management, monitoring the performance of the company and holding management accountable for its performance. It is not, however, the role of the board to manage the company or to deliberate on areas that are clearly the province of management. It is not the role of the board to provide leadership. In fulfilling its functions the board needs to remain critical and objective. Leadership of the company needs to come from the CEO.

Directors must act honestly, with due care and diligence and are responsible both individually and collectively for the actions of the board. Directors must put forward their views to ensure thorough examination of issues and must challenge the views of other directors and management if appropriate. All directors will be aware of their fiduciary duties to the company and must not allow conflicting interests to interfere with the discharge of those duties<sup>5</sup>. The board will have a process for managing conflicts of interest, which is in accordance with the *Corporations Act 2001* (the Corporations Act) and common law. To ensure directors competently discharge their duties, the board must act on a fully informed basis by having adequate access to and interaction with management

5. Chapter 2D of the *Corporations Act 2001* sets out the duties and powers of directors and other officers.

as well as access to relevant information. It is the responsibility of directors to ensure they have accurate and sufficient knowledge on which to base their decisions.

The corporate governance framework in Australia<sup>6</sup> establishes minimum requirements for public companies to ensure they meet the basic requirements of shareholders and requires disclosure of information on financial and non-financial matters. A good board will have a strong commitment to transparency, disclosure and accountability and will aim its governance arrangements at achieving outcomes rather than simply meeting minimum standards required by law.

### **Governance in closely held companies**

As with listed public companies the pattern of ownership is the principal factor which influences the nature of governance structures and processes in closely held companies. In the establishment of an overall governance framework, the issue of ownership will cause one mechanism of governance to be chosen rather than another.

Governance in closely held companies can take several forms depending on ownership arrangements. These organisations will often have shareholders who are themselves public or large private companies and may in fact be subsidiaries. They sometimes constitute joint ventures in, say, the mining industry. In Australia there are a number of large organisations which are family owned with a relatively small number of shareholders who have strong commonality of interest. There are also large family owned organisations with very little common interest between member shareholders. In many cases the parent or holding company will be a foreign corporation.

In conglomerates where a number of companies exist under an ultimate parent entity, it is not unusual for structures to be employed to support the CEO of the parent company in the supervision of these bodies. In particular, a specific small group will exist to monitor the operations and performance of the various operating subsidiaries. That group will interact with subsidiaries in the collection of information and report directly to the CEO, supporting him/her in holding to account the management of the subsidiary.

It is important to note that having only a small number of shareholders does not, in itself, imply a correspondingly small size. There are many companies and organisations in Australia that are quite significant in size, yet have a very small number of shareholders.

6. Corporate governance requirements for listed public companies in Australia include those set out in the Corporations Act, common law, the Australian Stock Exchange (ASX) Listing Rules and accounting standards (which include disclosure of financial matters). The ASX Corporate Governance Council issued in March 2003 a set of corporate governance principles and best practice recommendations for Australian listed companies.

There is in fact, a very important category of large private sector commercial organisations which are either closely held or under the ownership of a single shareholder. There may be more such organisations of significance than there are public companies of comparable size.

The smaller the size of the shareholder base, the more practical and efficient it is to delegate a high degree of autonomy within a framework of very tight supervision of factors critical for success both in the short and long term. The owners maintain direct control over management on strategy and cultural factors and leave management to undertake the day-to-day operations of the business. In such cases, a governance board will not necessarily provide the most appropriate way to ensure the long-term success of the enterprise. Owners will oversee the performance of management on a direct and immediate basis, and hold them accountable if they do not perform according to expectations. In undertaking their functions, management will usually be required to brief owners regularly in terms of key performance indicators (KPIs) and risk management.

There are, of course, plenty of examples in large closely held organisations which demonstrate that management governed by owners can perform at least as well as those high performing publicly owned corporations governed within the traditional non-executive board framework.

In circumstances where an owner or small group of owners decide to install a board to oversee the operations of the company, for the board to operate effectively, it will need to have autonomy and full power to act. However, there will be a risk that in such cases any views an individual owner expresses may limit the objectivity and judgement that are the characteristics of good governance through a board.

A board may inadvertently constitute a layer of obstruction to the owner seeking to direct management. Alternatively, management itself may see little benefit in the board and seek to deal directly with the owner wherever possible, reducing the effectiveness of the board and creating an environment of poor governance. Where required, some of the secondary benefits of a board, in terms of technical expertise and skill, can be sourced through business consultants and specialist advisors.

## **Governance of statutory authorities**

Statutory authorities are established to undertake functions of government or provide services to the community on behalf of government. Essentially, they represent a delivery vehicle for the implementation of established policy and the delivery of intended outcomes

based on those policies. Statutory authorities are often established when a degree of operating independence is seen to provide either objectivity or to promote efficiency depending on the nature of the task. Statutory authorities are established by legislation which, in most cases, will enunciate a specific set of arrangements under which a statutory authority will operate.

There are several ways in which establishing statutory authorities contributes to objectivity and efficiency. These include:

- separating specialised activities from the broader and more complex set of requirements of a portfolio department
- providing a narrow and clearly defined range of functions the authority is to fulfil
- establishing a degree of independence through codifying the role of the authority and defining the powers of the Minister
- creating a distinct body that might deal with cross-portfolio matters.

Portfolio secretaries have to reconcile a range of competing priorities, including providing support to the Minister and government in fulfilling their policy objectives, evaluating the effectiveness of policy and performance of the portfolio in achieving government priorities, as well as providing a range of services. Through establishing a separate entity within the portfolio to deliver a narrow range of outcomes, the Government can allocate dedicated resources to achieving specific functions. This provides confidence for the Parliament, the Government and the community that sufficient commitment and resources are being provided to areas of specialisation.

By providing a narrow and clearly defined range of functions the authority is to fulfil, its efficiency is likely to be maximised by allowing those with responsibility for managing the authority to focus solely on their delegation.

Some of the work performed by statutory authorities is sensitive and requires objectivity. The establishment of authorities with clearly specified boundaries of interaction both between peer public sector organisations and government provides confidence to the community that operations are carried out in an independent and objective manner.

However, it is the independent nature of these bodies that makes a framework of governance imperative to ensure that power is both provided and limited. This framework should be aimed at ensuring both short and long term success in, for example,

administering regulation both impartially and objectively and delivering services with an appropriate balance of efficiency and quality.

## **Government responsibilities**

Governments must govern. They are given responsibility for the delivery of a range of functions and services on behalf of the Australian community and are held to account by the public for their performance through the scrutiny of the Parliament, and through the electoral process.

The executive power of the Commonwealth, conferred on the Governor-General by section 61 of the Constitution, is exercised by Ministers under section 64 of the Constitution. In accordance with these provisions and the general principles of responsible government, Ministers are responsible for administering their departments and have a duty to execute and maintain the laws of the Commonwealth.<sup>7</sup>

Government activities are almost always directed at addressing societal issues for which the market is believed to not provide adequate solutions. These activities include being a regulator, provider of services and owner of commercial enterprises which may be monopolies and/or may undertake community service obligations (CSOs). Whether it is influencing economic outcomes through monetary policy, regulating market place behaviour, effecting income redistribution or providing services with CSOs, these activities can be viewed as promoting outcomes which the market would not otherwise have achieved.

In an environment of scarce resources, almost all functions performed by government will confront the irreconcilable demands of competing interests. Accordingly, it follows that if government entities achieve outcomes different to those that would have occurred without intervention, for the benefit of the community as a whole, stakeholders' interests will have been affected. Governments are elected based on a range of policies, including those which go to the issue of allocation of scarce resources between competing interests. Governments are typically elected with a mandate for certain policies and are ultimately held accountable for outcomes achieved, including the distribution of resources. Given that governments are accountable in this way, clearly, frameworks need to recognise the role of the Minister in the governance of authorities.

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7. Aitken G and Orr R, 2002, *Sawer's The Australian Constitution*, Third Edition, Canberra, Australian Government Solicitor, p 110.

## **Statutory authorities and the role of Ministers**

Ministerial responsibility for statutory authorities is established through legislation and the AAO that specifies the legislation for which each Minister has responsibility<sup>8</sup>.

A major determinant of the governance arrangements of statutory authorities is their enabling legislation. The enabling legislation will in most cases detail the relationship between the Minister and the statutory authority, establishing the level of independence within which the statutory authority will operate. The level of ministerial involvement in the operations of Commonwealth statutory authorities varies greatly depending on the objectives and functions of an authority. At the very least, Ministers have a general power to require authorities to provide them with the information necessary for them to meet their accountabilities and fulfil their duties to uphold the laws of the Commonwealth. In summary a Minister's involvement in the governance of a statutory authority will range from:

- extremely limited involvement (as in the case of the Australian National Audit Office where the Auditor-General has a high level of independence in the performance of functions)
- partially restricted levels of involvement, often establishing operational independence
- high levels of control, including comprehensive powers to direct activities, as would generally be the case where an authority's main role is service delivery.

The latter two levels of ministerial involvement are addressed in this report as the governance issues associated with the extremely limited level of ministerial involvement are beyond the scope of the review.

However, the extent of ministerial power in respect of a statutory authority is dependent not only on the powers provided in the enabling legislation but also whether or not the authority is established as a body separate from the Commonwealth (a body corporate).

Where the enabling legislation of an authority is silent on the powers of a Minister, it cannot be assumed that power does not exist. Where a statutory authority is not created as a body corporate, constitutionally, it remains part of the department of state. In these circumstances, the responsible Minister generally has the same powers in respect of the authority as he or she has in respect of the department of state, except for those matters

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<sup>8</sup> Ministerial responsibilities are set out in the Administrative Arrangements Order made by the Governor-General on the recommendation of the Prime Minister.



for which the authority has independent statutory responsibilities, including any decision-making powers that may be conferred on it by the enabling and any other related legislation.

Consequently, the powers of a Minister in respect of a statutory authority need to be considered in the context of its legislative framework (including the Australian Constitution). However, the range of possibilities can be summarised by noting that irrespective of whether an authority is a body corporate or not, a Minister cannot ordinarily direct the authority in relation to matters for which it has statutory responsibilities unless provided for by the enabling legislation. As it is operational independence that the enabling legislation will seek to ensure, for the purposes of this report, the analysis will assume that the legislative framework protects the operational independence of an authority.

Ministers frequently have the power to determine appointments<sup>9</sup> and may direct statutory authorities either through issuing directions or through policy, including if the Parliament agrees, legislative amendments. Where statutory authorities fail to meet performance expectations, however, it can be Ministers and not the boards or office holders of statutory authorities, who are ultimately held accountable by the Parliament and the public. As Ministers have a clear constitutional and legislative responsibility in the governance of statutory authorities it is vital they receive adequate support in the execution of their responsibilities.

Just as a CEO in a conglomerate, where there are a number of entities requiring oversight, would expect to receive advice and support, it is important for Ministers to receive adequate support including reports on the operations and performance of statutory authorities within the portfolio and objective advice.

## **The appropriate structures for statutory authorities**

Similar to a board in a public company, a governing board in a statutory authority can only perform a governance role effectively when it has the full power to act, including the freedom to determine strategy and direction, and the capacity to appoint and terminate the CEO. To get the best from boards in the public sector, the governance arrangements must create an environment for boards to perform their roles with critical thought, objectivity, wisdom, authority and the ability to exercise judgement.

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9. Under enabling legislation Ministers may have the power to determine appointments either directly or by recommendation to the Governor-General.

Bearing in mind the accountability of Ministers under the Commonwealth system of government (derived from the Westminster system) for many of the functions performed, it is impractical to delegate full power to act in governance terms, particularly to individuals who are neither accountable through elections nor through employment in the public service. The responsibility of governments to govern and the role of Ministers in supervising authorities highlight the importance of establishing governance arrangements that reflect these requirements.

The role of the Minister in the governance of some statutory authorities may be considered to be equivalent to that of a single owner of an organisation who would retain the right to direct the management on critical success factors, making a board redundant. This parallel is not diminished by the fact that many authorities need to preserve the objectivity and statutory independence of their decision-making.

Further, given the nature of the functions of many statutory authorities, boards have little opportunity to add value. Governments often delegate the administration of a narrow set of functions, limiting the issues to be addressed by the authority to the efficient and effective delivery of outcomes. This is essentially a management task. In addition, the price, quality and quantity of goods or services produced by the authority are in most cases established by government, removing the need for entrepreneurial supervision.

Given the role of the Minister in determining policy and overall strategy for statutory authorities responsible for a discrete range of functions, it is likely a CEO or a collection of office holders (a commission) will provide a practical and effective mechanism for ensuring alignment of operations with the specified delegation and the priorities of the Minister. These types of arrangements, with a clear understanding of what is to be achieved and concise delegation of authority, also provide a straightforward basis for accountability.

Accordingly, the question arises as to whether boards will provide effective or appropriate governance for statutory authorities. When implementing a board, for it to perform effectively the Government must delegate it the full power to act. In addition to internal strategy setting, the board should be responsible for the supervision of management, the oversight of risk and the ability to appoint and terminate the CEO. In situations where it is feasible to delegate the full power to act, such as commercial operations, a board will provide an effective form of governance.

In circumstances where statutory authorities operate with a degree of statutory independence, Ministers will be unable to provide direction in relation to day-to-day

operations. This independence distinguishes to some extent the governance arrangements of statutory authorities from those of a closely held company. Given the impact that statutory authorities can have on the public, including the business community, effective governance instruments need to be in place to ensure that adequate supervision occurs<sup>10</sup>.

As has already been stated, increased independence also increases the need for governance, particularly when this independence is combined with power. In the absence of the objective oversight a board comprised of independent directors can provide, the review considers that some statutory authorities require an alternative form of independent oversight and scrutiny.

Oversight mechanisms should not have the potential to allow ministerial interference with the day-to-day decision-making by statutory authorities. However, Ministers should have the ability to request an independent investigation of specific systemic issues. This would provide an additional source of independent advice for government and the Parliament about the way in which policy is administered and on improvements to systems and interactions with the public. In this sense, oversight mechanisms would operate as a means to assist the department support the Minister in holding statutory authorities accountable, including when they are not performing their functions in accordance with the expectations of government or the public.

Through the use of appropriate oversight mechanisms, the advocacy of community concerns is facilitated and those affected by the operations of statutory authorities are provided with an avenue for the expression of concerns associated with the quality of the administrative process. It is essential, however, that an oversight body is not able to interfere with the statutory independence of authorities. For example, it should not be possible for stakeholders to attempt to use it to pervert a regulator's objective application of regulation.

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<sup>10</sup>. An oversight mechanism for addressing individual complaints about the administrative actions and procedures of the Commonwealth currently exists in the form of the Commonwealth Ombudsman.

## Chapter 3 – What the review found

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In seeking to collect information on the effectiveness of existing governance arrangements for Commonwealth statutory authorities, extensive stakeholder consultations were undertaken. Consultations included, but were not limited to, Ministers, portfolio secretaries, chairmen of boards and chief executives of relevant statutory authorities, as well as the Auditor-General, the Commonwealth Ombudsman, a range of private sector representatives, including peak industry bodies and non-government organisations. This chapter summarises key findings of the research conducted by the review including that collected through the stakeholder meetings.

As established earlier, for the purposes of the review, governance is about ensuring the long-term success of an activity. This includes understanding success (*clarity of purpose*), organising for success (*structures, powers and relationships*) and ensuring success (*accountability and disclosure*).

### Clarity of purpose

Clarity of purpose is essential for effective governance. It requires executive managers to have a clear understanding of what they are required to achieve. For statutory authorities, this is determined by an understanding of the breadth of their responsibilities. However, information presented to the review indicated several issues associated with clarity of purpose. These include perceptions that the scope of the legislation is broad, that authorities operate beyond the bounds of their legislation and that there is overlap in the issues being considered by authorities.

The business community raised a number of concerns relating to the clarity of purpose for regulatory authorities, with these authorities sometimes considering issues beyond the scope of their functions and an overlap in the range of issues covered by the ACCC, ASIC and APRA. In addition, the review identified the potential for authorities governed by boards with non-executive directors to seek to expand their operations entrepreneurially.

For most of the authorities considered in the review, the enabling legislation provides the principal source of information on purpose and functions. The enabling legislation generally identifies the purpose of the authority, either through the administration of the

legislation or through a description of the purpose, including codifying powers and limitations on power.

The extent to which it is desirable to prescribe the breadth of a statutory authority's functions in its enabling legislation depends on the nature of its role. In the case of service delivery agencies it may be desirable to provide flexibility in the range of functions provided. For the HIC and Centrelink, the enabling legislation is deliberately broad in the way functions are defined. The respective Ministers can specify additional functions and can provide directions as to how functions are to be performed. Centrelink is able to deliver progressively a greater proportion of Commonwealth services as the business case for doing so is established. In the case of the HIC, the enabling legislation codifies the range of functions it is expected to perform, but also provides scope for additional functions to be performed, either within existing resources, or as requested by the Minister. Given the deliberately broad parameters in the enabling legislation of these authorities, Ministers clearly have a role in determining the breadth of their operations.

On the other hand, authorities which have significant powers, such as the enforcement powers and associated sanctions available to a number of the regulatory authorities, should have clearly defined parameters in the scope of their operations. Good governance will ensure that these agencies have a clear understanding of their role and provide adequate oversight to ensure they operate within their delegation.

The extent to which Ministers can direct or influence the activities of authorities depends largely on the legislative framework they operate within, including their enabling legislation. The enabling legislation for the large majority of statutory authorities includes provisions for the Minister to either direct the authority in relation to its performance and exercise of its powers, or to indicate to the authority that it disagrees with the policies of the authority. In all such cases, the legislation requires the directions to be provided in writing and to be either gazetted, tabled in Parliament or included in the annual report. However, the review notes that these powers of direction do not appear to provide a preferred vehicle for governments to establish clarity in authorities' purpose and function as they are rarely used.

In the case of the ATO, taxation legislation is silent on the Minister's powers of direction. However, as is the case for other statutory authorities that are not incorporated (that is, not established as a body corporate), the Minister has an overarching power in respect of the ATO to the extent that it does not interfere with the commissioner's administration of taxation legislation. This distinction may not be widely understood.

Consequently, the review sought to identify alternative mechanisms which might assist in establishing clarity of purpose.

The two Acts establishing the financial framework that statutory authorities operate within, the *Financial Management and Accountability Act 1997* (FMA Act) and the *Commonwealth Authorities and Companies Act 1997* (CAC Act), each have different provisions dealing with the application of general government policy to authorities. The differences between the Acts and the appropriateness of the coverage is canvassed later in this chapter, but it is sufficient to point out that neither Act provides for a level of direction that would assist in clarifying purpose and function. Sections 28 and 43 of the CAC Act allow the Government to write to Commonwealth authorities and companies requiring them to comply with general government policy. These provisions relate to general government policy only and are also very rarely used. The FMA Act has no such general provisions, however, the Finance Minister issues directions in relation to the use of resources and section 44 requires chief executives to promote the efficient, effective and ethical use of Commonwealth resources, which is generally understood to require compliance with general government policy.

Analysis of the Budget-related outcomes and outputs statements for the authorities considered by the review indicates that these alone will not provide a reliable mechanism for providing clarity of purpose and function. Outcomes statements are a high level expression of what government is seeking to achieve through the activities of the portfolio. Consequently, the outcomes statements provide little additional clarity in the functions of an authority.

The outputs statements provide a description of the products and services an agency intends to produce which will contribute to achieving the Government's desired outcomes. While the process of agreeing intended outputs with the Minister has the potential to provide an opportunity for the Minister and the statutory authority to reach a common view on purpose, the determination of the appropriate set of outputs is frequently within the practical control of the authority. Further, a review of the outputs indicates that they are expressed either at a high level or in a generic way, limiting their usefulness as a means for clarifying purpose.

As the existing formal mechanisms are not assisting in providing greater clarity, the informal interactions between the Minister and authority will be critical in clarifying

purpose. However, stakeholders highlighted a number of issues that cloud this relationship. These include:

- the presence of a board, which introduces another layer of participation
- a common perception that all statutory authorities are at arms length from government, irrespective of the arrangements established by the legislative framework
- a common perception within the public service that the financial independence associated with coverage by the CAC Act implies being at arms length from government
- there is little published material assisting stakeholders in identifying appropriate boundaries in their relationships and interactions.

### **Finding**

While the review identified several mechanisms by which governments may seek to clarify the objectives for statutory authorities, it considers there is scope to improve the means by which this is achieved.

### **Performance of boards**

Information collected by the review indicated several factors which reduce the effectiveness of boards. These include issues about clarity of purpose, the extent of the delegation of power to the board and the skills and experience of the directors.

As discussed in the previous chapter, boards can only provide effective governance when they have the full power to act. When a board is created and not given adequate power, not only will it be unable to provide effective governance, but it also introduces an additional layer of participation in the governance framework, potentially clouding accountabilities.

The review identified two main factors which diminish some boards' power to act. These are boards not having the power to appoint and terminate the CEO and strong and effective relationships being established between CEOs and Ministers.

A significant source of authority for any board is the power to appoint and remove the CEO. For several of the boards considered, these powers did not rest with the board. The enabling legislation for these authorities provides for only a limited set of circumstances in which CEOs can be removed. In addition, responsibility for decisions relating to the

appointment and reappointment of the CEO rests with the Minister. Consequently, the authority of boards in these circumstances will be limited to the extent to which they can influence the decisions of the Minister. However, the capacity of the board to influence these decisions is reduced where the level of trust and confidence the Minister has in the CEO is high.

Further, a CEO who establishes direct and regular contact with the Minister is able to use this relationship to influence both the board and the Minister. Where a CEO seeks to influence the direction of the board, he/she may be able to present the views of the Minister, as expressed in previous conversations, to exert pressure on the board to act in a certain way. Similarly, a CEO who is able to secure the support of the board for a particular course of action may justify taking actions not consistent with the priorities of the Minister on the basis that he/she was directed to do so by the board.

One exception to this principle identified in the course of the review is the RBA. While the board does not have the power to appoint and terminate the CEO, based on evidence provided to the review, the board was assessed as providing effective governance in determination of RBA policies. The structure of the board and the nature of its responsibilities meet the expectations of the international financial community with respect to effective governance arrangements. Divergence from such arrangements may affect international confidence in the independence of the RBA. The governance arrangements should remain unchanged.

Clarity of purpose is essential for authorities operating with boards, particularly those operating with non-executive directors drawn from the business community. In the absence of a clear direction and purpose, a board is likely to consider that its role includes exploring new ways to utilise the assets of the organisation. While such behaviour is appropriate for government business enterprises (GBEs), for those authorities established to focus on delivering a narrow range of outputs, this behaviour is not desirable. Even in the case of a GBE, entrepreneurial activity can be undertaken only within the parameters set by the CAC Act, the GBE's corporate plan, the GBE's company constitution or enabling legislation and the constraints of being a government body (including any constitutional issues that therefore arise).

The presence of a board also has the potential to create confusion in the exercise of power. Directors who understand their role to be ensuring the success of the entity may interpret the priorities of the authority in such a way as to be in conflict with government objectives. This could arise, for example, where broader government policy objectives



indicate a course of action that is different to that which the board would have taken in the absence of this policy.

Without clarity in dealing with such conflicts, directors may understand their broader duty being to act in such a way as to protect the interest of the authority. However, typically, the priorities of the board should be the priorities of government as the representative of the community. Unless limited by the legislative framework, governments, as the representatives of the community and with ultimate accountability for the outcomes that are achieved by the authority, should have the capacity to direct the board to act in accordance with government priorities.

One of the significant issues identified is that despite the oversight of an authority being delegated to a board, Ministers will often remain accountable for its actions. While not an authority included in the terms of reference, a good example of such a case is the Civil Aviation Safety Authority (CASA). Despite the existence of the board, the community expected the Minister to be accountable for the performance of the authority. In measures designed to strengthen accountabilities while maintaining CASA's power to take appropriate action, the Government has taken steps to restructure CASA, by removing the board, and taking a greater role in the direction of the entity.<sup>11</sup>

An evaluation of the backgrounds of directors on boards included in the review indicated a broad range in terms of skills and experience. Of those authorities considered by the review which operate under board supervision, there appears to have been a range of criteria used in considering the desirable qualities of candidates for appointment. These include experience in governing large and complex organisations, background in the sector, representation of stakeholders and skills.

Consultations with those responsible for the identification and appointment of appropriately experienced and qualified people indicated difficulty in identifying candidates who are appropriately experienced and known to be suitable for appointment, particularly for the larger organisations.

It is well understood by those who are involved in the identification of candidates for board appointments in the private sector that the pool of experienced and skilled people is small, particularly for directorships in large enterprises. Consequently, it is not surprising that the public sector also finds it difficult to identify and attract relevantly experienced and skilled people. This situation is exacerbated by the fact that many public

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11. CASA Reform, media release of 18 November 2002 by the Hon John Anderson MP, Deputy Prime Minister and Minister for Transport and Regional Services.

sector boards do not possess the full power to act and consequently provide little opportunity to make a difference.

Consequently, board appointments in the public sector have often been based on a number of factors that may be considered valuable to the organisation other than the wisdom that is born of experience in governing large organisations.

Many directors were identified as having experience in the sector in which the authority either operates or regulates. These directors are often able to provide the board with insights and information on the workings of the sector. Another common approach within both the public and private sectors is to appoint to boards people with specific skills and qualifications in areas that are valued by the board. These will often include people with backgrounds in accounting, information technology and human resources. While useful to the board, as discussed in Chapter 6, both the authorities and the boards have avenues other than board appointments to access this information and skills as required.

Another common basis for appointment to public sector boards has been the representation of stakeholders. These include representatives of recipients of government services, sectors being regulated, the workforce and secretaries of purchasing departments. Such appointments are said to help the board ensure that it is well briefed on all interests in evaluating the strategies of management. However, an issue that was often raised is managing the conflicts of interests that arise for these directors. The review considers that while these types of appointments are appropriate for advisory boards, for governance boards they fail to produce independent, critical and objective thinking. Representational boards do not provide the best form of governance for an authority due to the potential for directors to be primarily concerned with the interests of those they represent, rather than the success of the entity they are responsible for governing.

The review considers that for the boards evaluated, governments have been able to attract a variety of skilled and professional people. However, they have been most successful in attracting high quality and experienced people to the RBA and the Australian Postal Corporation. To some extent this may be due to the prestige associated with appointments to these boards but it is also likely to be a consequence of a more complete delegation of power to act. It is of course the level of experience and professionalism of board members, which ultimately determines the extent to which that power is exercised. The review is satisfied that in these two cases the powers have been used effectively.

## Findings

Governing boards that do not have full power to act are not able to provide effective governance and reduce clarity in direction and purpose.

It can be difficult to recruit appropriately experienced people to directorships, particularly to the larger Commonwealth authorities, due to the limited pool from which to draw, competition from the private sector, and a perception of a lack of ability of the board to make a difference.

Due to the lack of experience in governing enterprises of the size of many public sector organisations and the inherent conflicts of interests that often arise for many potential candidates for board appointments, a range of other skills and backgrounds is sought in selecting directors, placing at risk the realisation of the full potential of the organisation in the long term.

The review considers that the boards of the RBA and the Australian Postal Corporation provide effective governance and are appropriate for these organisations.

## Structures

Governance arrangements and structures in Commonwealth statutory authorities vary significantly. The variations between authorities include being subject to either the FMA Act or the CAC Act, or both, and being structured to operate under either a governance board or executive management.

There are significant differences between the FMA and CAC Acts, with implications for the appropriate governance structures. These include:

- CAC Act authorities are bodies corporate with separate legal identities to the Commonwealth and hold money and other assets in their own right.
- The FMA Act provides for clear lines of accountability to the Minister for Finance and Administration in relation to use of public money and other Commonwealth resources.
- CAC Act authorities do not have to comply with government policy, including as it relates to the use of resources (for example, Commonwealth procurement policy), unless specifically required under sections 28 and 44 of the CAC Act.

- The CAC Act is drafted to accommodate a board structure, whilst the FMA Act assumes an executive management structure.

There is significant variation in the governance structures established for the entities covered in the review. These differences are evident between those performing different types of functions as well as those performing similar functions. The HIC and Centrelink are both established to provide services to the community on behalf of government, through Commonwealth agencies. However, the HIC is established with a board and is covered by the CAC Act, while Centrelink is covered by the FMA Act and, unusually, is also governed by a board. Apparently, given the need to strengthen the governance power of the Centrelink board, the *Financial Management and Accountability Regulations 1997* establish the chairman of the board as the chief executive for FMA Act accountability purposes. However, the actual chief executive officer is the agency head for PS Act purposes. This situation creates an anomaly of having two chief executives for accountability and governance purposes.

Another example can be found with the regulatory bodies. Each of the three regulatory agencies considered in the review, has been established differently. The ACCC is established as a commission (without a board) and covered by the FMA Act, ASIC is established as a commission (without a board) and covered by the CAC Act (as well as the FMA Act regarding the public money it receives) and APRA is currently established as an authority, is governed by a board and is covered by the CAC Act.

The freedom from general government policy associated with the use of resources, and accountability to the Minister for Finance and Administration for the use of those resources, is justified for those authorities competing with the private sector, or for those authorities not funded by the Commonwealth. However, the review was not able to identify any benefit in terms of operational freedom or objectivity in having other Commonwealth authorities covered by the CAC Act. These authorities perform functions on behalf of the Government and are funded by the Commonwealth Budget, and consequently should comply with general government policy in the use of resources.

The variations in structure between Commonwealth agencies also extend beyond those discussed in this section. Agencies can also be established as 'executive agencies' under the PS Act, or functions may be established within the departmental structure, headed by a statutory office holder, with no direct appropriation and generally no direct employment powers. These variations have not been discussed in any detail as they are beyond the scope of the review.

## **Finding**

Given the significant differences in structures evident between Commonwealth agencies, and the associated implications for governance, the review has identified the need for a consistent approach to structuring agencies and establishing effective governance frameworks, including where to use boards and the application of the FMA and CAC Acts.

### **Purchaser/provider arrangements**

Two of the agencies considered by the review are funded through purchasing agreements with other government agencies to provide services on their behalf. These are commonly referred to as 'purchaser/provider arrangements'. While a funding arrangement does not in itself represent a mechanism of governance, there are issues of governance associated with these arrangements.

The main issue for governance is the extent to which these arrangements affect the way those responsible for governing the organisation work towards ensuring its success. For Centrelink and the HIC, success is considered to be the efficient and effective delivery of specified services. The issue for the review to consider has been the extent to which the purchaser/provider arrangements impact on the governance of the organisation in such a way as to promote the more efficient delivery of services while simultaneously ensuring the quality of the services delivered are aligned with those being demanded by the purchasing agencies.

In the cases of both Centrelink and the HIC, the purchaser/provider arrangements are seen as a means to provide leverage to the portfolio department to ensure the services being delivered are in line with their requirements. However, information collected in the course of the review indicates that purchasers obtain only minimal leverage in the procurement of these services due to several factors including:

- The annual cost of the services is established and paid for in advance of the services being delivered.
- There are no alternative providers for the majority of services.
- The service providers are, as yet, not able to identify accurately the transaction costs for the services being delivered. This reduces the purchasing department's ability to link the price paid to the volume delivered and to develop benchmarks.

- The incentives for the major purchasing agencies to be good purchasers are diminished by the fact that they do not benefit from any price reduction.
- Any attempt by the purchasers to withhold money based on under-delivery of services will result in greater risk to the purchasing department in services not being delivered adequately, undermining the achievement of the outcomes for which the purchasing department is responsible.

It is the assessment of the review that there are considerable resources being consumed in managing the purchasing agreement with very little or no benefit. As the large majority of services being delivered by a service delivery authority is within the purchasing department's portfolio, greater leverage over price and quality of services being delivered could be achieved through direct accountability of the authority to the Minister.

## **Finding**

From a governance perspective, the review was not able to identify a net benefit in the use of purchaser/provider arrangements for services being delivered within a portfolio due to the lack of purchasing power of the portfolio department.

## **The sharing, exercise and appropriate limitation of internal authority**

It is important for entities to establish power-sharing frameworks that enable them to achieve their purpose in an efficient and effective manner. The supervision of staff in the performance of their duties, including the exercise of power, is a management rather than a governance issue. However, governance should ensure that there is a system to delegate power to appropriately skilled individuals, allowing them to make decisions consistent with the purpose of the organisation. Additionally, governance requires that there be systems and reviews established to ensure that power is limited and exercised in a responsible manner and decision-makers have clear lines of accountability.

Office holders and staff of statutory authorities receive power either directly or through delegations from enabling legislation and the administration of specific legislation. In ensuring power is appropriately exercised, ideally there will be systems for the independent review of the quality of decisions made. This is particularly relevant where there is a high degree of discretion available to decision-makers and where decisions can have significant impacts on individuals, business and the broader community.

Statutory authorities identified in the terms of reference were requested by the review to provide information on how internal authority is shared, exercised and appropriately limited within their organisations. Through this information, supplemented by additional research, the review sought to develop an understanding of the broad frameworks and practices existing within statutory authorities that impact on decision-makers.

While specific legislation provides the basis for power, the exercise of that power may also require compliance with a statutory authority's financial and employment frameworks. For example, the CAC Act imposes obligations on an officer (including a board member) of an authority in the discharge of their powers<sup>12</sup> and the FMA Act requires chief executives to ensure the efficient, effective and ethical use of Commonwealth resources<sup>13</sup>. Further, the employment framework of a statutory authority, such as the PS Act, may also influence a decision-maker in the exercise of power through identifying appropriate values and conduct in the performance of duties.

There are also a number of external factors that may influence the exercise of power by statutory authorities. These factors include reviews of decisions, policies relating to conduct and guidance material regarding the exercise of delegated powers, such as:

- the review of decisions by bodies such as the Administrative Appeals Tribunal, the Australian Competition Tribunal and the Federal Court of Australia, including under the *Administrative Decisions (Judicial Review) Act 1977*
- the obligation for the Commonwealth and its Commonwealth bodies to act as a model litigant<sup>14</sup> under the Legal Services Directions issued by the Attorney General<sup>15</sup>
- the requirement for delegates to exercise their own discretion, as provided by section 34A of the *Acts Interpretation Act 1901*.

Governance arrangements will also ideally ensure that decision-makers are appropriately skilled and subject to review, particularly where the delegation of power occurs to less senior staff. All authorities specified in the terms of reference advised they have established frameworks and processes for delegating power. Additionally, all authorities had systems for review of delegation frameworks as part of audit and/or risk management arrangements.

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12. Refer Part 3, Division 4 (Conduct of officers) of the CAC Act.

13. Refer section 44 of the FMA Act.

14. The obligation requires Commonwealth bodies to act honestly and fairly in handling claims and litigation brought by or against it.

15. Pursuant to section 55ZF of the *Judiciary Act 1903*.

The functions and size of authorities vary and accordingly there were differences identified in the manner in which authorities delegated and reviewed the exercise of power. Some authorities, such as ASIC and the ATO, provided information reflecting initiatives to improve the quality of decision-making across the organisation through issuing guidance to delegates providing an indication of when power should or should not be exercised.

Better practice governance arrangements are considered to include a focus on risk management of delegation frameworks and place value on continuously seeking to improve the quality of decision-making. A distinguishing factor in the information provided was that some statutory authorities appeared to be more proactive in seeking to improve delegation frameworks including through consideration of comments from stakeholders, of the basis for complaints and of the findings of external review mechanisms.

## **Finding**

Frameworks for sharing, exercising and limiting power in statutory authorities can be affected by a number of internal and external factors. All authorities had frameworks in place for sharing power and procedures for review of delegations. However, some authorities reflected a more proactive attitude to risk management, including through the use of external mechanisms for the early identification of problems associated with delegation frameworks.

## **How statutory authorities relate to outsiders**

Unlike in the private sector where companies get constant feedback on the value of their outputs, consultations with stakeholders often represent the only significant source of information and feedback for authorities. Consequently the nature of public services often requires effective consultation to ensure the achievement of objectives as efficiently and effectively as possible, whilst causing minimum imposition.

Consultations undertaken by the public service are extensive. However, only those consultations linked to issues affecting an organisation's success are relevant to governance and are of interest to the review. Consultation associated with the development of broader policy is the responsibility of the portfolio department and while important to the success of statutory authorities, does not form part of the governance arrangements themselves.



The manner in which an organisation is perceived by outsiders and the extent to which it takes into account the impact on stakeholders is critical to its success. Several of the statutory authorities considered in the review have such critical relationships with the public, particularly business. Consequently, good governance should ensure these relationships are well managed.

The review found that for some of the governing boards considered, the appointments to the board were sometimes based on representing interest groups. This has ensured that boards are not only able to access a range of skills and expertise of practitioners in relevant industries, but also to ensure the views of parties interested in the governance of the authorities are represented. However, as previously discussed, the review does not consider that this basis for appointments provides for the best governance arrangements. Representational boards will not provide effective governance and skills and expertise can be accessed as and when required, just as the interests of stakeholders can be addressed through other means. Consequently, consideration should be given to alternative forms of interaction with stakeholders.

Of the statutory authorities considered there are significant differences in the types of relationships they have with the public, with implications for the appropriate forms of engagement.

It could be argued that of all statutory authorities, the ATO has the most significant and wide-ranging relationship with the community, involving people both as individuals and also where they may be participants in business or non-profit organisations or as tax professionals. To assist the community in that relationship, the ATO has established a wide range of consultative arrangements dealing with the implementation and administration of taxation legislation. These arrangements, which continue to evolve, may take many forms – national and regional liaison committees involving senior representatives of the ATO and representatives of peak business bodies, working parties, task forces, discussion documents, seminars and conferences.

The implementation and administration of taxation legislation is of equal importance to government. The Board of Taxation, a non-statutory advisory body, was established by the Government in 2000 to provide advice on the quality and effectiveness of taxation legislation. A key role of the board is to consult widely with the community about implementation aspects of tax policy decisions by government. An example is the July 2002 report by the board,<sup>16</sup> following its consultation with the community proposing the creation of the office of the Inspector-General of Taxation.

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<sup>16</sup> Board of Taxation, 2002, *Inspector-General of Taxation: A Report to the Minister for Revenue and Assistant Treasurer*.

Members of the Board of Taxation are senior people representing a range of interests drawn from the non-government sector, plus three *ex officio* members – the Commissioner of Taxation, the Secretary of the Department of the Treasury and the First Parliamentary Counsel. The board receives its references from Ministers in the Treasury portfolio rather than from the ATO and is supported by a small secretariat in the Department of the Treasury.

The review found a high level of support for the Board of Taxation, including from peak industry bodies. The board provides an effective mechanism for government to identify potential issues prior to the implementation of tax policy and to provide an avenue for the community to have its views heard and considered by a body comprising largely non-government representatives. The Board of Taxation is not a governance mechanism, however, its advisory and consultative role provides government with valuable information about community views on the administration of taxation legislation.

The relationship between statutory authorities having a regulatory function and the regulated community is also significant. Like the ATO, regulatory authorities have established mechanisms for consultation with the regulated community. Some of these are effective while others are not.

As could be expected, the regulated community has a keen interest in how regulatory authorities exercise their powers, especially those involving discretion and where punitive action may be a possibility. The regulated community's interaction with the regulators is driven, therefore, by at least two needs. First, is the need to develop an understanding of the priorities and strategies of regulators and second, for scope to raise any concerns with those responsible for the governance of the regulators about the way in which regulators carry out their functions. These two needs must be met in order for the regulators to have the support and particularly the respect of the regulated community.

The information provided to the review by some in the regulated community and also by regulators suggests that current consultation mechanisms deliver information but may not always provide sufficient scope for an effective exchange of views or dialogue. A lack of meaningful engagement constitutes a serious lost opportunity to build community respect for regulatory authorities.

A further issue to emerge was a reluctance of individuals or businesses in the regulated community to voice complaints with a regulator about the way in which it uses its discretionary powers, because of the perceived possibility for an adverse future reaction.

The relationship between authorities having a service delivery function (for example, the HIC and Centrelink) and the community is also broadly based. Advice from the community on the quality of its interaction with these authorities is critical to understanding public perceptions in order for the authorities to respond with remedial action or improvements leading to better service delivery. The HIC and Centrelink each use a range of mechanisms to collect feedback from the community, including surveys, focus groups and representational committees.

## **Findings**

Meaningful consultation between the community and statutory authorities is critical to their success.

The lack of effective consultation for some regulatory authorities represents a serious lost opportunity to build the respect of the regulated community.

## **Accountability and disclosure**

Accountability frameworks are an essential part of governance. Those with responsibility for setting direction and providing oversight need to know an authority is achieving its objectives and is doing so in a manner consistent with the legislation and where relevant, the priorities of government. This requires those responsible for the performance of the authority to have a clear line of accountability to those responsible for governance.

The accountability and disclosure framework covering statutory authorities has a variety of components. An authority's enabling legislation typically requires an authority to provide an annual report to the Minister for tabling in the Parliament. An authority's financial framework (FMA or CAC Act) requires the audit of financial accounts and may require notifying the Minister of significant events. An authority may be reviewed by the Auditor-General through a performance audit. Its operations may also be subject to scrutiny by a parliamentary committee. In addition, authorities generally are subject to the full range of administrative law provisions, including investigations by the Commonwealth Ombudsman, freedom of information requests and review of decisions by the Administrative Appeals Tribunal.

While each of these components provides both a level of insight into the performance of statutory authorities and assistance in their accountability for their performance, the analysis and findings discussed earlier in this chapter suggest there is scope for improvement.

A common concern raised by the business community in both consultations and in submissions, is the absence of effective accountability for the way in which the regulators go about their task. There was almost universal concern that regulators are effectively accountable to no-one for the systems and procedures they employ in performing their functions. In particular, there was considerable concern regarding what appeared to be a 'presumption of guilt' in the way in which some areas of regulation are being enforced, including the way the media has been used. While it was commonly agreed that regulators require objectivity and independence from government in the exercise of their regulatory duties, this should not translate into an absence of governance.

In discussion with the ACCC, the chairman indicated that the courts provide the ultimate source of accountability for the way in which the Commission goes about its function. It is the view of the Commissioner that if a company believes that the Commission has not acted in accordance with the powers provided to it under the *Trade Practices Act 1974*, these disputes can be settled in the courts. However, the review notes that the concerns raised by the business community do not always relate to whether or not the Commission acts within the powers provided by the Act. Further, the courts can represent a costly means of settling disputes, often with significant time delays.

Consequently, there is a need for effective governance that is capable of ensuring regulatory authorities are accountable for their behaviour in the way they go about their regulatory functions. However, there are several factors impacting on the capacity of the Minister to exercise effective governance. These include:

- limitations on a Minister's capacity to direct authorities in terms of the conduct of their operations
- the presence of a board which does not have full power to act, having the effect of confusing and diluting accountabilities between the Minister, the board and the chief executive
- the lack of clarity in relationships and responsibilities reduces the capacity of Ministers to be satisfied with existing accountability arrangements
- the 'hands off' aura surrounding statutory authorities, which arises from the need for operational independence, means that the boundaries of the relationships between statutory authorities, Ministers and portfolio departments are not clear to the participants.

As discussed in Chapter 2, it is the independence of statutory authorities, particularly those with significant power, that makes effective governance essential. Clearly, the areas of necessary independence of statutory authorities need to be protected. Governance structures need to strike a balance between maintaining those necessary areas of independence and enabling government to both govern and get the best in terms of performance from statutory authorities.

A number of private sector representatives consulted by the review argued that boards are likely to provide an effective form of governance for many public sector organisations. Their view had regard to several factors, including the general success of boards in providing governance in private sector organisations. Some also advanced the view that in respect of the public sector, especially where a Minister's power to direct a statutory authority is limited, there could be value in the presence of non-executive directors because they may offer an objective view and detached form of oversight. An alternative view from the private sector acknowledged that boards may not be appropriate in all circumstances, especially where it is more appropriate for an executive or group of executives to be taking regulatory action.

This review of statutory authorities demonstrates that where those boards have been empowered with full authority to act, and are structured appropriately, they were effective in providing oversight of the management of the relevant authority. An example can be found in the Australian Postal Corporation.

However, this review has found that boards are not an appropriate form of governance for many statutory authorities, especially those whose functions are to regulate or are largely 'non-commercial'. Consequently, the review sought to identify an alternative from the 'governance tool kit' that might assist the portfolio department in the provision of objective oversight in the absence of a board.

The Inspector-General of Taxation canvassed earlier in this chapter provides an independent and objective office to investigate systems established to administer taxation legislation. Its role is in relation to identifying systemic issues and recommending improvements in administration, rather than investigating individual complaints of maladministration which remains the responsibility of the Commonwealth Ombudsman. To avoid the potential for overlap, the Inspector-General of Taxation is required to consult with the Commonwealth Ombudsman and the Auditor-General at least annually.

The Inspector-General of Taxation provides an alternative governance structure by providing an independent source of advice to government in matters relating to systems

in tax administration and enabling taxpayers (including industry, likely to be represented by peak bodies) to raise issues about the administration of taxation legislation.

### **Finding**

The model of an Inspector-General provides an effective mechanism in providing objective oversight and can be considered as an alternative in the 'governance tool kit'. However, the model may not be applicable broadly and its suitability should be considered on a case-by-case basis.



# Chapter 4 – Governance going forward

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The initiatives to improve the performance of statutory authorities identified in this chapter build on the concepts of governance raised in Chapter 2 and take into account the limitations of current governance arrangements outlined in Chapter 3. In discussing these opportunities, a range of issues is explored, including:

- defining success of statutory authorities operating in the public sector
- establishing a clear purpose for statutory authorities
- achieving greater clarity of roles and responsibilities between Ministers, portfolio departments and statutory authorities
- support for Ministers in conducting their governance roles
- appropriate governance structures for statutory authorities
- opportunities to ensure more consistent application of existing legislative structures
- organisational culture and values.

## Creating statutory authorities

As discussed in Chapter 2, statutory authorities are often created with a degree of independence to provide either objectivity or to promote efficiency in the way in which an activity is undertaken.

The reason for establishing a statutory authority will determine the nature of the relationship with the Minister. Statutory authorities established to operate with objectivity, such as regulatory agencies, may be established in such a way as to limit the capacity of the Minister to influence their exercise of statutory power. Statutory authorities established to promote efficiency, such as service delivery agencies, are likely to have greater powers of direction for Ministers.

Creating a statutory authority also has the benefit of separating the policy advising function from the implementation role, ensuring that advice is independent of the



interests of those implementing policy. However, it is important that the benefits of establishing functions separate from government are significant enough to warrant the creation of statutory bodies which operate with independence, because of the corresponding diminution of ministerial power to supervise the performance of such bodies.

The powers and functions of statutory authorities and office holders are generally specified in significant detail in the enabling legislation. While this is a feature of statutory authorities, it also has the effect of limiting the flexibility in responding to changing government and community priorities. Legislation may become dated and can be difficult to change.

Consideration should be given to whether functions can be accommodated successfully within a departmental structure or an executive agency, reducing the need for the creation of a separate authority and the associated costs and demands placed on the public sector.

As government remains accountable for the performance of statutory authorities, careful thought needs to be given to any decision to create bodies that will operate with a higher level of independence than departments of state, as this will impact on ministerial ability to supervise directly the performance of such bodies. The value of a centrally located coordination function to assist government in this regard is canvassed later in this chapter.

## **Understanding success**

The concept of success is central to good governance. Clear measures of success provide greater transparency about a statutory authority's performance to the Government, the Parliament and the public.

Success in the private sector is commonly recognised as increasing shareholder value. Success in these terms is easily measurable due to its largely economic basis. For statutory authorities, success is generally associated with effective and efficient achievement of the objectives set by government and/or the Parliament. However, the definition of success will differ between authorities and consideration of a number of elements is required.

While government has many roles, the review has considered the activities of statutory authorities whose functions include regulation, the provision of Commonwealth services

and commercial operations. The differing functions and objectives of these entities will impact on how success is achieved.

The measures of success for Commonwealth commercial bodies are relatively easy to define, as their functions and objectives closely resemble the features of the private sector. To succeed, commercial bodies are expected to operate efficiently and competitively and achieve an acceptable rate of return on investment taking into account the risk of the enterprise. In addition, commercial bodies must also be able to meet any CSOs allocated by government.

Success for a regulatory body may be determined according to the levels of compliance by the regulated community with the legislation being administered and the ability to remedy non-compliance in an efficient and effective manner. A regulator must also be able to build and maintain the respect of the regulated community for the way in which it conducts its operations. The regulated community does not have to agree with the regulator's decisions but the regulator should be regarded by the community as operating with competency and equity within its delegated responsibilities.

The success of a service delivery agency rests on its ability to deliver efficient and effective services to the community, to produce quality interactions with those receiving the services and to generate positive perceptions by the community about the standard of service being provided.

## **Clarity of purpose**

Having a clear purpose is essential to effective governance. Organisations which do not operate with clear purpose have a limited capacity to define long-term goals and are unlikely to meet the expectations of stakeholders. For statutory authorities, a clear purpose is essential to meeting the objectives of government and the expectations and needs of the public.

When a statutory authority is unsure of the expectations of government there is a risk it will operate in a manner that represents a wider mandate than its legislation may envisage, leading to inappropriate use of resources and unintended outcomes. There is also the risk that a statutory authority will not be undertaking operations that a Minister has anticipated, also resulting in a failure to meet expectations.

Statutory authorities determine their purpose from a variety of sources including legislative frameworks, particularly their enabling legislation and any ministerial

directions. However, as discussed in Chapter 3, the current governance frameworks do not always ensure statutory authorities have a sufficiently clear understanding of their purpose.

The review proposes a governance mechanism that would ensure that individuals responsible for the performance of statutory authorities clearly understand the expectations of government including the outcomes for which they would be held accountable. The review recommends that a Statement of Expectations from the Minister and a response from the authority, outlining commitment from the authority to the Minister's expectations, would be an appropriate mechanism for fulfilling this need.

A Statement of Expectations would enable a Minister to provide greater clarity about government policies and objectives relevant to a statutory authority, including the policies and priorities it is expected to observe in conducting its operations. A statement would not, however, seek to impinge on the level of independence or objectivity provided to an authority under legislation, and accordingly would need to be consistent with the power provided to a Minister under the legislative framework of the relevant authority.

In order to demonstrate understanding and commitment to the expectations of a Minister, a statutory authority would be required to respond to the statement. The response, a Statement of Intent, would outline how the authority intends to undertake its operations, and how its approach to operations will be consistent with the Statement of Expectations. Within the powers available, the Minister could seek a modification of the Statement of Intent if it did not address expectations sufficiently.

For this process to be meaningful, responses should include performance indicators that enable assessment of the performance of an authority against expectations. This would require authorities to identify relevant KPIs, which would include financial and non-financial measures limited to those critical to the success of the authority and presented in a format that can be independently verified if required. For objectives to be achieved, it is important that Ministers and statutory authorities have a clear understanding of the elements being measured and how each measure is derived. For statutory authorities to be accountable for meeting the expectations of Ministers, information regarding performance against the agreed KPIs should be available to the Minister as required and made publicly available.

The Statement of Expectations and the response from the statutory authority would apply in the absence of other arrangements enabling Ministers to endorse direction and convey expectations of performance. For instance, a number of commercial bodies, including

GBEs, obtain endorsement from Ministers on broad strategy and purpose through the corporate planning process. As part of this process, a GBE produces a Statement of Corporate Intent (SCI) reflecting, amongst other things, details on code of ethics, accountability and broad performance expectations (as the SCI is not to include commercial-in-confidence information). The corporate planning process including the SCI, performs a similar function to the proposed ministerial Statement of Expectations and an authority's Statement of Intent, as it assists in ensuring a clear understanding between a Minister and a GBE on its purpose and operations.

Statements of Expectations and Intent would be subject to review at least annually and more regularly if deemed appropriate. For instance, a review of the documents would be warranted if a new Minister or a new head of the authority were to be appointed or if there were to be a shift in government approach in a relevant area. The Statements of Expectations and Intent would be made public as soon as is practicable after agreement is reached, to provide transparency and raise community awareness about the expectations of government and the responses of authorities.

#### **RECOMMENDATION:**

*The Government should clarify expectations of statutory authorities by Ministers issuing Statements of Expectations to statutory authorities; by statutory authorities responding with Statements of Intent for approval by Ministers; and by Ministers making Statements of Expectations and Intent public.*

*– Statements of Expectations would need to take into account the nature of the independence of each statutory authority and may not be necessary where the existing governance framework provides for a comparable arrangement (for example, as is the case in respect of GBEs).*

## **Organising for success**

With a clear understanding of the meaning of success and the clarity of purpose, the appropriate roles, relationships and structures can be established.

### **Clarity of roles**

Chapter 3 identified some uncertainty about the degree to which statutory authorities, Ministers and portfolio departments can appropriately engage in meaningful exchanges. Uncertainty about what 'independence' means in respect of each statutory authority,

especially given authorities have differing degrees of ‘independence’ leads participants to be cautious. Removing uncertainties, by clarifying and enunciating roles, would help to develop a common understanding of governance structures and consequently their use.

The parties central to the governance of statutory authorities are Ministers, statutory authorities and portfolio departments.

### **Relationship between the government and statutory authorities**

The principle of responsible government<sup>17</sup> requires Ministers to be accountable to the Parliament (and ultimately the public) for government administration, including the activities of statutory authorities within their portfolios. Accountability is achieved in a variety of ways, including by statutory authorities reporting annually to Ministers who table those reports in Parliament, and by Ministers responding to questions in the Parliament about any matter within their portfolios, including the operations of statutory authorities.

Although not universal, the enabling legislation of a statutory authority typically provides a capacity for the responsible Minister to issue directions to the authority. The scope of ministerial directions varies from authority to authority, ranging from extensive powers of direction to the capacity to direct an authority to adhere to broad government policies. Where an authority has a regulatory function, ministerial powers of direction may be defined so as to exclude direction in relation to how an authority handles individual cases (for example, ACCC legislation). In those limited circumstances where a statutory authority is empowered with policy-making responsibilities, for example the RBA’s power to determine interest rates, the responsible Minister has a reserve power of veto.

The principle of ‘collective’ ministerial responsibility reflects the convention that all Ministers accept joint responsibility for the agreed policies of the Government, regardless of whether or not there are implications for their individual portfolios. On those occasions where a government makes a policy decision on objectives not specific to an individual Minister’s portfolio but which, nevertheless has implications for the portfolio, the Minister’s responsibility is to ensure the policy decision is implemented, including in any statutory authorities within the portfolio, subject to legislation. Given ministerial responsibility for legislation and resourcing, statutory authorities should advise the Minister of proposed interactions with the Parliament prior to doing so.

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17. Referred to by Aitken G and Orr R, 2002, *Sawer’s The Australian Constitution*, Third Edition, Canberra, Australian Government Solicitor, p 108.

Ministers have a role in the appointment of office holders, either directly or by recommendation to the Governor-General. The people who hold the most senior positions in statutory authorities are critical to performance, making the selection process a crucial responsibility borne by Ministers.

The Minister for Finance and Administration has a role in the financial management of statutory authorities under the FMA and CAC Acts, and in the case of those authorities which are also GBEs, the Minister for Finance and Administration also has shareholder responsibilities.

In exercising these responsibilities, Ministers are supported primarily by their departments.

### **The role of the portfolio department**

The responsibilities of the secretary, as provided for in the PS Act, include managing the department and providing advice and support to the Minister in fulfilling his or her obligations of accountability to the Parliament. The PS Act also promotes a public service which is *'responsive to the Government in providing frank, honest, comprehensive, accurate and timely advice and in implementing the Government's policies and programs.'*<sup>18</sup>

Departments are the primary source of public sector advice to Ministers and are best placed to support Ministers in the governance of statutory authorities. In this respect, the portfolio secretary has a role akin to an advisory function within a parent company in providing advice to the CEO about the activities of the company's subsidiaries. Departments have a role in advising Ministers on options involving establishing statutory authorities, on the performance of statutory authorities, in developing policy and legislation and in supporting Ministers during the passage of legislation through the Parliament.

The advisory role of departments includes, but is not limited to, advice and analysis on key documents produced by statutory authorities (for example, financial performance, corporate plan, progress against objectives and annual report) and on appointments to statutory office holder or board positions.

Departments, having this policy advice role, are best placed to provide whole-of-government advice on any matters arising from the activities of statutory authorities in relation to policies and frameworks. They have built the necessary infrastructure,

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<sup>18</sup> Subsection 10(f) of the *Public Service Act 1999*.

resources and culture to assist them to fulfil this role as the primary source of public sector advice and support to Ministers. The Australian public service has developed practices that assist its ability to develop policy options for government and implement agreed government policies. These practices include inter-departmental committees, regular meetings of portfolio secretaries, and consultative networks with business and the community.

The ministerial advisory and support role provided by departments enables Ministers to receive advice on matters relating to statutory authorities from a more objective source; that is, a source removed from the day-to-day operations of a statutory authority but informed about whole-of-government policies and priorities and with the responsibility to provide a Minister with the best possible advice.

This advising and support role would include advising the Minister on the terms of the proposed Statement of Expectations and consideration of the response from the relevant statutory authority, advice on meaningful KPIs for statutory authorities, advice on performance by statutory authorities and guidance on matters relating to the appointment of office holders and board members.

A strong working relationship between the department and statutory authorities in the portfolio, in particular between the portfolio secretary and the head of each statutory authority, is a pre-requisite to supporting the relevant Minister in governance responsibilities. Provision of appropriate information by statutory authorities to departments will assist them in their policy development and advisory role.

### **Relationship between the statutory authority, the Minister and the department**

As mentioned previously, statutory authorities operate under a set of accountability arrangements that requires them to provide the Minister with certain information. This includes an annual report and Budget information, and may include a corporate plan, advice about 'significant events' or advice in advance of committing the authority to expenditure above a particular value. For example, authorities covered by the CAC Act are required by sections 15 and 16 to notify relevant Ministers of 'significant events' and to keep the relevant Ministers informed.

Ministers and statutory authorities are likely to have developed arrangements for regular communication in addition to formal reporting requirements to ensure both parties are kept informed of relevant matters and that there are 'no surprises' for the Minister.

Ideally, with the Minister's concurrence, regular information on performance provided by the head of an authority to the Minister would be provided in parallel by the authority to the department to enable the department to fulfil its role as advisor to the Minister. Similarly, any matter of significance the head of an authority raises with the Minister would be notified to the department also. The governance arrangements for GBEs reflect such an arrangement: the development of corporate plans involves discussions with the departments of shareholder Ministers.

Statutory authorities can assist government in policy development by keeping departments informed, including by drawing to attention any issues identified as providing an opportunity for improvement. By working more closely with departments, statutory authorities would be contributing to supporting departments in their policy advice and support role to Ministers.

#### **RECOMMENDATION:**

*The role of portfolio departments as the principal source of advice to Ministers, should be reinforced by requiring statutory authorities and office holders to provide relevant information to portfolio secretaries in parallel to that information being provided by statutory authorities and office holders to Ministers.*

### **Governance structures for statutory authorities**

With a clear understanding of what is to be achieved, the appropriate governance structure can be established. The establishment of structures not suited to the circumstances of a statutory authority will have a negative impact on the performance of the authority's functions. For example, where boards are employed in inappropriate circumstances a number of hazards may obstruct good governance and performance.

Boards in public companies are an effective governance mechanism as they are delegated full power to act (within the constraints of the law). The power of the board in a public company is derived from the ability to appoint and remove the CEO, appoint the chairman and new directors,<sup>19</sup> finalise and approve strategy, define the values and culture, 'say no' to management and give final approval to the sale and purchase of significant assets. When these powers are diluted or modified, a board of directors is rendered useless.

19. New directors appointed by the board are generally subject to confirmation by shareholders at the next annual general meeting in accordance with the *Corporations Act 2001*.



Inevitably, in many statutory authorities the government retains power over at least some of these elements. Where government considers it inappropriate to delegate the full power to act, a board will not deliver the best governance outcomes. When a board is restricted in its ability to act, either through formal limitations or through informal relationships which bypass the board, it will fail to perform an effective governing role, thereby reducing performance of the authority and providing ineffective supervision of management. With a few notable exceptions, boards in statutory authorities are likely to be an unnecessary layer in the accountability framework.

Where a CEO establishes regular contact with the Minister, the relationship between the Minister and the chairman becomes superfluous, as it would in a private sector closely held company. The inability of a board to either prevent this from occurring or add value to this relationship makes the board's task of effective oversight of the performance of management difficult if not impossible.

The accountability process is further complicated in a number of ways by the existence of a board with less than full governing powers. In such cases, the board will often become captured, and tend to become an ally of the CEO, rather than an objective critic and fail to provide governance. Management may use a board to obtain agreement for activities that may not otherwise be agreed by the Minister and then use the justification of 'board approved' to explain why actions are occurring. In these circumstances a board that lacks one of the key sources of power will not be effective in holding management accountable.

Where a board is established without adequate power there is a risk that it may seek to define a role for itself other than one of governance. This is sometimes achieved by utilising its collective knowledge and expertise in a particular field, in a manner similar to a consultancy service, and engaging in issues of management rather than focusing on ensuring the organisation is striving for high performance. Alternatively, a board seeking to identify a role for itself may adopt an entrepreneurial approach and seek to establish new areas of activity for the statutory authority outside the parameters of its delegation or the expectations of government.

Those statutory authorities with mainly commercial operations and where it is seen appropriate to delegate the full power to act will generally be better suited to a governance structure that includes a governing board. A board structure will provide the statutory authority with the necessary freedom to develop and implement business policies in a manner that is responsive to the demands of the market in which it is operating. A governing board will also be appropriate where the Commonwealth is not

the sole owner, for example, where an authority is established by a number of governments or is funded by industry levies.

Where it is not feasible for the Minister and/or Parliament to delegate the full power to act, a governance board is not practical. This is particularly the case in those authorities where Ministers play a key governance role through the determination of policy and strategy. In these statutory authorities the issues to be addressed are limited to the efficient and effective performance of the activities specified through legislative parameters. This is essentially a management-oriented task. The optimum governance structure for most non-commercial authorities is that of an executive management that reports directly to the responsible Minister. The executive management structure may be headed by either one or more commissioners or a CEO. An executive management structure provides a direct line of communication between the Minister and those performing legislated functions, and the clearest and most direct line of accountability to the Minister.

#### **RECOMMENDATION:**

*Governance boards should be utilised in statutory authorities only where they can be given the full power to act.*

### **Inspector-General of Regulation**

The greater the independence of a statutory authority from government and the greater the power of that statutory authority, the greater is the need for governance. This is particularly the case for those authorities where a governing board is not an appropriate structure and the statutory independence of the authority limits the Minister's capacity to provide direct supervision of management. In such cases there may be a need for an additional mechanism of governance.

The recently legislated role for the Inspector-General of Taxation to undertake independent investigation of systems used to administer tax law and report to the Treasurer and the Parliament provides an additional source of governance. The Inspector-General serves as an avenue for the concerns of taxpayers with the systems of the ATO to be independently investigated. The Inspector-General model is likely to have similar value in other areas of government operations where there is significant impact on the community. Concerns of stakeholders with systems and procedures are more likely to be raised in a full and open manner when doing so does not have the potential to affect their ongoing relationship with an authority.

An Inspector-General with capacity to investigate both systems and procedures would also add value if implemented in the area of regulation. The operations of regulatory authorities have a considerable impact on the community, particularly business. The nature of the relationship between regulators and the regulated, including the potential use of punitive powers, may make it less likely that concerns with the administration of legislation will be highlighted through regular interactions.

Establishing an independent body with resources dedicated solely to investigate regulatory systems and procedures would provide the community with a mechanism to ensure that the regulators are being held to account for the way in which they exercise their powers. An Inspector-General of Regulation would provide an efficient means of ensuring independent scrutiny and is not an additional layer of administration in the governance framework of regulatory authorities.

The role of the Inspector-General of Regulation would complement the existing role of the Commonwealth Ombudsman. As in the case with the Inspector-General of Taxation, an Inspector-General of Regulation would be expected to consult with the Auditor-General and the Ombudsman in settling his or her work plan so as to avoid duplication.

Where statutory authorities provide services, dissatisfied individuals are able to seek redress through the Ombudsman. Where a pattern of complaints emerges, the Ombudsman has the power to undertake investigations into systemic issues. However, in the case of systemic regulatory issues, it is the opinion of the review that the business community will be more inclined to seek an investigation of issues through an Inspector-General of Regulation.

An Inspector-General of Regulation, in combination with the governance roles of Ministers and their departments would create a comprehensive governance framework for regulatory authorities.

**RECOMMENDATION:**

*The Government establish an Inspector-General of Regulation to investigate, where necessary, the systems and procedures used by regulatory authorities in administering regulation.*

## Central coordination

Analysis of governance arrangements in existing statutory authorities in Chapter 3 indicates that there is further opportunity to improve consistency in the structures and application of legislative frameworks to these bodies. Given the value the contribution of statutory authorities can add to government outcomes, it is important they are established with appropriate governance arrangements that enable high performance. It is also essential for authorities to be established with the structures and legislative frameworks that will assist them to efficiently and effectively fulfil their purpose and the expectations of stakeholders.

Accordingly, the Commonwealth will benefit if it were to allocate a coordinating function to a centrally located group with expertise in the application of appropriate governance and legislative structures to the various types of statutory authorities. This group would be charged with developing guidance and advising portfolio departments and relevant agencies when statutory authorities are being created, wound up or altered. This group should also be well placed to provide timely advice to government on issues surrounding the development of new statutory authorities or in any review of current arrangements for existing statutory authorities. This advice should include appropriate governance structures, financial frameworks and employment arrangements.

### RECOMMENDATION:

*The Government should allocate a function to a centrally located group to advise on the application of appropriate governance and legislative structures when establishing or reviewing statutory authorities.*

## Selecting the right financial framework

The review found that there is scope to improve consistency in application of the FMA Act or the CAC Act to statutory authorities.

The overall structure of a statutory authority and the ownership of assets should influence the selection of a suitable financial framework. The most suitable financial management structure to be applied to a statutory authority should be guided by the appropriateness of:

- placing control of the entity's cash and other assets outside the ownership or control of the Commonwealth

- vesting financial management powers in the apex or executive director of the authority and not a board structure
- the authority operating outside of general government policies such as procurement policies.

The CAC Act and the FMA Act are structured differently and impose different requirements on officers operating under them. In considering whether to apply either the CAC Act or the FMA Act to a statutory authority the following points should be considered.

### ***Commonwealth Authorities and Companies Act 1997***

The CAC Act was generally framed assuming a governing board structure and prescribes accountability arrangements for boards with both non-executive and executive directors. Management and accountability provisions of the CAC Act mirror similar provisions under the Corporations Act and provide a flexible framework for statutory authorities to respond in a timely manner to changes in the relevant market.

The CAC Act is structured in a way that provides statutory authorities greater freedom from general government policies compared to entities under the FMA Act. To make CAC Act authorities subject to the requirements and comply with general government policy requires a significant administrative process. Section 28 of the CAC Act details how the responsible Minister may notify directors of a statutory authority of applicable general government policies. For these reasons, the CAC Act is suited to those statutory authorities in circumstances where either a governing board is given the power to act, where the assets do not belong to the Commonwealth, or where there is a need for operations to occur generally unfettered by general government policies (such as in commercial operations).

### ***Financial Management and Accountability Act 1997***

The FMA Act provides an appropriate framework for the proper management of public money and property where these assets are owned or held by the Commonwealth. The Act is concerned with bodies that form part of the core Commonwealth financial framework and in comparison to the CAC Act, allows government to more readily direct aspects of the financial management framework of an entity.

The structure of an authority subject to the FMA Act is generally not well suited to the inclusion of a governing board as the Act vests authority and places responsibilities on a single chief executive as the head of the statutory authority. It can however, accommodate

an advisory board structure where the board might advise the chief executive in a non-binding manner or within a relationship where it is subordinate to the chief executive.

It is important to note the financial framework applicable to an authority does not affect the operational independence and objectivity required to discharge its statutory roles. It is an authority's legislative framework which establishes the required level of operational independence necessary to exercise statutory powers objectively.

## **RECOMMENDATION:**

*Financial frameworks generally be applied based on the governance characteristics of a statutory authority, that is:*

- *The Financial Management and Accountability Act 1997 be applied to statutory authorities where it is appropriate they be legally and financially part of the Commonwealth and do not need to own assets. (Typically, this would mean Budget-funded authorities.)*
- *The Commonwealth Authorities and Companies Act 1997 be applied to statutory authorities where it is appropriate they be legally and financially separate from the Commonwealth and are best governed by a board.*

## **Organisational culture and values**

Governance aims to modify the actions of individuals, by providing guidance about appropriate decision-making and behaviour. The culture created within an organisation is an important aspect of governance as it informs the way in which all activities are undertaken and impacts on overall performance. Culture will influence the way in which an organisation perceives itself, the way it approaches tasks, its behaviour towards those it interacts with and the way in which it is perceived including the level of respect it receives.

The culture of an organisation is underpinned by the values and beliefs of those responsible for governance and leadership. Those responsible for governance should encourage the development of sound values<sup>20</sup> that are, in turn, exemplified by management. If well supported, values should:

- permeate the activities of an organisation

20. Where statutory authorities employ staff under the PS Act, those staff are subject to the Australian Public Service Values and Code of Conduct.

- be evident in relationships and interactions with owners and employees
- determine the way an organisation presents itself to the outside world.

Where an organisation operates with a level of independence from the owners, it is important that the values and culture foster a sense of responsibility towards owners and stakeholders. For statutory authorities, which operate with a degree of independence from Ministers, it is important that their governance arrangements include values that promote a sense of accountability and openness to the Government, the Parliament and the public. In this regard, the review is supportive of statutory authorities adopting values similar to those on which the principles in Cadbury's Code of Best Practice are based: openness, integrity and accountability.<sup>21</sup>

In their relations with outsiders, statutory authorities most often demonstrate their cultural approach through consultation and disclosure arrangements and through their own behaviour.

### ***Consultation***

In most instances, consultation in itself is not considered to be a function of governance. However, the way in which statutory authorities relate to outsiders is of particular interest to the review for a number of reasons.

In the private sector, consultations with stakeholders occur when market indicators, such as price and market share, require supplementation to assist in the development of strategy (often in the form of market research). In the public sector, such market signals are rare, and consultation often represents the only source of information and feedback from the community. Consultation by statutory authorities with their customers or clients can be critical for government, as the public often has no discretion other than to comply with the policies and programs being administered by statutory authorities, and in some cases, has no alternative source from which to access services.

Effective consultation is necessary to ensure that statutory authorities are achieving their objectives as efficiently and effectively as possible, whilst causing minimum imposition on the community. The values with which statutory authorities approach these interactions will greatly influence outcomes and will reflect the way in which they and government are perceived by the community. In considering consultation as it relates to governance, it is

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<sup>21</sup> *The Financial Aspects of Corporate Governance* (The Cadbury Report), p 16.

important to note that consultation is not a mechanism through which effective accountability can be established.

As identified in Chapter 3, the review observed that a criterion for membership of some Commonwealth governance boards has been to represent community and sectional interests. The review does not support appointments to governance boards on this basis as representational boards increase the risk that success will be jeopardised. Consequently, the review encourages replacing these consultative and advisory opportunities with more appropriate mechanisms, such as the initiatives canvassed below, to ensure these opportunities are not lost.

The review identified extensive consultations between statutory authorities, departments and stakeholders, and does not seek to comment on, or prescribe, the full range of consultative opportunities. However, two specific forms of consultation were identified as being critical to the success of particular statutory authorities, and warrant further attention. These are:

- exchange of information, where a dialogue between the entity and stakeholders serves to increase understanding and compliance
- advice from stakeholders, representing input into policy development and planning processes.

The way in which consultation is approached by regulators will be reflected in the relationships it builds with the regulated community. It is the opinion of the review that a lack of meaningful engagement by regulators with the regulated community will lead to a lack of understanding of the issues confronting both sides and destabilisation of these relationships. The lack of understanding has the potential to create significant friction, as one party seeks to force change whilst the other is resistant. This friction imposes costs on both the regulated and the regulators and leads to a significant loss of respect for the regulators.

As the activities of regulators and other statutory authorities impact on the community, consultation should be open and feedback on the quality of decision-making treated seriously.

Regulators need to approach their task with a commitment to being open to the concerns of individuals and business and to building and maintaining respect. The establishment and support of effective dialogue with the regulated community, is considered by the review to be critical to the long-term success of regulatory bodies. The review supports



the establishment of regular fora between the regulators and senior representatives of the regulated community to share information, develop broader understandings and to exchange views. To be successful, such fora require the commitment of senior representatives from both the regulators and business to an open and meaningful dialogue.

Consultation associated with the development of policy, or its implementation, is the responsibility of the portfolio department. However, given the contribution that statutory authorities make to the development of policy and their significant role in its implementation, formalised mechanisms to consult with the community and to seek advice on the impact and effectiveness of their programs are of interest to the review.

In addition to the usual consultation that is expected to occur in the development of policy, there may be circumstances where a formal consultation mechanism can provide greater assurance for government in developing and planning policies likely to have significant impact. Circumstances that may require such a mechanism include those where it is envisaged that the implementation of a policy may impact widely and/or negatively on the community or on sections of the community. This type of consultative mechanism would most commonly be used subsequent to the finalisation of policies to identify issues associated with the implementation of possible policy changes. As identified in Chapter 3, an existing mechanism that currently provides such input is the Board of Taxation.

The Board of Taxation is seen to be effective because its members are people who have a good command of the issues and are respected by the communities they represent. As the criteria for appointment to an advisory board will sometimes be quite different to those appropriate for appointment to a governing board, the people best placed to provide advice on policy will often not be the best people to provide governance oversight. There is only a small population which would be considered appropriate for both.

In most cases it will not be necessary to have standing boards or committees of advice. Convening a group of appropriate people from time to time, based on need, seems entirely practical (unlike in the case of the Board of Taxation, given the constant need for advice in the formulation of policy and its implementation).

### ***Disclosure***

Against the background that many statutory authorities undertake their functions with a degree of independence from Ministers, the way in which they approach disclosure of performance information is of interest to the review.

Openness and disclosure of relevant information is essential to the effectiveness of accountability frameworks. Disclosure requirements impose obligations on an organisation to provide core information on which others can base judgements. Essentially, governance cannot work properly if information is not provided to those who delegate power, their advisors and external commentators.

Good reporting should assist statutory authorities to demonstrate their cultural approach towards particular issues and should reflect a commitment to particular values. For instance, the review considers that informative and balanced reporting demonstrates a commitment to accountability, openness and integrity. Good reporting will articulate organisational values, and show how they have been applied in the conduct of activities and the achievement of performance.

A comprehensive approach to disclosure requires those responsible for the performance of the statutory authority to accept responsibility for the activities undertaken and the ensuing impact on performance and the community. Acknowledging a responsibility to report thoroughly and accurately on a range of performance and governance issues can serve to build and maintain the respect of those on whom the activities of statutory authorities impact.

It is important that disclosure is continuous. This will involve statutory authorities providing Ministers with information on key aspects of performance. A cultural commitment to continuous disclosure supports the 'no surprises' approach that ensures Ministers and departments are aware of critical issues as they occur. This ensures the opportunity for serious issues to be handled in consultation with the Minister and the department and to limit damage that might otherwise occur.

The annual report is the primary vehicle for statutory authorities for disclosing relevant performance and governance information to Ministers, the Government, the Parliament and other stakeholders.

Existing annual reporting requirements for CAC and FMA bodies differ, as they are tailored to take into account the different relationships CAC and FMA bodies will have to government. The requirements are also framed to assume CAC bodies will operate under a board whilst FMA bodies generally will not. Statutory authorities must disclose information in their annual reports on a number of governance issues including the responsibilities and remuneration of directors and senior executives, the role of committees, the approach to risk and procedures for ensuring ethical standards. Although it is up to individual statutory authorities to adopt a values-driven approach

to the way in which matters are reported, the review encourages the values of accountability, openness and integrity to be demonstrated through reports.

The review proposes that some of the initiatives put forward throughout this chapter, such as the Statements of Expectations and Intent and outcomes of investigations undertaken by the Inspector-General of Regulation, should be publicly disclosed. This is necessary to achieve maximum benefit by ensuring that stakeholders of statutory authorities are fully informed of the manner in which these mechanisms are utilised.

The review does not propose imposing any other specific disclosure obligations for statutory authorities as it believes too many requirements promotes a 'black letter' approach and a minimalist attitude to disclosure, whereby organisations comply with requirements in a 'tick the box' manner. Instead the review encourages statutory authorities to ensure the quality of the information they disclose by focusing on a manageable number of indicators crucial to success.

#### **RECOMMENDATION:**

*Statements of Expectations and Intent should include those values central to the success of the authority, including those relating to its relationships with outsiders.*

### **Achieving success**

In order to achieve success, mechanisms must be available to the owner, or those representing the owner, to hold to account those responsible for performance. It is important for Ministers, where appropriate, to have access to initiatives that assist in ensuring statutory authorities are accountable for the outcomes they produce.

Initiatives discussed earlier in this chapter will improve the governance of statutory authorities in a variety of ways. These initiatives have thus far been canvassed with an emphasis on particular objectives, for instance ensuring clearer purpose or improving relationships. However, the review considers many of these initiatives also contribute to assisting Ministers in ensuring success, by providing additional opportunities to improve the accountability of statutory authorities.

The proposed Statements of Expectations and Intent would assist in ensuring clarity in purpose as well as providing a clearer basis for assessing performance. Making these documents publicly available would provide greater transparency for the Parliament and the public about government expectations of statutory authorities. By requiring authorities

to report against KPIs, which link government expectations to performance, Ministers would be able to determine the extent to which an authority is meeting government expectations.

It is the opinion of the review that an Inspector-General of Regulation would also provide the basis for greater transparency and accountability of the activities of regulatory bodies, by reporting to Ministers and the Parliament on investigations into systemic and procedural issues associated with the enforcement of regulation. The proposed Inspector-General of Regulation would have no power to direct a regulator to accept recommendations to improve systems and procedures. The review considers that making information public will place pressure on regulators to ensure high standards in their administration of regulation. In order for these initiatives to operate effectively as part of the accountability framework, Ministers will need to be well supported by receiving advice from their departments.



# Chapter 5 – The templates

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The templates for Commonwealth statutory authorities are built on the principles and findings discussed in Chapters 2, 3 and 4. The templates are aimed at assisting in the establishment of effective governance arrangements for statutory authorities, achieving clarity in roles and responsibilities, and providing guidance in establishing arrangements for new authorities.

## Applying the templates

The templates have been developed in a generic manner based on the work of the review including the existing governance frameworks of the eight entities considered by the review. Based on the broad nature of the arrangements canvassed in the templates they are considered applicable to other statutory authorities, and potentially beyond, to a wider range of public sector bodies.

The purpose of the templates is to serve as a reference point. They are expressed as an ideal. It is noted that circumstances may exist where, for valid reasons, the templates would need to be varied to take into account any unique factors. However, it is suggested that any variation considered should be questioned on the basis of whether it would lead to weaker governance arrangements. Overall, the templates should provide a basis enabling comparison with existing structures, and inform views as to whether those structures can be improved.

The templates have been developed assuming that responsible Ministers establish arrangements, where required, whereby their departments receive appropriate information from statutory authorities either in parallel to the Minister or on behalf of the Minister. (It is assumed that appropriate information would need to be determined on a case-by-case basis.)

## Two governance models

Selection of the appropriate governance template for a statutory authority should be based on whether the Government is willing or able to delegate full power to act.

The Board Template assumes the Government has determined the relevant statutory authority is one where it is appropriate for the board to have the necessary power to act including the power to appoint and remove the CEO, the power to determine directions, approve policies and corporate plans, and oversee management.

The template has been developed on the basis that the Minister has a role equivalent to that of a single shareholder. The role of the Minister as described in the template would be different where the Commonwealth is not fully responsible for the statutory authority.

The Executive Management Template assumes the Government has determined that a full delegation of power to act is not appropriate. That is to say, when governance of an executive, or an executive management group (for example, a commission) is carried out directly by the Minister with departmental support and advice. In this case, the executive management of a statutory authority is charged with the efficient and effective performance of the functions allocated to a statutory authority through its legislative framework.

With a view to improving the performance of statutory authorities, the templates have been developed based on the roles of Ministers, their departments and statutory authorities as recommended by this report (including departments receiving information from statutory authorities in parallel with Ministers). It is noted however, that there are many other stakeholders to the governance arrangements of statutory authorities including the Parliament, the Auditor-General and Commonwealth Ombudsman.

## **Board Template**

The Board Template will be appropriate for statutory authorities undertaking predominately commercial operations. The Board Template will also be appropriate in circumstances where the Commonwealth itself does not fully own the equity, or is not solely responsible for outcomes. The main example is where there are multiple accountabilities, or where funding is predominantly through private sources (including industry levies).

### **Minister**

The Minister's role may be compared to the role that a single owner would have in the private sector over the operations of a wholly owned enterprise where a board has been delegated responsibility for performance. The Minister ensures clarity in the broad strategic direction of the statutory authority and holds the board accountable for its performance.

## ***Clarity of government expectations***

In setting the broad strategic directions for a statutory authority the Minister clearly sets out the expectations of government, thereby providing a strong sense of purpose to the authority's operations. In enunciating the Government's expectations, the Minister ensures that they are consistent with the powers provided under the authority's governance framework.

This information may be transmitted through a range of mechanisms including the Minister's Statement of Expectations (where appropriate), communications with directors on appointment, the Minister's endorsement of the corporate plan and consideration and agreement to the authority's SCI (or Statement of Intent, where appropriate).

Optimally, the Minister (like the shareholder in the private sector) seeks to minimise the extent of his or her influence within the areas of decision-making delegated to the board. The board is responsible for approval of the strategies and policies, the oversight of management and is held accountable for the statutory authority's performance in meeting its purpose determined through the broad direction set by the Minister. However, the Minister receives for endorsement the corporate plan, already approved by the board, reflecting strategies, risk management and projected performance (or other relevant matters) and may either require further explanation or indicate where the plan may be inconsistent with general government policy and objectives.

Section 28 of the CAC Act enables Ministers to require authorities covered by the Act to comply with general government policies. Where the Government and/or the Parliament has delegated the board the necessary power to act the application of general government policies to the authority is likely to be limited.

## ***Overseeing performance***

The Minister holds the board accountable for the performance of the organisation as the board has been delegated the necessary power to approve strategies for the enterprise as well as oversight management's performance.

While the board has been delegated the necessary power to act, the Minister needs to be kept informed of the authority's operations and ensure performance is acceptable. Key performance indicators and regular reporting arrangements need to be agreed and implemented to ensure that the Minister is adequately informed of the authority's operations.



In holding the board accountable for the performance of the organisation and its own performance, a Minister may consider a number of options, which would need to be consistent with parameters imposed by legislation. Where the Minister requires further information to assess the performance of the board the chairman should provide briefing (including outcomes of board assessment review processes – see Chapter 6). The Minister may wish to either meet the chairman or the board to discuss any issues of non-performance. The Minister may also seek a submission from the board detailing proposed remedial action. Where the circumstances warrant stronger action, and consistent with powers provided through the legislative frameworks, the Minister may wish to consider not renewing appointments or removing the chairman, directors or the entire board.

### ***Appointments and terminations***

The performance of the board can have a significant impact on the performance of a statutory authority. Given ministerial responsibilities, Ministers need to be well supported in making appointments.

When an appointment is being considered by a Minister, the Minister is briefed by the chairman, and advised by the relevant department on the profile of appropriate characteristics, attributes and experience that would benefit the board prior to making a decision. In cases of reappointment, the Minister and the chairman discuss the current performance of the board and individual directors prior to his or her decision.

As mentioned above and consistent with powers provided through legislative frameworks, where circumstances warrant stronger action, the Minister may consider not renewing appointments or removing the chairman, directors or the entire board.

### ***Communication***

In dealing with the statutory authority it is expected that the Minister communicates primarily with the chairman, on both a formal and informal basis.

There may also be circumstances where the Minister considers it necessary to communicate with the CEO. However, this should only occur in conjunction with the chairman, otherwise there will be a reduction in the ability of the board to provide effective management oversight.

In circumstances where the authority is not meeting the performance expectations of government, specific clarification by the Minister will assist the board in its task.

Communication tools include the ministerial Statement of Expectations (where appropriate), communication with directors on appointment, the Minister's endorsement of the corporate plan and consideration and agreement to the authority's SCI.

### **Portfolio department**

The department's role is to support and advise the Minister in his or her governance responsibilities. Support and advice covers a wide range of issues including the appropriate strategic direction, the performance of functions including expectations and results, risk management, corporate plans, appointments and the performance of any CSOs allocated to the statutory authority.

In order to ensure the department is the principal source of advice it needs to be across all relevant issues of a statutory authority. Accordingly, the department and statutory authority work together to ensure the department is well placed to brief the Minister in a timely manner. The department will clearly enunciate its appropriate information requirements, and look to develop and maintain both informal and formal relationships with the authority that will assist the flow of information on a regular basis and in a timely manner.

### **Statutory authority**

The board is responsible for ensuring the success of the statutory authority through its executive management team and within the broad strategic directions set through its governance framework, including by the Minister.

### ***Strategy and policy direction***

Within the broad strategic direction set by the Minister the board independently approves strategy developed by management, oversees its implementation and ensures risk is adequately managed. The board is responsible for informing the Minister in a timely manner of significant issues impacting on the authority, including risks and associated mitigation strategies.

### ***Oversight of performance***

The board is responsible for the performance of the authority's functions. The powers of the board will be determined by a variety of mechanisms including the enabling

legislation, duties and obligations established by the CAC Act, the Corporations Act (where applicable) and the common law.

### ***Annual corporate plan***

The board is responsible for approving an annual corporate plan, developed by management, for ministerial endorsement. In order to enable the department to brief the Minister on the corporate plan it will be beneficial for management to keep the department informed of relevant issues as the plan is developed. Where required the chairman should be available to discuss the plan with the Minister. The plan is provided to the department in parallel in order that the department may advise the Minister.

### ***Performance indicators***

The board is responsible for ensuring that management develops relevant indicators to accurately measure the performance of the authority. The KPIs should be limited in number to those seen to be crucial to success and presented in a format that can be independently verified if required. The KPIs and targets are endorsed by the Minister as part of the corporate plan process.

The authority consults with the department in the development of KPIs and targets to ensure the department is in a position to brief the Minister on their validity and acceptability.

### ***Appointment and termination of the chief executive officer***

The board is responsible for supervising the CEO and has the power of appointment and termination. Generally, it will be better practice for the chairman and the Minister to consult prior to the final decision on issues involving the employment of the CEO. Where the board does not have the power to appoint and terminate the CEO it cannot be effective, and the alternative template should be used.

### ***Communication***

The board is responsible for keeping the Minister informed of significant issues and relevant risk mitigation strategies. Effectively, it should operate on a 'no surprises' basis for the Minister. The chairman meets with the Minister at least annually and as required to brief him or her on the authority's progress against agreed KPIs and relevant matters.

If required, the board advises the Minister of mitigation strategies for underperformance or failure to meet broad strategic requirements.

The chairman advises the portfolio secretary of issues to be discussed with the Minister prior to formal meetings, to allow the department sufficient opportunity to prepare adequate briefing for the Minister.

Ideally a copy of all reports sent to the Minister is forwarded in parallel to the department to ensure the Minister is appropriately supported in fulfilling his or her responsibilities. Additionally, better practice would suggest there would be regular meetings between department officials and management of the statutory authority to ensure the department remains in a position to quickly brief the Minister on performance issues relating to the statutory authority.

The Statutory authority prepares the SCI (or Statement of Intent if appropriate) for the Minister's agreement.

## **Executive Management Template**

Statutory authorities undertaking regulatory and service provision operations are likely to be most effective when an executive management group or commission is governed directly by the Minister with departmental support and advice.

Statutory authorities undertaking provision of services or administering regulation will have varying degrees of delegated power depending on their legislative frameworks, ministerial directions and other mechanisms.

## **Minister**

The Minister's role and responsibilities for a statutory authority are determined by its governance framework. The level of independence provided to an authority by its legislative framework, including whether or not it is a body corporate, impacts on the ability of the Minister to supervise and direct the authority.

## ***Clarity of government expectations***

Clarity of purpose and expectations will be provided through a range of tools including the ministerial Statement of Expectations and in letters of appointment.

To assist a statutory authority organising to meet its purpose, the Minister clearly sets out the expectations that the Government has for the operations of the authority including the alignment with government policies, priorities and consistency of its administration within the parameters established by legislation.

In setting out government expectations, the Minister should not impinge on the level of independence from government provided to a statutory authority through its legislative framework.

Ministerial responsibility includes policy oversight and development in regard to an authority's operations and ensuring that the level of operational independence remains appropriate for the delegation of power provided to an authority.

### ***Overseeing performance***

Executive management is accountable to the Minister for the performance of the statutory authority. Executive management is delegated the necessary power to act within the range of functions provided by legislation and the Minister is kept informed of the authority's operations in order to be satisfied the authority's performance is acceptable. Key performance indicators and regular reporting structures are agreed and implemented to ensure the Minister is adequately informed of the authority's operations.

Key performance indicators should be limited to those seen to be crucial to success and include both financial and non-financial measures. In holding executive management accountable for its performance, the Minister may consider a number of options, the availability of which will vary depending on the powers provided to him or her by a statutory authority's legislative framework. For example, Ministers may discuss any issues of non-performance directly with executive management or seek a submission detailing proposed remedial action. Where circumstances warrant stronger action, and subject to the provisions of the enabling legislation, the Minister may consider not renewing appointments or removing office holders mid-term.

### ***Appointments and terminations of executive management***

The performance of executive management has a significant impact on the performance of a statutory authority. Given ministerial responsibilities, Ministers need to be well supported in identifying and considering candidates for appointment.

Under the enabling legislation for a statutory authority the Minister, or the Governor-General on the Minister's advice, is responsible for appointment of executive management. In supporting the Minister in the appointment process the department briefs the Minister on a profile of appropriate skills and experience and a list of potential candidates for a vacant position, taking into account any requirements contained in the governance framework and consulting with other areas of government as required.

In preparing briefing for the Minister the department may consider, where appropriate, advice from the statutory authority on the profile of appropriate skills and experience required for the position and a list of potential candidates.

Ministers may clarify roles and responsibilities of appointees through the Statement of Expectations and through letters of appointment.

Where the performance of authorities calls for stronger action, and consistent with legislative powers, Ministers should consider not renewing appointments or removing executive management mid-term.

### ***Communication***

In dealing with the statutory authority it is expected that the Minister will primarily communicate with the executive management of the authority, on both a formal and informal basis. Informing the portfolio secretary in parallel of communications with the authority facilitates the provision of independent advice by the portfolio secretary to the Minister.

Mechanisms that will assist the Minister to clearly enunciate issues include the Statement of Expectations, letters of appointment (where appropriate) and regular communication with the executive management.

### **Portfolio department**

The department's role is to support and advise the Minister in his or her governance responsibilities by being the principal source of advice. Support and advice covers a wide range of issues including policy development and maintenance, appropriate delegations for operations, appropriate strategic direction, appointments, review of performance expectations and results, the preparation of the Statement of Expectations, advice on an authority's Statement of Intent and letters of appointment.

In order to ensure the department is the principal source of advice it needs to be across all relevant issues concerning a statutory authority in order to be in a position to brief the Minister in a timely manner. Accordingly, the department and the statutory authority work together to ensure the department is well placed to brief the Minister. The department will clearly articulate its appropriate information requirements and develop and maintain both informal and formal relationships with the authority to assist the flow of information in a timely manner.

### **Statutory authority**

The executive management is responsible for ensuring the success of the statutory authority within the operational parameters set through its governance framework.

### ***Strategy and policy direction***

Within the parameters set by the governance framework executive management is responsible for efficiently and effectively delivering the functions of the statutory authority and for ensuring risk is adequately managed. Executive management is responsible for informing the Minister in a timely manner of significant issues impacting on the authority, including risks that face the authority and associated mitigation strategies.

The role of the statutory authority is to implement policy, not to develop policy. The statutory authority should provide feedback on the practical operation of existing and proposed policy to the portfolio department and work closely with the department to ensure implementation is consistent with the intended focus of the policy.

### ***Performance indicators***

Executive management is responsible for ensuring the statutory authority develops relevant indicators that accurately capture and measure the performance of the authority. The KPIs should be limited in number to those seen to be crucial to success and presented in a format that can be independently verified if required. The Minister agrees performance indicators and targets as part of the process of clarifying expectations.

The statutory authority consults with the portfolio department in the development of KPIs to ensure the department is in a position to brief the Minister.

## ***Communication***

Executive management keeps the Minister informed of significant issues and relevant risk mitigation strategies. The statutory authority should operate on a 'no surprises' basis for the Minister. Executive management will meet with the Minister at least annually and as required to brief on the authority's progress against agreed KPIs, targets and other relevant matters. If required executive management will also advise the Minister of mitigation strategies for underperformance or failure to adequately deliver on the functions of the statutory authority.

Executive management should advise the portfolio secretary of issues to be discussed with the Minister prior to formal meetings, to allow the department sufficient opportunity to prepare adequate briefing for the Minister.

Ideally a copy of all reports sent to the Minister will be forwarded in parallel to the department to ensure the Minister is appropriately supported in fulfilling his or her responsibilities. Additionally, better practice indicates regular meetings would occur between department officials and the statutory authority to ensure the department remains in a position to quickly brief the Minister on performance issues relating to the statutory authority.

The statutory authority, in response to the ministerial Statement of Expectations, prepares a Statement of Intent indicating how it will meet the expectations of government.

## **Additional mechanisms of governance**

### **Inspector-General of Regulation**

Regulatory authorities have a significant impact on business and the community in general. Such authorities tend to have broad and significant powers of investigation and compulsion, and may have an ability to impose penalties. They tend also to function with a high level of operational independence from the responsible Minister.

An Inspector-General of Regulation would assist Ministers in the governance of regulatory authorities. Such an office, modelled on the Inspector-General of Taxation, would assist in ensuring regulatory authorities are accountable to the Parliament, Government and the community, for the manner in which they exercise their statutory duties, without compromising their statutory independence.



### ***Investigation of systems and procedures***

The role of an Inspector-General of Regulation would be to investigate the systems and procedures used by regulatory statutory authorities to administer regulation and to recommend improvements where appropriate. Proposed functions are:

- to investigate systems and procedures established by authorities to administer regulation, including systems and procedures for dealing or communicating with the public generally, or with particular people or organisations, in relation to the administration of regulation
- to investigate systems established for regulation, but only to the extent that the systems deal with administrative matters
- to report to the responsible Minister on the outcome of investigations, including recommendations on how the systems investigated could be improved.

The proposal is for an independent statutory office of Inspector-General of Regulation, reporting to the Treasury Ministers. Other Ministers having responsibility for regulatory authorities would be able to refer a reference to the Inspector-General of Regulation through the Treasurer.

In establishing an office of Inspector-General of Regulation, care would be required to ensure the role does not extend to a review of regulatory case decisions, but remains focused solely on improving systems and procedures. Care would also be needed in ensuring that the areas of necessary independence of regulatory authorities are protected.

### ***References to the Inspector-General of Regulation***

The Inspector-General of Regulation could be directed by a Treasury Minister to undertake an investigation. Ministers responsible for other regulatory authorities outside the Treasurer's portfolio could ask for the Inspector-General of Regulation to be directed to undertake an investigation through the Treasurer.

The Inspector-General would be able to conduct an investigation on his or her own initiative. An example might be an investigation initiated as a result of something drawn to the Inspector-General's attention by a member of the regulated community.

The Inspector-General would be able to determine the priority of his or her work program. To avoid duplication of effort, the Inspector-General would be required to consult annually with the Auditor-General and the Commonwealth Ombudsman.

### ***Conduct of investigations***

The Inspector-General of Regulation would have wide discretion in establishing the means by which he or she conducts an investigation. For example, the Inspector-General may choose to call for public submissions or ask particular people or organisations to make submissions. The Inspector-General may choose to make submissions publicly available (excepting, of course, any personal or commercial-in-confidence information).

The Inspector-General would require powers to compel the production of documents from regulatory authorities and to take evidence from authority personnel. Those powers would not extend to directing regulatory authorities, other than to require the disclosure of information or documents for an investigation.

Should a proposed report by the Inspector-General include material likely to be critical of a regulatory authority, the authority would be given an opportunity to comment on that material before the Inspector-General finalises the report.

### ***Reports to be publicly available***

As is usual practice, the Inspector-General would be required to report annually to the Treasury Ministers, who would then table the annual report in Parliament.

To ensure transparency and to maintain the respect and confidence of regulatory authorities and the regulated community for the Inspector-General of Regulation, it would be desirable for reports on investigations by the Inspector-General to be made public as soon as possible after the completion of an investigation. The Inspector-General would have an ability to advise the Treasury Ministers of any particular sensitivities that might warrant delaying publication for a period of time.

### ***Statements of Expectations and Intent***

Ensuring statutory authorities have a clear understanding of their purpose is essential to their ability to meet the expectations of government, Parliament and the public. Communication of government expectations to authorities is critical to ensuring programs and services to the community and regulatory outcomes are consistent with government

policies and objectives. A clear understanding of purpose and expectations also assists in strengthening the accountability of statutory authorities to Ministers and the Parliament.

In combination, Statements of Expectations articulated by Ministers and the formal commitment by authorities to fulfil these expectations in Statements of Intent would greatly assist in clarifying the purpose, functions and objectives of statutory authorities. The Statements of Expectations and Intent should be concise documents, written in plain English, made public and reviewed on at least an annual basis.

### ***Statement of Expectations***

The Statement of Expectations articulates the responsible Minister's expectations of a statutory authority in regard to performance, objectives, values and broader government policies. The statement specifies the purpose and functions of the authority and communicates the objectives and priorities of government to be incorporated into the authority's approach to administering legislated responsibilities. The statement should not be in conflict with powers and functions specified in the statutory authority's legislative framework, nor should it impinge on any areas of legislated independence.

The Statement of Expectations provides clarification of government expectations of a statutory authority. While the enabling legislation should outline roles and responsibilities of executive management in clear and specific terms, the Statement of Expectations will communicate in greater detail the expected approach of a statutory authority as it performs its functions.

### ***Statement of Intent***

The statutory authority must formally commit to meeting the expectations of Ministers in a Statement of Intent. The process of exchanging statements would enable both parties to clarify expectations and reach mutual understanding about the purpose and priorities of the authority.

The authority's commitment should outline the initiatives the authority is taking or intends taking to meet the expectations and priorities of government. The Statement of Intent should draw a clear link between the Minister's Statement of Expectations and the authority's ability to meet these expectations, through the articulation of measurable and verifiable KPIs. This ensures the Minister can clearly hold the authority accountable for its performance.

The Statement of Intent should outline the values the authority intends to incorporate into its approach to undertaking functions.

In finalising the Statement of Intent, the authority requires the Minister's agreement on its content. To assist this process, the portfolio department should advise the Minister and consult with the statutory authority on issues relating to content including the development of KPIs and the measurement of performance against KPIs.

### **Advisory board in the implementation of policy**

Good governance will ensure that adequate consultations occur on issues relating to the success of the enterprise. In addition to the usual consultations that are expected to occur in the development of policy there may be circumstances where an advisory board needs to be established to assist the government in the implementation of policy.

The creation of an advisory board on the implementation of policy will be useful in circumstances where the government is introducing policy which has the potential for significant impact on the community. Through an advisory board the government can receive feedback on how to implement policy in the most effective manner.

#### ***Role***

The advisory board's main role should be to contribute a business and broader community perspective to improve the implementation of government policy. An advisory board would assist a Minister in testing the potential impact of policies on the community and identify opportunities to implement policy more effectively. Where an advisory board is appropriate (a decision depending on the nature of policy being implemented and on whether other policy consultative mechanisms are in place and are working effectively), the board should operate based on references from a Minister and should report directly to the Minister with its findings.

#### ***Membership***

The advisory board members should be appointed from within the business and wider community having regard to their ability to contribute to facilitating consultation and analysing the implementation of policy issues. In this regard representational appointments are entirely appropriate for an advisory board. To assist in the advisory board's considerations, particularly in relation to the background of the policy and

options for implementation, adequate public sector representation should occur through the relevant portfolio secretary and statutory authority head also attending meetings.

***Support for the advisory board***

The board should operate independently but should be supported through secretariat services provided by the portfolio department. Depending on the volume and complexity of references, provisions may also need to be created to allow the board to engage private consultants, if required, to assist in its references.

## Chapter 6 – Getting the best from governance boards

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There are circumstances where boards will be an appropriate and important part of the governance arrangements of statutory authorities. Board members should be appointed solely to represent the collective interests of the owners. In the current context this means the community through its elected representatives (the Government and Parliament). Any concern for other stakeholders should occur only when it will lead to the satisfaction of the owners' collective interests.

This chapter provides guidance to assist Ministers, portfolio departments and statutory authorities to achieve high performance from governance boards where they are considered an appropriate governance mechanism. In order to achieve a high standard of governance, it is essential for board members to be focused on ensuring the success of the statutory authority and for governance arrangements to support their roles and promote their ability to perform to their highest potential.

The guidance has been developed after consideration of private sector practices, where appropriate, and through application of the skills and experiences of the review to the public sector environment. The guidance concentrates on a number of factors associated with the governance arrangements of boards, particularly those which influence the creation of optimal environments and procedures for promoting performance and is presented with a view to getting the best performance from a board. In doing so, the guidance considers:

- board size
- committees
- appointments
- tenure
- development
- performance.

## **Board size**

The size of the board should be developed taking into account factors such as the size, complexity and risk of the entity's operations and the needs of the board, including the number of board committees that may be required. Accordingly, the review considers it is not possible, nor is it appropriate, to recommend a one size fits all approach when looking at boards in the public sector. It should also be noted that over time the optimal board size for an entity may vary in line with changes in its functions or the needs of the board.

Based on current thinking on best practice in the private sector a board of between six and nine members (including a managing director if there is one) represents a reasonable size. Boards with members within this range seem to be more easily able to create an environment for the active participation in meetings by all directors.

Boards with less than six members may have difficulty in meeting their statutory responsibilities due to workload pressures and the potential lack of breadth of views. This situation will be exacerbated in periods where vacancies exist. There is also the risk that smaller boards may find it easier to become involved in practices which are not conducive to governance, such as becoming involved in management decisions rather than overseeing them.

There are, however, circumstances where a larger board may be warranted. For example, when management of the risks of the entity is such that a number of board committees are required, larger board membership may be appropriate.

### **BETTER PRACTICE:**

*Board size should be developed taking into consideration factors such as an entity's size, complexity, risk of operations and the needs of the board.*

## **Board committees**

Board committees are a commonly used mechanism for the board to enhance its effectiveness through further detailed oversight and supervision of areas of special risk critical to the success of the entity. Private sector best practice employs board committees only to focus on the supervision of risks that are critical to the success of the entity.

To assist in the efficiency of operations and for reasons of accountability, committees should operate with a clear written mandate from the full board. The operations of committees should also be agreed including how committees will report to the board and how committees will interact with management and other relevant parties. This will clarify whether a committee has the power to make decisions and approve management proposals or report to and make recommendations to the board.

A director should be appointed to chair each committee, and should be responsible for its operations reporting back to the full board. It is considered better practice that the chairman of the full board should not be the chairman of all committees and in particular the audit committee. Amongst other things this allows for a more even distribution of workloads, a greater focus on risk management and provides an opportunity for directors to develop additional experience. However, circumstances may occasionally arise particularly if there is a major crisis, where the board chairman will play a greater role.

While committees may be created to assist with the workload of the board, the board remains responsible for overall governance of the entity, that is all directors will be singly and collectively responsible for all board decisions, whether made by a committee or the board. Accordingly, all board members should be given the opportunity to attend committee meetings. If they have a special interest in the issues being addressed from time to time, non-committee members should have the right to participate fully in the meeting, but should do so in a manner that is mindful that the committee is responsible to the board for the mandate it has been given. All board members should receive meeting papers for all committees so they are always fully informed.

#### **BETTER PRACTICE:**

*Committees are a useful mechanism for the board to enhance its effectiveness through further detailed oversight and supervision of the management of risks that are critical to the success of the entity. Committees should be used only for this purpose.*

## **Appointment of directors**

In meeting their responsibilities Ministers will either directly appoint directors to boards or make recommendations to the Governor-General on candidates for appointment.

In order to get the best from the board, and the entity itself, it is important to ensure the board has the necessary skills and experience to carry out its responsibilities. The ability



of a board to provide effective governance will be placed in jeopardy if its members are inexperienced or inappropriately skilled or the board as a whole is dysfunctional. To ensure this does not occur, Ministers need to be well supported in terms of advice in the appointment process.

In the appointment process, consideration should be given to the impact a new director or chairman will have on the culture and efficiency of the board, as well as the skill and experience requirements of the board. In making appointments/reappointments, Ministers need to be well supported through two main sources of advice.

First, it is recommended that the responsible Ministers discuss with the chairman the needs of the board. In discussions, the chairman should be in a position to discuss the current performance of the board and the skills the board needs to meet its current and forthcoming obligations. In carrying out this function, the chairman should consider whether a board committee of non-executive directors is required to determine the skills and experience requirements of the board in preparation for discussions with responsible Ministers.

Second, it is expected that responsible Ministers will be well supported by their portfolio departments when considering the appointment/reappointment of directors. Accordingly, portfolio departments should monitor boards, including skills and structures, and be in a position to brief Ministers with views on any skills requirements of the board and potential candidates. This function will be particularly relevant when considering the appointment/reappointment of a chairman.

Boards require the skills, experience and characteristics necessary to ensure the success of the entity. In the appointment process, consideration should first be given to the attributes of potential appointees including the ability for critical thought, objectivity, wisdom gained through appropriate experience, authority and the ability to exercise judgement. Subsequently, consideration should be given to the skills that will be beneficial to the board. For example, as boards are involved in the oversight of financial management, it will be beneficial to have members with financial skills and experience. However, it should be stressed that such skills are a secondary consideration as specialist advice can be accessed by the board as required.

The review does not support representational appointments to governing boards as representational appointments can fail to produce independent and objective views. There is the potential for these appointments to be primarily concerned with the interests of those they represent, rather than the success of the entity they are responsible for

governing. While it is possible to manage conflicts of interest,<sup>22</sup> the preferred position is to not create circumstances where they arise.<sup>23</sup> In the private sector, representational appointments arise in the context of representatives of the parent company sitting on the board of subsidiaries. It is the observation of the review that this creates a number of issues for the governance of the organisation, including:

- The representative distorts consideration of issues given the importance placed on his or her views by other board members.
- The mind of the representative is interested first and foremost in the needs of the parent company which becomes an issue when the parent company is not the sole owner.
- There is potential for the representative to become captured by the subsidiary in which case he or she becomes an advocate rather than an objective critic.

Similarly, care should be exercised when appointing public servants to boards.

In circumstances where a departmental staff member is appointed on the basis of representing the government's interests or having a 'quasi' supervision approach, conflicts of interest may arise and poor governance is likely. Through participation in decision-making, either directly or implied, the departmental representative may become an advocate for the organisation rather than contributing critical comment. This also has the potential to create an incentive for the other members of the board to meet to discuss and agree on important issues separately from formal meetings, without involving the departmental representative, thereby removing the formal board meeting as the main decision-making forum of governance. Membership of the board by the related departmental secretary is unwise unless there are specific circumstances which require it.

The above points do not mean that departmental representatives should not attend board meetings as agreed by the chairman. No objections are raised to either staff of the entity or other public servants attending specific parts of a meeting to discuss or clarify issues with the board.

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22. The *Commonwealth Authorities and Companies Act 1997* contains provisions addressing appropriate actions where conflicts of interest exist.

23. Richard Humphry in the Review of GBE Governance Arrangements, p 27, supported this premise, '...boards should not be appointed on the basis of representation... boards, on the other hand, should be appointed on the basis of achieving a mix of skills that will provide for the firm to be managed in a way that produces the best outcomes for the shareholders.'

Once the Government has made a decision on the appointment/reappointment of a director, the responsible Minister should provide a letter of appointment to the director detailing at least:

- the Government's expectations of the director including compliance with legislative requirements
- the term of the appointment, reflecting that this will be on the basis of acceptable performance and that annual performance assessments will occur
- the Government's general philosophy associated with tenure of board appointments (that is, the likely maximum number of terms that a director may be considered for appointment as discussed below)
- the basis for remuneration and arrangements for review.

**BETTER PRACTICE:**

*In getting the best from boards, appropriately experienced directors are critical to good governance.*

*Representational appointments to boards have the potential to place the success of the entity at risk.*

*Responsible Ministers should issue appointment letters detailing government expectations of directors.*

## **Board tenure**

In considering board appointments there is a general issue of balancing the benefits of continuity within a board versus the provision of opportunity to enhance performance through the introduction of greater experience and/or fresh thinking.

Finite board terms are considered by the review to be important. They provide an indication to directors that they should have no expectation of appointments continuing beyond one term. Appointment terms of three years are generally favoured with an expectation that the contribution of a director will increase with knowledge and experience of the entity. This is consistent with the rotation requirements of the Australian Stock Exchange (ASX) listing rules and the governance arrangements for Commonwealth GBEs. Additionally, a three-year term allows a director a reasonable

period of time to demonstrate his or her contribution to the governance of a statutory authority.

Currently, there is a serious shortage of qualified and experienced non-executive directors in Australia, making it difficult to recruit appropriately skilled directors to fill board vacancies in both the private and public sectors. This situation has the potential to adversely impact on Australia's economic efficiency if there are insufficient highly experienced directors available to be appointed to boards of major institutions.

The regular rotation of directors will assist in addressing this shortfall in Australia. Such a system allows directors the opportunity to provide the benefit of their skills and experience across a range of entities, with there being no doubt that the movement is a function of governance rather than a reflection of performance. The regular rotation of directors will also assist in ensuring there are opportunities for new directors to build and broaden experience.

Accordingly, it is suggested that in the case of statutory authorities, directors should not continue on a board for more than two terms<sup>24</sup> (or a total of six years). In relation to the position of chairman, it will usually be beneficial to have the acceptable service period extended. For example, where an existing director becomes chairman, extending the service period up to three terms (or a total of nine years) would be warranted. The longer period of service for the chairman allows for an adequate period to make a contribution at this level and assists in providing continuity of direction for the entity.

The above-mentioned board terms are suggested as a guide and should be applied taking into account specific circumstances. For example, there may be circumstances that require reappointment of existing members to allow the organisation the benefit of continuity while going through a major change or while managing a significant risk. In such circumstances, where directors are approaching reappointment having served two terms (or six years) the Government may wish to consider a further appointment term of one to two years.

#### **BETTER PRACTICE:**

*Maximum board service periods allow for a structured rotation of directors.*

24. Consistent with the Corporations Act, in the private sector it is considered that board terms start at the time the person's appointment is approved by shareholders at the Annual General Meeting.

## Development of the board

It is important that directors acquire knowledge of the operations of the entity and have the opportunity to improve their skills in areas that are of benefit to it. It is recommended that directors be either a member of the Australian Institute of Company Directors or equivalent, and either have undertaken or will complete shortly after appointment formal training on meeting their responsibilities as a director.

All boards should have orientation programs for new members. While the details of the programs will vary between organisations, they should be aimed at fully informing a new director on the main governance and operational aspects of the entity, including through provision of governance documentation relating to the statutory authority. New directors should gain first hand experience of operations and meet with senior management and key external stakeholders. An adjusted orientation program should be undertaken with reappointments whereby directors are provided with updates on key elements of the normal orientation program. The chairman should be responsible for the orientation and ongoing development of directors.

The development of directors should not be limited to the orientation process. During a director's term it is advisable that the chairman ensures the director has opportunities for ongoing professional development.

### **BETTER PRACTICE:**

*All boards should have orientation programs and directors should have the opportunity for ongoing professional development.*

## Performance

A formal performance process needs to occur in order to ensure that the Government is getting the best from a board. It is expected that the chairman and the responsible Ministers will meet at least annually and include discussions on the performance of the board. For the chairman to be effective in these discussions, he or she will need to be able to discuss the outcome of the annual performance evaluation process for the board and, if required, the performance of specific directors. These discussions will ensure responsible Ministers are better able to consider the appointment/reappointment of directors.

While there are several methods for conducting performance assessments, including self-assessment, a system that involves an independent assessor and confidential questionnaires for peer group assessment is considered the most effective in providing accurate feedback. Questionnaires should be completed by all directors and include sections on the effectiveness of the board and on the performance of individual directors including the chairman. The assessor would consolidate the responses and provide feedback relating to each director directly to them individually with summaries going simultaneously to the chairman. Through the use of an assessor, the source of any comment will remain confidential.

The characteristics of boards can vary greatly and there are circumstances where directors may have concerns about a formal performance process. However, tensions associated with the performance system will be reduced if the process is conducted transparently with directors agreeing to the steps involved and the format of the questionnaire that will be employed. Additionally, directors should benefit from the process through receiving constructive feedback that will provide them with the opportunity to improve their skills or modify their behaviour.

**BETTER PRACTICE:**

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*Annual assessments of the board need to occur to ensure government gets the best from the board.*



# Appendix A – Terms of reference

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The review is to examine and report on improving the structures and the governance practices of Commonwealth statutory authorities and office holders, with particular attention being paid to those that impact on the business community.

The objective of the review is to identify issues surrounding existing governance arrangements and to provide policy options for Government to improve the performance and get the best from statutory authorities and office holders, and their accountability frameworks.

- An expected outcome of the review is the development of a broad template of governance principles and arrangements that the Government may wish to extend to statutory authorities and office holders, and potentially beyond, to a wider range of public sector bodies.
- The template should be developed taking into account the improvements achieved over the last six years in the public sector based on legislation and arrangements already in place.

In undertaking the review, consideration will need to be given to the unique status of the Commonwealth as owner or shareholder, as the sovereign government and the source of regulatory authority.

The review should address the following issues:

## **Existing Governance Frameworks**

- Analysis of existing governance arrangements for statutory authorities and office holders.
  - The analysis is expected to include how statutory authorities and office holders relate to outsiders (including clients and customers) and how internal authority is shared, exercised and appropriately limited.



### **Existing Government Stewardship**

- Selection processes for board members and office holders, the mix of experience and skills required by boards, their development requirements and their relationship to Government and agency management.
- The relationship between statutory authorities and office holders and portfolio Ministers and Departments, the Parliament and the public, including business.

### **Good Governance**

- Determination of best practice corporate governance structures, including formal accountability and risk management requirements, existing within the private sector and public sector.
- Opportunities to improve the governance arrangements for statutory authorities and office holders, particularly those that have critical business relationships such as: the Australian Taxation Office, Australian Competition and Consumer Commission, Australian Prudential Regulation Authority, Reserve Bank of Australia, Australian Securities and Investments Commission, Health Insurance Commission and Centrelink.
  - Consideration will need to be given to whether existing relationship structures between statutory authorities and office holders and portfolio Ministers and departments, the Parliament and the public, including business, can be improved to achieve better outcomes.
- Initiatives that may be undertaken to improve the performance and bottom line results of statutory authorities and office holders, including accountability and reporting mechanisms.
- Initiatives that may be applied by the Government to drive, where appropriate, the behaviour of statutory authorities and office holders towards better performance.

### **Governance Going Forward**

- Development of a template of governance principles and policy options that the Government may wish to extend to statutory authorities and office holders.
- Development of principles to assist with determining administrative structures and selection processes that would be likely to be the most effective in implementing particular government policies and programmes.

An important component of the review will be consultations with Ministers, the private sector and key agency CEOs and statutory office holders.

A report to the Prime Minister and the Minister for Finance and Administration should be produced within six months from commencement.

14 November 2002

## Appendix B – Structures of the eight entities

Statutory Authority/Agency	Enabling Legislation		Employment Framework		Financial Framework		Purchaser/ Provider	Board of Directors	Advisory Body <sup>1</sup>	Inspector General <sup>2</sup>
	Act	Minister's power of direction	Enabling Act	PS Act	FMA Act	CAC Act <sup>3</sup>				
Australian Postal Corporation	<i>Australian Postal Corporation Act 1989</i>	May direct except on rates of postage and charges. <sup>4</sup>								
Reserve Bank of Australia	<i>Reserve Bank Act 1959</i>	The Governor-General acting with advice of the Federal Executive Council may by order, determine the policy to be adopted by the bank. <sup>5</sup>								
Australian Prudential Regulation Authority	<i>Australian Prudential Regulation Authority Act 1998</i>	The Governor-General acting with advice of the Federal Executive Council may by order, determine the policy to be adopted by the APRA.								
Australian Securities and Investments Commission	<i>Australian Securities and Investments Commission Act 2001</i>	Minister may give ASIC a written direction about policies it should pursue or priorities it should follow in performing or exercising any of its function or powers under Corporations legislation (other than the excluded positions). <sup>6</sup>			(Part 2)					

Statutory Authority/Agency	Enabling Legislation		Employment Framework		Financial Framework		Purchaser/ Provider	Board of Directors	Advisory Body <sup>1</sup>	Inspector General <sup>2</sup>
	Act	Minister's power of direction	Enabling Act	PS Act	FMA Act	CAC Act				
Centrelink	<i>Commonwealth Services Delivery Agency Act 1997</i>	Minister has power of direction. <sup>7</sup>								
Health Insurance Commission	<i>Health Insurance Commission Act 1973</i>	Minister has power of direction. <sup>8</sup>								
Australian Taxation Office	<i>Taxation Administration Act 1953</i>	N/A <sup>9</sup>							10	
Australian Competition and Consumer Commission	<i>Trade Practices Act 1974</i>	Minister may give the Commission directions connected to the performance of its functions on the exercise of its powers under the Act. The Minister must not give directions in relation to certain parts of the Act. <sup>11</sup>								

1. Advisory Board providing advice to the responsible Minister.

2. Inspector-General reporting to the responsible Minister.

3. Exceptions to specific sections may apply on a case-by-case basis.

4. In specific circumstances the Minister may issue a direction in relation to bulk interconnection services.

5. In circumstances where there is a difference of opinion on policy between the Treasurer and a RBA board, the Treasurer may submit a recommendation to the Governor-General.

6. Minister is also unable to give directions in respect of the manner in which ASIC deals with a particular case.

7. Minister may specify functions. The Minister may give directions to the board about the performance of the agency's functions. Minister may give directions to the board about the performance of its functions, the exercise of its powers, the conduct of its meetings or in relation to the terms and conditions of appointment of the CEO. Minister may notify the board of general government policies that are to apply in relation to the agency, the board and the employees.

8. Minister may specify additional functions by determination. The determination may specify the manner in which the Commission is to perform the function specified in the determination. The Minister may by written notice give directions to the Commission about the performance of its functions and exercise of its powers. The Minister may enter into an agreement with the Commission about the performance of its functions and exercise of its powers.

9. The *Taxation Administration Act 1953* creates the offices of Commissioner and Second Commissioners and provides for the Commissioner to have general administration of the Act (Commissioner also has, for example, general administration of the *Income Tax Assessment Act 1936*). The Minister's powers relate to the ATO as a statutory agency, as generally discussed in Chapter 2.

10. Board of Taxation (non-statutory body).

11. Minister must not give directions under certain sections of the Trade Practices Act (e.g. Part IV, the Competition Policy provisions), including in relation to individual cases.

## Appendix C – Board composition of the five entities having boards

Statutory Authority/Agency	Chairman		CEO	Portfolio Secretary
	Executive	Non-Executive		
Australian Postal Corporation				
Australian Prudential Regulation Authority				
Reserve Bank of Australia	1		N/A <sup>2</sup>	
Centrelink				(non-voting)
Health Insurance Commission				

1. Governor of the RBA.

2. Section 20 of the *Reserve Bank Act 1959* provides for the Governor to be the Chairperson of the Reserve Bank Board.

# Appendix D – Consultations

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## Ministers of State

The Hon John Howard MP, Prime Minister

*Cabinet Policy Unit*

Mr Peter Conran, Secretary

Mr Paul McClintock, then Secretary

The Hon Peter Costello MP, Treasurer

Senator the Hon Nick Minchin, Minister for Finance and Administration

Senator the Hon Richard Alston, Minister for Communications, Information Technology and the Arts and Deputy Leader of the Government in the Senate

Senator the Hon Amanda Vanstone, Minister for Family and Community Services and Minister Assisting the Prime Minister for the Status of Women

Senator the Hon Kay Patterson, Minister for Health and Ageing

Senator the Hon Helen Coonan, Minister for Revenue and Assistant Treasurer

Senator the Hon Ian Campbell, Parliamentary Secretary to the Treasurer

## Departments

Dr Peter Shergold AM, Secretary, Department of the Prime Minister and Cabinet

Mr Max Moore-Wilton AC, then Secretary, Department of the Prime Minister and Cabinet

Mr Jeff Whalan, Deputy Secretary, Department of the Prime Minister and Cabinet

Dr Ken Henry, Secretary, Department of the Treasury

Mr Jim Murphy, Executive Director, Department of Treasury

Dr Ian Watt, Secretary, Department of Finance and Administration

Ms Helen Williams AO, Secretary, Department of Communications, Information Technology and the Arts

Ms Jane Halton, Secretary, Department of Health and Ageing

Mr Mark Sullivan, Secretary, Department of Family and Community Services

Mr Ken Matthews, Secretary, Department of Transport and Regional Services

## **Statutory Authorities**

### *Australian Competition and Consumer Commission*

Professor Allan Fels AO, Chairman

### *Australian Postal Corporation*

Mrs Linda Nicholls, Chairman

Mr Graeme John AO, Managing Director

### *Australian Prudential Regulation Authority*

Dr Jeffrey Carmichael AO, Chairman

Mr Graeme Thompson, Chief Executive Officer

### *Australian Securities and Investments Commission*

Mr David Knott, Chairman

### *Australian Taxation Office*

Mr Michael Carmody, Commissioner of Taxation

### *Centrelink*

Mr John Pascoe AO, Chairman

Ms Sue Vardon, Chief Executive Officer

### *Health Insurance Commission*

Mr Peter Bunting, Chairman

Mr Jeff Harmer, then Managing Director

### *Reserve Bank of Australia*

Mr Ian Macfarlane, Governor

## **Commonwealth bodies**

### *Auditor-General*

Mr Pat Barrett AO

*Australian Public Service Commissioner*

Mr Andrew Podger

*Commonwealth Ombudsman*

Prof John McMillan

*Board of Taxation*

Mr Richard Warburton, Chairman

**Government commissioned reviews**

HIH Royal Commission

Trade Practices Act Review

**Industry bodies**

Australia and New Zealand Banking Group Limited

Australian Bankers' Association

Australian Chamber of Commerce and Industry

Australian Consumer Association

Australian Doctors' Fund Limited

Australian Institute of Company Directors

Business Council of Australia

Chartered Secretaries Australia Limited

Commonwealth Bank of Australia

Consumers Federation of Australia

Consumer Law Centre of Victoria

Financial Sector Advisory Council

ICS Global Limited

Insurance Council of Australia

Investment and Financial Services Association Limited

Law Council of Australia



**Other**

Mr Alan Cameron AM, former Chairman of Australian Securities and Investments Commission

Mr Ted Evans AC, former Secretary, Department of the Treasury

Professor Meredith Edwards AM, Director, National Institute of Governance, University of Canberra

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Air Services Australia

Australian Broadcasting Authority

Credit Union Services Corporation (Australia) Limited

Dr S Turnbull

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Mr R Aldons

Mr R Bennett

Mr T Ravlic

Resolution Holdings Pty Limited

Mr R Szatmari

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Australian Securities and Investments Commission

Australian Taxation Office

Bank of England

Centrelink

Coles Myer Limited

Council of Financial Regulators

Health Insurance Commission

Investment and Financial Services Association Limited

National Roads and Motorists Association

Reserve Bank of Australia

Westpac Banking Corporation

## Appendix F – Review Secretariat

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Mr John Uhrig AC was supported in the review by a small secretariat comprising the following individuals:

Mr Mark Wiggins

Secretary to the review

Department of Finance and Administration

Mr Shane Bennett

Department of Finance and Administration

Ms Christine Briton

Department of Finance and Administration

Ms Juleen Browning

Australian Competition and Consumer Commission

Ms Sarah Murray

Australian Public Service Commission

Ms Sandra Patch

Department of the Treasury

Ms Fabiola Peresan

Department of Finance and Administration

Mr Geoff Stafford

Department of Family and Community Services

Mr Martin Webb

Department of Finance and Administration



# Definitions

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For the purposes of this report, the following definitions apply:

## **Administrative Arrangements Order**

The Administrative Arrangements Order issued by the Governor-General assigns to each Minister the administration of a department and various Acts.

## **Board of directors**

A group comprising a mix of non-executive and executive directors that collectively acts in the interests of the company or authority to provide governance.

## **Chairman of board**

A director, elected by fellow directors or appointed by a Minister or Governor-General, to lead the board and chair meetings.

## **Chief executive**

For the purposes of the FMA Act: Secretary of a department of State or a person identified as chief executive of a prescribed agency listed in Schedule 1 to the *Financial Management and Accountability Regulations 1997*.

## **Chief executive officer**

Senior executive with overall responsibility for management of a company or authority, the report refers to managing director, Commissioner or Governor in a similar context.

## **Closely held company**

A company with a limited number of shareholders.

## **Commission**

A statutory authority with a full time executive management structure that is a directly accountable to a Minister.

For the purposes of the report a commission structure would not include a governing board with a majority of non-executive directors.



**Commissioner**

An office holder defined as a commissioner by legislation, usually in a commission, but not necessarily (for example the Australian Taxation Office is managed by the Commissioner of Taxation and Second Commissioners).

**Department of state**

A department created by the Administrative Arrangements Order made by the Governor-General.

**Director**

A director is a person that is part of the governing body, appointed as either an executive or non-executive.

The CAC Act defines director as follows:

- (a) for a Commonwealth authority that has a council or other governing body – a member of the governing body; or
- (b) for a Commonwealth authority that does not have a council or other governing body – a member of the authority; or
- (c) for a Commonwealth company – a person who is a director of the company for the purposes of the *Corporations Act 2001*.

**Executive agency**

An agency established under section 65 of the *Public Service Act 1999*.

**Executive board**

A board comprised of executive members only (that is, there are no non-executive members).

**Executive management**

Senior management structure responsible for the functions and governance of the authority subject to direction from the owners.

## **Governance**

Governance encompasses the arrangements by which the power of those in control of the strategy and direction of an entity is both delegated and limited to enhance prospects for the entity's long-term success, taking into account risk and the environment in which it is operating.

## **Office holders**

The office holders considered by the review are those persons appointed to statutory positions in the governance structure of a statutory authority. Depending on an authority's particular structure, these positions would include the CEO or managing director, commissioners and members of a board of directors. The scope of the review did not extend to other persons who may be office holders in the sense of that term as it may be used more broadly in the Commonwealth public sector.

## **Outcomes statements**

High level expression of what government is seeking to achieve through the activities of the portfolio.

## **Outputs statements**

Describe the products and services an agency intends to produce which will contribute to the achievement of government's desired outcomes.

## **Owners**

The shareholders in a company. For a statutory authority, the owners are the community through the Parliament and government.

## **Portfolio**

The area of responsibility or duties of a Minister in a government as assigned by the Administrative Arrangements Order.

## **Portfolio department**

The responsible Minister's department as assigned by the Administrative Arrangements Order.

**Portfolio secretary**

The secretary of the portfolio department.

**Purchaser/provider arrangements**

Funding of an agency through purchasing agreements with other government agencies to provide services on their behalf.

**Regulatory authorities**

Those entities that administer legislation on behalf of government to regulate the behaviour of individuals and/or organisations.

**Responsible Minister**

The Minister assigned responsibility for administering the enabling legislation of an authority.

**Statement of Corporate Intent**

Document produced by a government business enterprise reflecting commitments contained in the corporate plan.

**Statutory agency**

A body or group of persons declared by an Act to be a statutory agency for the purposes of the *Public Service Act 1999*.

**Statutory authority**

A public sector entity created by a specific law of the Commonwealth. For the purposes of this report the term includes a statutory agency having statutory office holders.

# Abbreviations

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AAO	Administrative Arrangements Order
ACCC	Australian Competition and Consumer Commission
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
ATO	Australian Taxation Office
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CASA	Civil Aviation Safety Authority
CEO	Chief executive officer
CSO	Community service obligation
FMA Act	<i>Financial Management and Accountability Act 1997</i>
GBE	Government business enterprise
HIC	Health Insurance Commission
KPI	Key performance indicator
PS Act	<i>Public Service Act 1999</i>
RBA	Reserve Bank of Australia
SCI	Statement of Corporate Intent

