

The Members of the Legislative Assembly  
Parliament House  
SYDNEY NSW 2000

In compliance with Section 38E of the *Public Finance and Audit Act 1983*, I present a report to the Legislative Assembly titled:

**Corporate Governance - Volume One: in Principle**

**Corporate Governance - Volume Two: in Practice**

**Corporate Governance - Supplement to Volume Two: Survey Findings**

A C HARRIS

Sydney  
June 1997



*Performance Audit Report*

**Corporate Governance**

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## **Corporate Governance**

### **Foreword**

Issues of corporate governance have long been a matter for concern in the private sector. Increasingly, issues of accountability, risk management and the cost of supporting board structures have become concerns in public sector corporate governance. The increased rate of commercialisation and corporatisation of Government enterprises with vast assets which are governed by boards, has focussed attention on corporate governance. In addition, there are a considerable number of statutory boards and trusts which govern organisations of social as well as economic significance.

Corporate governance issues include the way an organisation is structured, operated and controlled in order to achieve long term strategic goals and good customer and employee relations. In the public sector, corporate governance is also about how the Parliament, Government and boards relate to one another in stewardship matters.

## **Outputs of the Performance Audit**

Because of the wide range of matters to be addressed, this performance audit is presented in **two separate Reports to Parliament**.

This Report, **Volume One: Corporate Governance in Principle**, considers relations between the Government and boards, and the extent to which boards add value. Various public sector governance models are examined, including those currently operating within NSW and those from five other jurisdictions.

**Volume Two: Corporate Governance in Practice** reports upon how actual corporate governance practices by NSW public sector boards compare with “better practice”.

A **Supplement to Volume Two: Survey Findings** has also been prepared, presenting The Audit Office’s survey findings in detail. This may serve as a useful benchmark for governance in the NSW public sector.

As a corollary to this performance audit, a **Guide Towards Better Practice in Public Sector Corporate Governance** is also being produced by The Audit Office and will be issued in the near future in collaboration with the Premier’s Department. This is targeted to the specific needs of public sector boards, taking account of the context within which they operate.



## **Executive Summary**

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## **Executive Summary**

### **Examining Corporate Governance**

Organisations in the New South Wales (NSW) public sector are controlled, directed or advised using a variety of arrangements. This process in many cases involves a board or committee.<sup>1</sup>

Public sector boards are, in the main, created by law. In doing so, Parliaments distinguish these bodies from normal Government bodies with the presumed intention that statutory bodies, in the exercise of their duties and powers, should not be subject to day to day oversight by Government.<sup>2</sup> Such statutory duties and powers may relate to running a government business activity; the exercise of a particular regulatory function (such as licensing); and/or to carrying out some other service or management function. Some boards are created for other less specific reasons.

Premier's Department database indicates that there are over 600 boards in the NSW Public Sector. Not all boards contribute to this database.<sup>3</sup>

The total costs to operate and support all boards are not recorded centrally. Drawing on information from the Premier's Department database, supplemented by cost data provided to The Audit Office by a small sample of boards, total costs (both direct and support costs) to run these 600 NSW public sector boards have been estimated in excess of \$73 million per annum<sup>4</sup>.

Costs need to be commensurate with the value-added by boards. This Report examines whether the models and the legislation under which these boards operate enable boards to add value to the governance process and therefore justify their costs.<sup>5</sup>

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<sup>1</sup> As indicated in Chapter One, the terms “boards” and “committees” are often used without any clear definition of either. In this Report, all are referred to as boards. The need for more precise definitions, accompanied by clearer criteria for governing or advisory boards, is considered vital in understanding the role and accountabilities of boards. In this Report, the term boards includes boards and committees which exercise some degree of governance and/or influence over Government policy or resource allocation.

<sup>2</sup> This needs to be recognised in considering issues of corporate governance in the public sector, and in making comparisons with the private sector.

<sup>3</sup> The figure of 600 excludes tribunals and forms of executive management committees.

<sup>4</sup> The distribution of these costs is approximately: 29 per cent for regulatory boards; 18 per cent for businesses; 3 per cent for Budget Sector companies; and 50 per cent for “other” boards.

<sup>5</sup> Details of the audit’s objectives, scope, criteria, methodology and costs are shown at Attachment 4.1.

The Audit Office considered evidence as to how, in practice, public sector corporate governance adds value.<sup>6</sup> Value-added has been examined by The Audit Office at both the system level and the individual level. As such, this Report explores four basic “in

- uncertainty as to what governance in the public sector means;
- confusion about board responsibilities and accountabilities given the existence in the public sector of Parliament, Cabinet and Ministers;
- features of current governance models that may add to, or detract from, a board’s ability to add value;
- transparency and merit of board appointments.

From an overall examination of corporate governance in the NSW public sector, The Audit Office has concluded that:

- governance issues are complicated because governance is not clearly defined;
- the costs of operating and supporting boards are high;
- current models of public sector governance in NSW contain inherent tensions and potential for conflict between boards and the Government (over and above that which might be expected between owners and management);
- the value-added by boards governing business and regulatory organisations (around 160) can be strengthened by providing them with powers that are sufficient to match their responsibilities. This should in turn be accompanied by improved public accountability; and
- there is not strong evidence as to how value is added by other boards (around 440). Subject to further review, significant rationalisation in this area may be appropriate.

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<sup>6</sup> In the private sector, the functioning of boards is called corporate governance. The same term will be used here in considering the operation of public sector boards.

## **Governance Models**

The Audit Office identified seven models of public sector boards currently operating in NSW.<sup>7</sup> Analysis of these models shows that a wide variety of arrangements exist for corporate governance. Certain features of some models may either constrain or maximise opportunities for adding value. For example, factors in the public sector which may limit the extent to which many boards are able to add value include:

- the board's limited role in setting strategic directions, including the social objectives of agencies;
- the Government's ability to control and direct the decision-making of many boards;
- blurred (poorly defined) roles and responsibilities between Ministers, boards and Chief Executive Officers (CEOs) for securing organisational performance;
- the board's lack of power over how its resources are controlled;
- limitations on the extent to which public sector boards manage stakeholder relationships;
- uncertainty as to the extent to which boards are responsible (in terms of liability) for the consequences of their decision-making;
- inadequate board power over the appointment and accountability of their Chair and CEO;
- the dominant role of central agencies, especially Treasury, in setting policies and monitoring agency business performance in what some boards regard as excessive detail; and
- lack of transparency in board appointment processes.

From an overall perspective, most of the governance models, to a greater or lesser extent, create confusion and tensions in the roles, responsibilities and decision-making powers of the board, the Minister and the CEO. The reason for these tensions is that most governance models do not provide boards with a clearly defined governance role accompanied by sufficient powers to match their responsibilities. The effect is that many boards have become high level advisory management committees rather than true governing boards.

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<sup>7</sup> The term “model” is used in a broad, generic sense to describe clusters of organisational arrangements underpinned by similar principles. In any “model” significant variation in organisational forms can occur. Government businesses can take a number of organisational forms. State Owned Corporations (SOCs) are one form. The other major category, non-corporatised Government Trading Enterprises, can take the form of a statutory body, a Government department or, increasingly, a business unit within a Government department (for example, the Registry of Births, Deaths and Marriages, within the Attorney-General’s Department). For the purposes of this audit, SOCs and non-corporatised GTEs are discussed separately.

The Audit Office believes that five guiding principles should be employed to achieve more effective governance:

- governance in the public sector should be clearly defined and understood;
- features of a governance model should be: simplicity, clarity, and consistency of approach across the public sector. The features should be reflected in the role and functions of the board and the role of the Government, regardless of the nature, size, assets or income of the organisation being governed;
- the roles of Ministers and boards should be clear and separate;
- the roles, powers, responsibilities and accountabilities of the Government, its Ministers and boards should be defined in legislation; and
- legislation should provide boards with sufficient authority to carry out their governance responsibilities, and an objective mechanism should be used to oversight/manage all board appointments according to agreed selection criteria.

In contrast to NSW, in other jurisdictions a central Government Office provides guidance and oversight in relation to governance functions. In others, Parliament performs an expanded role in public sector corporate governance (encompassing Parliamentary involvement in board appointments, and less contentiously, Parliamentary review of board achievements).

Based on the above “principles for better governance”, The Audit Office has identified a range of desirable actions and/or changes to current arrangements, for each of the various forms of public sector boards.

**Government Businesses**

In general, the requirements for and value-added by governing boards are maximised for Government businesses (including Government Trading Enterprises (GTEs) and State Owned Corporations (SOCs))<sup>8</sup> when:

- the board is responsible to the Minister for the organisation meeting its goals;
- the board appoints the CEO and is able to set the general policies by which the Government’s goals can be met;
- the organisation has a clear commercial focus;

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<sup>8</sup> SOCs take two forms: statutory SOCs and company SOCs. This is explained later in the Report.

- the Government could not unilaterally, or without offering compensation, impose its non-commercial policies on the organisation; and
- the board controls resources either through employing them directly or having a formal contract with the provider.

In NSW, the company SOC model most closely approximates these features. Under this model, corporations established under State law are required to meet the provisions of *Corporations Law*. The model provides the important advantages of greater clarity and transparency than other models. This model also provides directors with settled law on their responsibilities and duties.

Both the company SOC and statutory SOC models still exhibit some inherent tensions. In particular, the Minister responsible for regulating the industry in which SOCs operate is often incorrectly seen as being responsible for, and therefore a spokesperson for, all a SOC's activities. This is notwithstanding that shareholding Ministers are meant to be accountable to Parliament for a SOC's commercial activities.

These tensions could be overcome by replacing part-time shareholding Ministers with a full-time Minister for Government businesses. This would allow for a single responsible Minister: although other Ministers could also have shareholder responsibilities, if required for *Corporations Law* or other reasons. However, direct dealings with the board would be through a single channel and a single Minister would be spokesperson for all businesses. This model approximates that currently used in New Zealand. An additional advantage of this arrangement is that there would be consistency in the legislative approach to governance of all Government businesses.

To ensure boards have powers that match their responsibilities, governing boards should appoint their own Chair and CEO.

## **Regulatory Bodies**

These principles of “better practice” governance should also apply to governing bodies which perform a major regulatory function. This would mean that all regulatory boards which also perform a governance role should:

- appoint their own Chair;
- appoint their CEO;
- have their CEO reporting to the board; and
- be responsible directly to the Minister for meeting the organisation’s goals.

Where the implementation of the board's decisions is carried out by a Government department (as is not uncommon for regulatory boards), there should be a contract with that department regarding the exercise of functions and powers, and services to be provided.

## **Other Boards**

There are many other statutory boards and authorities in the NSW public sector which undertake a variety of functions: such as operating specific facilities and services; minor regulation; local planning; marketing and/or advice. Evidence from the Premier's Department database indicates that the majority (some 440) of boards in the NSW public sector fall into this broad category.<sup>9</sup>

For boards in this “other” category, The Audit Office found that there was a need to determine whether:

- the role and functions were still necessary;
- a board was needed to carry out the role and functions; and
- the board added value.

Such issues for each board were not examined in this broad study. They need to be examined on a case by case basis.

The audit did disclose that the extent to which *enabling legislation* for these other boards defines a governance role and functions varies considerably. The extent to which such boards *exercise* this governance role also varies. A majority of these boards are subject to Ministerial direction and control, and in effect, many have become high level advisory committees.

The Audit Office also found that many of the statutes establishing these boards were quite old. In practice, the need for the role and functions which such boards carry out, or the need for a *board* to fulfil that role, may no longer exist. A review of these boards may suggest that the Government should delete certain activities or divest them to other bodies, such as local government.

If the role and functions carried out by a board in this category are still needed, then a review of the most appropriate and cost effective arrangement to deliver the role and functions is required. This would involve an assessment of each board against a set of criteria<sup>10</sup> to evaluate its continued relevance and effectiveness (in terms of value-added and future needs).

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<sup>9</sup> There are some boards in this number which fulfil similar functions but are non-statutory.

<sup>10</sup> Some suggested basic criteria for this purpose are included at Attachment 4.2 as a starting point.

Where alternate arrangements to deliver a board's role and functions are more cost effective, action could be taken to delete a particular board. As an example, some boards appear to have as their principal role the provision of advice and representative or community input. A review might show that this can be satisfied in ways that are less expensive than by the creation of a board. However, if such boards are to continue, their public accountability arrangements should be improved.

A close review of these issues in each portfolio would enable such boards to be examined on a case by case basis. Ways to approach such reviews are provided in this Report. Results of similar reviews carried out overseas are also provided for information. These provide options for the approach and timing of reform. However, an active process to have matters concluded within two years is strongly supported.

A large number of boards would likely continue following such reviews (although opportunities for improvement in their operation would probably be identified). Certainly there are many boards in this category which perform vital statutory duties, and do so effectively. However, through a detailed review it may be possible to reduce significantly the number of boards. This would generate substantial savings. For example, a 30 per cent reduction in the number of boards in this category would provide gross savings in the order of \$12 million per annum.

For the future, a timetable for systematic and regular review of such boards (ie. other than those boards governing businesses and controlling regulatory functions), would ensure that the continuing needs for boards are reviewed on an ongoing basis.

**Obtaining Value from Directors**

It is often assumed that boards add value because of the relevant specialist expertise directors bring to the board. The relevance of the background or specialist expertise of individual directors was not examined in detail by The Audit Office. However, from an overview it was not readily apparent that the credentials of all board members would necessarily provide a strong value adding base. The lack of a transparent appointment process in many cases exacerbates the problem.

The Audit Office also observed that time available to directors is limited by virtue of their concurrent directorship on a number of public sector boards. In total, 13 per cent of directors held more than one directorship.<sup>12</sup> The Audit Office survey showed that most boards meet for less than half a day per month.<sup>13</sup>

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<sup>11</sup> This is covered in further detail in Volume Two: *Corporate Governance in Practice*.

<sup>12</sup> Membership of private sector boards is not recorded on the Premier's Department database.

Accountability of individuals, either directors or the CEO, is also constrained by the confusion (outlined earlier) which exists regarding the respective roles, responsibilities and powers between the Government, the board and the CEO.

There is no standard system for evaluating the achievements of most boards, as opposed to that of the organisation, and there is scant evidence of structured evaluation of boards being undertaken.

## **Recommendations**

1. The role of boards should be clearly defined, and specific criteria developed, so that boards can be clearly classified as either governing or advisory.
2. Legislation should be reviewed targeting priority areas and policies developed to clarify and strengthen the respective role and functions for governing and advisory boards.<sup>14</sup>
3. Governance models, legislation, policies and practices should:
  - be based on principles of simplicity, clarity and consistency in approach;
  - provide boards with sufficient and clearly defined powers and authority for them to carry out their statutory role. There should be a corresponding appropriate level of public accountability;
  - set minimum standards for:
    - ◊ roles and responsibilities of the shareholder and portfolio Ministers;
    - ◊ roles and responsibilities of central agencies;
    - ◊ board appointments and composition;
    - ◊ CEO appointments and performance appraisal;
    - ◊ measuring and reporting board performance;
    - ◊ clarity and consistency regarding liabilities; and
  - make a clear statement that all governing boards should appoint their Chair and CEO.

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<sup>13</sup> This is covered in further detail in Volume Two: *Corporate Governance in Practice*.

<sup>14</sup> Criteria for adding value and for accountability have been developed by The Audit Office (included in this Report) which may serve as a basis from which detailed legislative provisions could be formulated.

4. A single model of governance should be adopted for all Government businesses, which provides maximum clarity and simplicity. A model designed around one Minister for Government businesses would achieve this result.
5. Boards in each portfolio not involved with running Government businesses or exercising prescribed regulatory functions should be reviewed against a set of criteria to assess the continued relevance and effectiveness of the board (in terms of value-added and future needs), and action taken to rationalise boards as appropriate. (Possible ways to carry out such reviews and to implement subsequent actions are included in this Report.)
6. There should be monitoring and reporting of the achievements and governance practices of *all* boards.
7. The costs of supporting *all* boards should be transparent and reported.
8. Strategies should be developed to provide ongoing education and consistent advice on governance matters for boards.

A NSW Public Sector Board Members Handbook<sup>15</sup> should be developed covering all boards to serve both as an induction manual and as an ongoing reference. The Handbook should include details of how legislation, policies, administrative arrangements and conventions affect board roles, responsibilities and duties.

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<sup>15</sup> The *Guide Towards Better Practice in Public Sector Corporate Governance* to be issued by The Audit Office may serve as a useful adjunct to such a Handbook.

## **Response to the Report from Premier's Department New South Wales**

*On behalf of my colleagues, the Director-General of the Cabinet Office and the Secretary of the Treasury I thank you for the opportunity to contribute to the development of your Office's Final Report of the Performance Audit on Corporate Governance in the New South Wales Public Sector.*

*In view of the wide reaching nature of the recommendations it is appropriate that the Final Report now be considered by the Government when it is tabled in the Parliament.*

*Once the Government has had time to consider the Report in detail I will ensure that the appropriate offices of the Premier's Department are available to respond to the Government's wishes in regard to the Report's recommendations.*

*Signed*

**C GELLATLY**  
**DIRECTOR GENERAL**  
*Date: 30 May 1997*



## **1. Responsibilities, Powers and Accountability: Governance Models**

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## 1.1 Introduction

Organisations in the NSW public sector are controlled and directed, or advised, using a variety of arrangements.<sup>16</sup> This process in many cases involves a board or committee.<sup>17</sup>

### What Types of Organisations have Boards?

Boards can be attached to many different types of organisations. These include:

- universities;<sup>18</sup>
- regulatory authorities;
- Government businesses;
- companies;
- statutory authorities such as area health boards;
- trusts; and
- non statutory authorities.

### Why are Boards Created?

Most of these boards are created by law. In doing so, Parliaments distinguish these bodies from normal Government bodies with the presumed intention that statutory bodies in the exercise of their duties and powers should not be subject to day to day oversight by Government.<sup>19</sup>

In “theory” the role of a board can be to provide:

- governance (direction and control); or
- policy and management advice.

The Audit Office found that these roles are not clear cut but rather they are currently “ideal types”. “Governing” boards can, in reality, be advisory and advisory boards can adopt, in practice, a governance role and functions at the Minister’s discretion.

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<sup>16</sup> The process of controlling and directing an organisation is commonly referred to as “governance”. See F. Hilmer, *Strictly Boardroom: Improving Governance to Enhance Company Performance*, Sydney Institute, 1993; H. Bosch, *Corporate Practices and Conduct*, Pittman, Sydney, 1995.

<sup>17</sup> As indicated in the Executive Summary, the terms boards and committees are often used without any clear definition of either. In this Report, all are referred to as boards. The need for more precise definitions accompanied by clearer criteria for governing or advisory boards is considered vital in understanding the role and accountabilities of boards.

<sup>18</sup> Universities are created under State statute, and as such are audited by The Audit Office. However, in many situations they are often not thought of as being part of the State public sector as they are funded by the Commonwealth.

<sup>19</sup> This needs to be recognised in considering issues of corporate governance in the public sector, and in making comparisons with the private sector.

Again, in theory, the full scope of governance functions of a governing board includes:

- setting direction;<sup>20</sup>
- securing organisational performance;
- ensuring compliance;
- managing stakeholders; and
- managing risk.<sup>21</sup>

Some boards are created for other less specific reasons.

However, The Audit Office found that the role and functions of boards in the NSW public sector are often ambiguous, in that their roles, functions, responsibilities and public accountability are not clearly defined and/ or may overlap with those of Ministers and the CEO.

**Why is the Role  
of Boards  
Unclear?**

The existence of Parliament, the Cabinet, Ministers and agency CEOs creates an elaborate set of relationships in the public sector. In attempting to apply private sector models, public sector arrangements need to take account of these complexities.<sup>22</sup> The respective powers and responsibilities of each party tend to create greater complexity in terms of accountability and controls than is the norm in the private sector.

The role, functions, responsibilities and accountabilities of boards in the public sector are often unclear because:

- there are a number of individuals and entities involved in making decisions about governance matters; and
- the roles, responsibilities and accountabilities of each party often have not been clearly defined, either in the organisational/ governance model, legislation or in the day to day operations.

As implied by the name, Budget Sector agencies usually derive their funds primarily from the annual budget prepared by Government and approved by Parliament. Budget Sector agencies are almost exclusively subject to full Ministerial control.

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<sup>20</sup> In the public sector, in accordance with overall Government policy.

<sup>21</sup> See Hilmer, 1993; Bosch, 1995.

<sup>22</sup> NSW Auditor-General's Report for 1996, Volume Three-Part 1, p. 13.

The Budget Sector accountability chain generally works as follows. There is:

- Ministerial accountability to Parliament and the general community using the Parliamentary appropriation process, annual reporting and the Guarantee of Service;
- a Performance Agreement between the Minister and each CEO which sets out the agency's mission, objectives and specific activities and outputs that the agency will deliver over a specified timeframe;
- a contract of employment and performance agreement between each CEO and members of the Senior Executive Service (SES) within the agency setting out the role, responsibilities and actions to be undertaken over the given timeframe; and
- a performance review and assessment process between supervisors and staff at all levels of the agency.

**The Problem for  
Budget Sector  
Boards**

Because of the number of parties and the complexity of interrelationships, it is important to define clearly the respective roles, responsibilities and powers of each party. From a governance perspective, there is a need for Ministers, boards and CEOs to have clear and appropriate roles, responsibilities and powers. This means that the powers of boards should match their responsibilities and accountabilities.

Currently the role, functions, responsibilities and accountabilities of boards in the Budget Sector are ambiguous in that board powers and responsibilities are not clear, nor are they commensurate with the responsibilities they are expected to fulfil. Usually the CEO is appointed by the Governor and is responsible and accountable to the Minister rather than the board, making CEO accountability to the board often informal and by "mutual" agreement.

The nature and extent to which these boards "govern" is therefore indefinable, as Ministers often retain power to control and direct a board. The areas in which Ministers can direct and control, the extent to which they can do so, and the manner in which this power can be exercised, are also often unspecified.

**The Problem for  
Non Budget  
Sector Boards**

Non Budget Sector agencies derive their revenue mainly from fees and charges. This sector includes statutory authorities which are instrumentalities created by Parliament. These authorities have their own legal identity by way of specific *enabling* legislation and they are equipped by Parliament with responsibilities, power and authority granted by this legislation. These entities are created with some independence from Government but, depending on particular provisions of legislation, can be subject to the directions of the relevant Minister.

Statutory authorities can be service oriented, regulatory or commercially oriented. Many service organisations are subject to the direction and control of the Minister. On the other hand, many regulatory authorities are specifically not subject to Ministerial Directions and this is specified in *enabling* legislation.

The Non Budget Sector includes Government owned businesses such as non-corporatised Government Trading Enterprises (GTEs) and State Owned Corporations (SOCs). In addition to *enabling* legislation, SOC have *supporting* legislation which sets out the fundamental principles which govern their operations. Both SOCs and GTEs can be subject to the direction of a Minister. Usually legislation constrains the type of directions Ministers can give to SOCs.

Boards in the Non Budget Sector, whether they are boards running businesses or other types of government organisations, face similar problems to boards in the Budget Sector. Board powers do not usually match their responsibilities, in that most boards still cannot appoint their CEO and/or they are under Ministerial control and direction to some degree. This situation even exists for some boards which “govern” businesses.

Questions then arise as to what governance means in the public sector, what should it mean, and why is it important?

**What does Governance in the NSW Public Sector mean?**

The Audit Office found that the meaning of governance, as evident in models, legislation and practice, is almost currently indefinable in the NSW public sector.

Premiers Department Guidelines<sup>23</sup> outlines categories of boards and suggests what the role of boards *should* be. Those *Guidelines* identify four “ideal” types of boards. They are:

Category A - Corporatised Entity:- Directors of these organisations are responsible to the Shareholders and *are not subject to direction and control by the portfolio Minister*<sup>24</sup>; (emphasis added)

Category B - Governing Board:- The board *should* be empowered to govern the management of the enterprise, and circumstances in which Ministerial control and direction will be exercised should be specific; (emphasis added)

Category C - Advisory Board:- The board provides advice to the Minister on all matters relevant to the management of an authority but the Minister retains unfettered right to control and direct the board and the CEO;

Category D - Advisory Council, Committee, etc.: - These bodies have little or no policy determination or operational executive functions and are established primarily to provide advice to a portfolio Minister on policy or operational issues.

The *Guidelines* imply assumptions about the degree and clarity of board powers and responsibilities which The Audit Office has not been able to substantiate, in terms of governance models, legislation and practice.

**The Number and Costs of Boards**

The Premier’s Department database indicates that there are over 600 boards in the NSW public sector. Not all boards contribute to this database and it excludes most of the several hundred trusts attached to the Department of Land and Water Conservation.<sup>25</sup>

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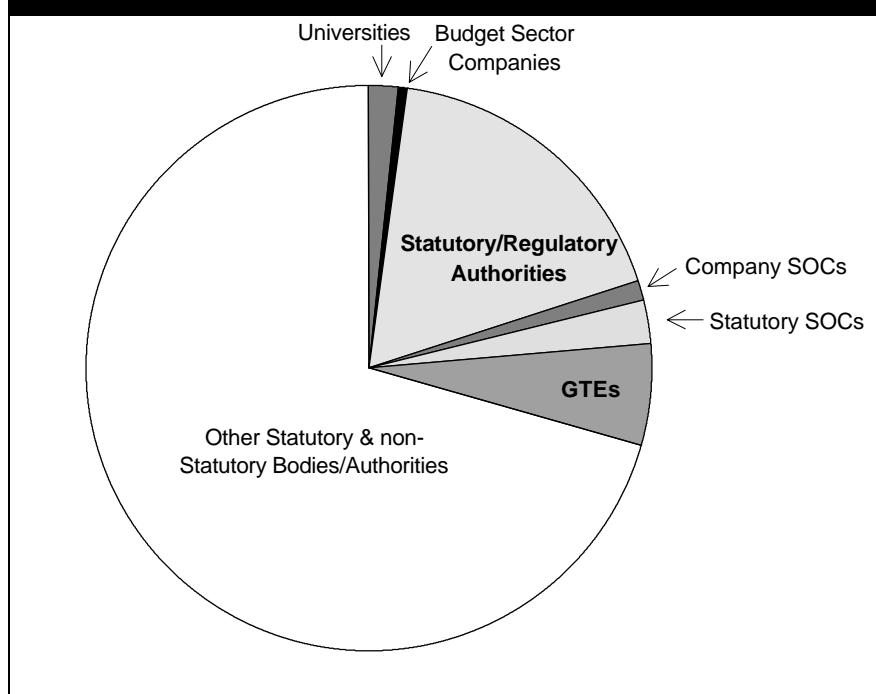
<sup>23</sup> Premier’s Memorandum 93-43 *Guidelines : Corporatised Entities, Statutory Authorities, Commissions, Advisory Bodies, Consultative Committees and Councils- Categorisation-Remuneration of non-executive Directors and Part-Time Members.*

<sup>24</sup> The Audit Office analysis of the models, legislation and practice indicates the opposite generally is the case.

<sup>25</sup> The database was created some time ago and its purposes were different to what current needs might dictate.

These 600 boards can be divided into seven general categories as shown in Figure 1. Drawing on costing information provided by the Premier's Department database, and a small sample of different types of boards, The Audit Office estimates that both direct and support costs for these 600 boards (including universities) could be as high as \$73 million per annum.<sup>26</sup> For full public accountability, the support required by boards needs to be clearly identified and costed. To justify such costs, significant value-added by boards is obviously imperative.

**Figure 1: Distribution of the Types of Boards across the NSW Public Sector**



**Source:**

1. Treasury for SOCs and GTEs
2. Premier's Department database for all other boards.

<sup>26</sup> Because not all boards contribute to the Premier's Department database, support costs are necessarily also underestimated. Directors fees alone, without sustenance and support costs, amount to \$13 million for 299 boards. Another 304 boards either have not supplied information on directors' fees to Premier's Department or have directors who do not receive fees. Support costs have been estimated from sampling such costs for a range of boards in different categories, and extrapolating these figures across the total number of boards in each category. The support costs for university councils, often not thought of as being part of the public sector although they are created under State Statute, form only a small portion of this \$73 million.

## 1.2 Principles for an Effective Governance Framework

To achieve full public accountability, boards need to add value and demonstrate that they are cost effective. This requires that boards operate under a model which allows them to be effective and efficient in carrying out their governance functions.

In seeking to extract proper value from public sector boards, overseas studies<sup>27</sup> have consistently emphasised the importance of putting an effective overall framework in place and getting the settings right. Effectiveness is enhanced when there is a clear, simple and consistent approach to governance. Public sector boards are not subject to the constant discipline imposed on most private sector boards by the ongoing market forces. However, as outlined previously, public sector boards operate in an environment that includes the non-executive legislature (the Parliament) and the executive (Cabinet, Ministers and departments).

In the United Kingdom, it has been stated that a key principle of effective public sector governance is that boards should retain full and effective control and monitor executive management and leadership.<sup>28</sup> To achieve this requires:

- a clear and appropriate definition of the role and functions of the board;
- consistency in approach to governance in terms of the roles of the board, Government and Parliament regardless of the nature, size, assets or income of the organisation being governed;
- clarity in and separation of the roles of Ministers and the board;
- definition in legislation of, the roles, powers, responsibilities and accountabilities of the Government, its Ministers and boards;
- legislation to provide boards with the authority to carry out their governance responsibilities; and
- a process to ensure reporting of board achievements and governance practices, including appointments.

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<sup>27</sup> see, for example, the Report of the Committee on *The Financial Aspects of Corporate Governance* (the Cadbury Report), Gee and Co. Ltd., London, 1992 and reports by the Provincial Auditor of Saskatchewan, Canada, "Survey Report and Examination plan: Board of Directors Audit", internal paper, 1993; *Report of the Provincial Auditor to the Legislative Assembly of Saskatchewan*, 1995.

<sup>28</sup> Chartered Institute of Public Finance and Accountancy (CIPFA) *Corporate Governance: A Framework for Public Sector Bodies*, CIPFA, London, 1995.

A second key principle for effective governance emerges from the first. If boards are to have powers that match the responsibility of their statutory duties, then the public (the ultimate shareholders) will rightly expect boards to be fully and publicly accountable. Elected governments will clearly have an interest in what boards are doing and will also expect boards to account to the Government for board actions and achievements. This is a direct and unavoidable consequence of a board being part of the State's public sector machinery. This practical reality can be accommodated without excessively undermining the principle of statutory independence of boards. To achieve this, Parliament needs to play a key role in the system of accountability for public sector boards and five conditions are met for boards with a governance role:

- roles and functions of each board are clearly defined, preferably in legislation;
- expectations as to what boards report upon are clearly defined;
- there is a Performance Agreement between the board and the Minister/Government;
- boards report achievements against this Performance Agreement to Parliament through the Minister; and
- the need for and the performance of boards are regularly reviewed by Government.

### **Criteria for Assessing Governance Models**

Drawing on the general principles set out in the preceding commentary, The Audit Office developed a number of specific criteria to assess the effectiveness of *governance* models, both in terms of the structure of the model, and processes for decision-making and public accountability. These criteria fall into two broad categories:

- the relationship between (and therefore the roles and responsibilities of) the board, Ministers, the CEO and central agencies; and
- public accountability.

Because of the importance of these specific attributes to the overall discussion about public sector governance, The Audit Office's criteria are set out in detail below.

### 1.3 Audit Criteria to Assess Capacity to Add Value

#### **Adding Value Criteria**

The principle underpinning the criteria regarding the relationship between the board, the Minister, CEO and central agencies is that the framework for the board and its decision-making processes should allow the board full and effective control over the organisation it is “governing”. This means that there should be a separation of powers and concomitant responsibilities between the board, the Minister and the CEO. To ensure that these conditions are met, these powers and responsibilities should be set down in legislation.

Specifically, The Audit Office’s criteria to assess the degree of “which a governing board can make is as follows:

#### **Separation of Powers**

- the Minister’s ability to issue directions in regard to a board’s activities should be subject to clear limits;
- the Minister should not be able to give directions to the board in terms of the exercise of the board’s statutory powers and duties;
- any Ministerial Directions to the board in regard to its activities should be in writing and publicly reported;
- there should be clear and agreed provisions for boards to refuse these Ministerial Directions; and
- where Ministerial Directions are imposed, there should be agreed provisions for boards to seek compensation for implementation of Ministerial Directions.

#### **Delineation and Independence in Roles, Functions and Responsibilities of the Board**

- roles, functions and responsibilities should be defined in legislation;
- roles, functions and responsibilities should be clarified in guidelines, charters or a Memorandum of Understanding;
- roles and responsibilities should be defined with respect to:
  - ◊ appointment of board members;
  - ◊ appointment of the Chair;
  - ◊ appointment of the CEO;

- ◊ decision-making and control;
- ◊ reporting arrangements;
- ◊ the provision of information by the board to Government;
- the Chair should be appointed by the board;
- the Chair should have a Performance Agreement with the board;
- the CEO should be appointed by the board; and
- the CEO should have a Performance Agreement with the board.

All parties need a clear understanding of their responsibilities and there needs to be a “robust” governance structure in order to be able to achieve full public accountability.<sup>29</sup>

#### **1.4 Audit Criteria for Public Accountability**

##### **Accountability Criteria**

Boards should be publicly accountable for their decisions. They should be accountable for:

- their statutory responsibilities;
- expenditure of public money; and
- governance practices.<sup>30</sup>

Boards should be accountable to all stakeholders for board performance. This includes reporting to the body that elected or appointed them.

To communicate the board’s achievements and practices, board performance needs to be:

- measured against standards and targets;
- rigorously and regularly reported; and
- regularly and publicly reviewed.<sup>31</sup>

This evaluation of board and board members’ performance needs to be supported by a regular assessment of the performance of the Chair and the CEO.

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<sup>29</sup> CIPFA, *ibid.*, p. 9.

<sup>30</sup> CIPFA, *ibid.*, p.22.

<sup>31</sup> CIPFA, *ibid.*, p.23.

Specifically, The Audit Office's criteria to assess the degree of public accountability of a board are as follows:

- the process of board appointments should be more rigorous;<sup>32</sup>
- there should be a Performance Agreement (or equivalent) between the board and the Government;
- the board should publicly report its performance;
- the performance of board members should be reviewed and reported upon by the board;<sup>33</sup>
- legislation should provide a clear basis for the removal of board members; and
- legislation should provide for the abolition or redefinition of positions on the board or of the board itself.

### **1.5 Comparison of Governance Models**

A summary of The Audit Office's analysis of the main governance models currently operating in NSW against the audit criteria for independence and accountability is provided in Table 1.<sup>34</sup> An expanded narrative analysis with examples is provided at Attachment 4.3.

The Audit Office identified seven broad types of board models currently operating in the NSW public sector. These models are:

- Universities;
- Budget sector companies;
- Statutory, regulatory authorities;
- Company SOCs;
- Statutory SOCs;
- GTEs; and
- Other Statutory and Non-Statutory Bodies and Authorities.

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<sup>32</sup> Currently Ministerial proposals for appointments are assessed by the Premier's Department and approved by Cabinet but selection criteria are not publicly specified (criteria for level of fee payment are provided in Premier's Department Guidelines). In November, 1995 the Government called for expressions of interest for board directors.

<sup>33</sup> This is recommended by the National Association of Corporate Directors (NACD), and is currently practiced by a few NSW public sector boards.

<sup>34</sup> It must be noted that there are variations within as well as across governance models. This analysis seeks to illustrate the inconsistencies and lack of compliance with the principles and criteria rather than be comprehensive.

The Audit Office analysis shows that a wide variety of arrangements exist for boards and that certain features of various models, or their implementation in practice, are commendable. However, it is apparent that several models confuse the governance and advisory roles and responsibilities of boards to act in a value-added way and several have inherent weaknesses from a public accountability viewpoint.

*1. Responsibilities, Powers and Accountability: Governance Models*

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**Table 1: NSW Governance Models - A Comparison**

<b>Model<sup>35</sup></b>	<b>Ministerial Direction and Control<sup>36</sup></b>	<b>Board Appointments</b>	<b>Chair Appointments</b>	<b>CEO Appointment</b>	<b>Public Accountability</b>	<b>Individual Accountability</b>
<b>Universities</b>	not subject to any Ministerial control	some directors appointed by State Minister; some made by university membership	appointed by university council	appointed by university council	Annual Report (not tabled in Parliament) Audit Report	usually no formal CEO Performance Agreement (PA)
<b>Budget Sector Companies</b>	not subject to any Ministerial control	appointed by Minister	appointed by board	appointed by board	reporting as per <i>Corporations Law</i> Audit Report	CEO accountable to board
<b>Regulatory Statutory Authorities</b>	some not subject to any Ministerial control, others are	appointed by Governor on advice from portfolio Minister	appointed by Governor on advice of portfolio Minister	appointed by Governor on advice of portfolio Minister	Annual Report Audit Report	PA usually with board but CEO may have dual accountabilities

<sup>35</sup> see Figure 1 for distribution of board categories across NSW public sector.

<sup>36</sup> Ministerial control referred to in all legislation with exception of companies.

## *1. Responsibilities, Powers and Accountability: Governance Models*

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<b>Company SOCs</b>	subject to Ministerial Directions for non-commercial functions; they must have Treasurer's approval and, must be in writing; entitled to reimbursement	appointed by Voting Shareholders	appointed by Voting Shareholders	appointed by board	Annual Report Audit Report Statement of Corporate Intent tabled in Parliament <sup>37</sup>	CEO PA with board
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<sup>37</sup> SCI operates as a Board PA with Voting Shareholders.

*1. Responsibilities, Powers and Accountability: Governance Models*

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**Table 1: NSW Governance Models - A Comparison (*continued*)**

<b>Model</b>	<b>Ministerial Direction and Control</b>	<b>Board Appointments</b>	<b>Chair Appointments</b>	<b>CEO Appointment</b>	<b>Public Accountability</b>	<b>Individual Accountability</b>
<b>Statutory SOCs</b>	subject to Ministerial Directions for (a) non-commercial functions; (b) public policy; and (c) public interest issues; must have approval of Treasurer and must be in writing; Minister must consult with board re (b) and (c); entitled to reimbursement.	Type One: appointed by Governor on recommendation of Voting Shareholders  Type Two: appointed by Voting Shareholders	Type One: appointed by Governor on recommendation of Voting Shareholders	Type One: appointed by Governor on recommendation of portfolio Minister and the board.  Type Two: appointed by Voting Shareholders	Annual Report Audit Report Statement of Corporate Intent tabled in Parliament	Both types: CEO accountable to board
<b>GTEs (may take form of statutory body or business unit in Government department)</b>	subject to Ministerial Directions for all functions	appointed by Governor on recommendation of portfolio Minister	appointed by Governor on recommendation of portfolio Minister	CEO appointed by Governor on recommendation of portfolio Minister and/or board; for business units of departments, CEO appointed by Minister	Annual Report Audit Report Statement of Financial Performance (SFP); not all GTEs have a SFP	CEO PA varies, in some cases PA with portfolio Minister, in other cases CEO accountable to board



*1. Responsibilities, Powers and Accountability: Governance Models*

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**Table 1: NSW Governance Models - A Comparison (*continued*)**

<b>Model</b>	<b>Ministerial Direction and Control</b>	<b>Board Appointments</b>	<b>Chair Appointments</b>	<b>CEO Appointment</b>	<b>Public Accountability</b>	<b>Individual Accountability</b>
<b>Other Statutory and Non-Statutory Bodies and Authorities</b>	usually subject to Ministerial control and direction	Statutory directors appointed by Governor on recommendation of portfolio Minister; others usually appointed by Minister	appointed by Governor on recommendation of portfolio Minister; others usually appointed by Minister	CEO appointed by Governor on recommendation of portfolio Minister	Annual Report Audit Report; non-statutory bodies accountable to Minister, may not report publicly.	PA usually with Minister or CEO of Portfolio Department

## Powers and Responsibilities

Better practice in *governance* allows boards to be effective by providing them with clear and appropriate powers to exercise their statutory responsibilities. The seven board models examined in this Report (see Attachment Four) illustrate that this basic principle of governance is not fully achieved in any of the models in the NSW public sector.<sup>38</sup>

Of the seven models, the company SOC model provides the greatest alignment between responsibilities and powers. It does this by:

- providing for greater clarity and transparency with regard to Ministerial Directions to the board. Such directions can only relate to non-commercial activities and must be in writing; and
- allowing the board to appoint its own CEO.

A major difficulty with the company SOC (and statutory SOC) model is that, in practice, accountabilities to the portfolio Minister (regulator) and Voting Shareholders become confused. One company SOC has sought to overcome this problem by developing a Memorandum of Understanding between the portfolio Minister, the Board and the CEO.

Statutory SOC models have a greater mismatch between responsibilities and powers and hence have a more limited capacity to add value. This is because:

- the scope for Ministerial Directions is wider encompassing non-commercial functions, public policy and public interest issues. The latter two are not defined in legislation; and
- the CEO appointment in the case of the Ports SOC model (Type One) is made by the Governor on the recommendation of the Portfolio Minister and the board. In the case of energy and rail SOCs (Type Two), the CEO appointment is made by the board after consultation with the Voting Shareholders.

As noted above, accountabilities of statutory SOCs are confused between the portfolio Minister and the Voting shareholders. This is particularly so when a Voting Shareholder (the Treasurer) is also the portfolio Minister, as in the case of the energy SOCs.

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<sup>38</sup> Treasury has been re-assessing models for Government businesses and has been developing a policy approach. At the time of writing this report, no policy has been finalised.

Regulatory authority models usually have a reasonable degree of match between responsibilities and powers. However, the audit did find variations across regulatory boards in that the portfolio Minister could give Ministerial Directions in some cases or could choose to reject advice in others. In addition, in most of these boards the CEO is appointed by the portfolio Minister.

Most other models of boards in the public sector allow the Government to select and appoint the CEO (through the Governor-in-Council or Minister).

Governing boards which do not have the power to appoint and remove their CEO have reduced control and authority. At the very least, there is confusion about lines of responsibility and reporting. At one extreme, the boards which do not appoint the CEO can be rendered powerless (Case F in Attachment 4.3 illustrates this).

At the other end of the spectrum are the university councils, where most members are appointed from the university itself. There are some Ministerial appointments on Councils. A Council also appoints its own Chair.

The mismatch between a board's authority and its powers, responsibilities and accountability is exacerbated when a CEO has his or her Performance Agreement with the Minister rather than with the board. Some CEOs are accountable to both the Minister and the board (for example, trusts and some regulatory agencies). Only in the universities, company SOCs, one form of statutory SOCs (electricity and rail model) and some regulatory authorities, is the accountability of the CEO clearly to the board.

From an overall perspective, the current situation creates confusion and tensions in the roles, responsibilities and decision-making powers of the board, the Minister and the CEO. Essentially, current models in use are deficient in that some of the models:

- provide public sector boards with the same responsibilities as their private sector counterparts to manage the affairs of their organisation, but they do not offer the boards the necessary authority for this function;<sup>39</sup> and
- disperse responsibility between the Minister, the board and the CEO without making it clear how accountability for the responsibility is to be effected.

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<sup>39</sup> Auditor General of Canada, *Report of the Auditor-General of Canada to the House of Commons - Chapter 10 : Crown Governance, Fulfilling the Responsibilities for Governance*, Minister of Supply and Services, Canada, 1995, p.10.

The consequence is that many non-business boards have become high level, advisory management committees rather than true governing boards.

## Public Accountability

The Audit Office analysis also indicates that there is considerable variation in the form of and extent to which boards are publicly accountable. This is both in terms of their achievements or governance practices either through reporting to Parliament or through other means. Only SOCs have rigorous reporting requirements which measure the organisation's achievements against standards or targets. Their performance is regularly reviewed by Treasury and reported in the form of a Statement of Corporate Intent "signed off" by both the Voting Shareholders and the board. The full Statement is required by SOC legislation to be reported in Parliament.<sup>40</sup>

The boards of other agencies are required to comply with legislative annual reporting and audit requirements. These are not as stringent in terms of requiring the reporting of board performance against standards and targets. Beyond these, most boards have no formal contract or arrangement with the Government. Companies of inner budget agencies do not report to Parliament except in so far as their "host" agency may include their activities in the departmental report.

In addition, there is no requirement to report the activities or achievements of the *board*. Often it is difficult to identify the achievements of the board as opposed to those of the organisation, especially if the board does not have full control of decision-making.

Private sector boards must comply with Australian Stock Exchange requirements that governance practices be listed in the Annual Report. Public sector boards are not so required by Government. However, some do report governance practices but the extent to which they do so varies considerably.<sup>41</sup>

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<sup>40</sup> Some GTEs provide a Statement of Financial Performance (SFP) but this is not reported to Parliament. Other GTEs do not provide a SFP.

<sup>41</sup> This is discussed further in Volume Two: *Corporate Governance in Practice*.

## **1.6 Improving Business and Regulatory Models**

The Audit Office analysis has highlighted a number of aspects of current governance arrangements which could be strengthened to achieve greater effectiveness and public accountability. These include:

- having greater rigour and consistency in approach to corporate governance, especially with regard to board appointments, monitoring and review;
- strengthening legislation to provide boards with the authority to carry out their governance role;
- introducing mandatory public reporting of board achievements for boards not currently reporting; and
- making reporting of governance practices standard and compulsory.

### **Lessons from Other Jurisdictions**

These issues of how to make governance more effective and efficient are far from unique to NSW. Studies of public sector governance in other jurisdictions generally find similar situations. Governance models in other jurisdictions have addressed these issues in various ways and offer some potential courses of action for reform. An outline of governance models in the Commonwealth Government, New Zealand, the Federal Government of Canada, British Columbia and Saskatchewan is provided in the next chapter.

## **1.7 The Need for Review of Other Boards**

The Audit Office has not sought to examine value-added by individual boards. Rather, The Audit Office considered the overall context within which boards seek to carry out their activities. This enables broad general issues and impediments affecting all public sector boards need to be identified.

The preceding analysis suggests that for boards not overseeing business and regulatory activities, ie. those in the “other” category, a board may not be the most appropriate way of drawing on “expertise”. The question arises as to whether all existing boards are the most efficient and effective means of controlling the activities they purport to control. If sufficient value-added cannot be achieved by a board, or if a cheaper effective alternative is available, consideration should be given to the ongoing need for a board.

The Audit Office found that many of the statutes establishing other boards were quite old. In some cases it could be that there is no longer a continuing need for the function itself. In others, the function may still be warranted, but the need for it to be controlled using a board may have altered. For example, the need for the particular activity to be established as a statutory function and controlled independently of Government may have changed since inception.

From an overall analysis, The Audit Office considers that there are sufficient questions concerning the extent to which boards are able to add value, to justify a detailed micro level review of boards in each portfolio. This would enable the necessary detailed fundamental matters to be examined on a case by case basis.

There are two main options for such a review. The first is to undertake a systematic review of existing boards. This could be done on a central basis by Government; separately by each Minister on a portfolio by portfolio basis; or independently by a Parliamentary Committee.

A second, and more radical, approach could be to “wipe the slate” clean and remove the majority of boards in this category in a staged repeal process. Prior to repeal, the continued existence of any board would have to be justified by Ministers to a Parliamentary Committee. Such an approach was taken by the Government to institute reform in the area of regulations, and it has the advantage of facilitating very large scale reform quickly.

Whatever approach is preferred, there are three key elements in such a review process. First, there is a need to develop criteria to evaluate and analyse the necessity for the continued existence and operations of boards. As a starting point, to assist such reviews a set of general criteria for reviewing the ongoing need for, and value of, boards has been developed by The Audit Office. These are set out at Attachment 4.2.

Second, the review process should also develop specific recommendations for the continuation, termination and re-organisation of particular agencies, boards and commissions.

Third, the need for boards and the manner in which they operate should be reviewed on an ongoing basis. This could be ensured by including sunset clauses in legislation creating boards.

A large number of boards would likely continue following such reviews (although opportunities for improvement in their operation would probably be identified). Certainly there are many boards which perform vital statutory duties and do so effectively. However, through a micro review it may be possible to reduce significantly the number of boards from the existing level. This would generate substantial savings. For example, a 30 per cent reduction in the number of boards other than business or regulatory boards would provide savings in the order of \$12 million per annum.

An example of the specific outputs and recommendations which can flow from such a review process is provided by an Operations Improvement Task Force in Ohio.<sup>42</sup> They found that there was a proliferation of boards and committees. They therefore suggested a review of the need for and performance of these boards and committees was warranted.

The Ohio Task Force's recommendations were that there should be:

- sunset legislation which would automatically cease operation of any new or existing board or committees within six years of establishment;
- legislation which would provide for any board not fulfilling its reporting requirements to be abolished;
- a review of advisory boards to determine whether the necessary advice can be provided by a broader group of representatives or clients. Use of alternatives to a structured board input should be considered. These include surveys, focus groups and temporary work groups;
- merging of functions into departments with similar existing functions;
- a consolidation of boards;
- a review of the nature and level of State involvement in occupational licensing and regulatory boards. These should be privatised where possible. Where privatisation is not feasible or desirable, the staff assigned to provide administrative duties for these boards should be consolidated;
- no payment to members (apart from expenses) where boards are retained, except where statute designates full or part-time board positions; and
- a temporary task force to implement the review process.

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<sup>42</sup> Operations Improvement Task Force Report, *Report on State Boards and Committees*, Ohio, USA, 1992.

## **2. Governance Models Elsewhere**

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## 2.1 Introduction

### Governance Models in Other Jurisdictions

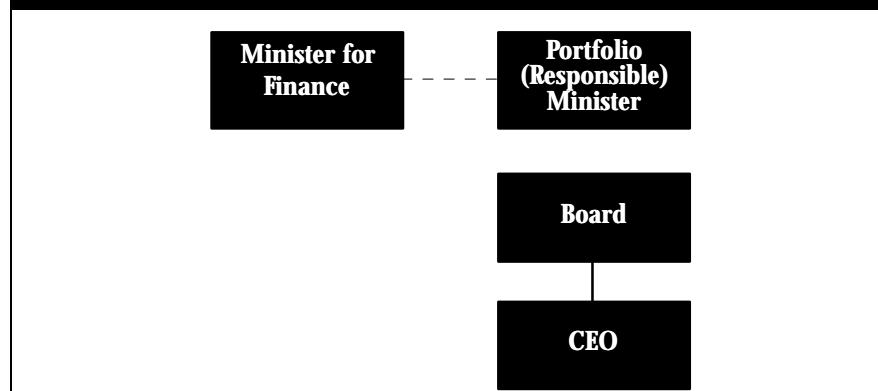
The analysis of models in other jurisdictions indicates that there is considerable variation in governance structures and processes. An analysis of five governance models is provided to illustrate the differences in approach and the strengths and weaknesses of each. The governance models considered are:

- the Commonwealth Government;
- New Zealand;
- Federal Government of Canada;
- British Columbia; and
- Saskatchewan.

## 2.2 The Commonwealth

An arrangement offering a high degree of clarity, simplicity and consistency in approach in terms of powers, responsibility and accountability is used in the Commonwealth for Government Business Enterprises (GBEs). Responsibility for these businesses rests with the portfolio Ministers. The portfolio Minister is the responsible Minister and the spokesperson for the GBE. Roles and responsibilities are clearly defined and documented in guidelines. Ministers have responsibility for strategic control while boards have “absolute” responsibility for GBE performance. The Finance Minister is to be consulted by the portfolio Minister when certain commercial decisions are required.

**Figure 1: The Commonwealth Governance Model for Government Business Enterprises**



The board's effectiveness is reinforced by boards having responsibility for:

- appointing their CEO;
- reporting to Ministers on a regular basis; and
- advising the Minister on board strengths and weaknesses and in this context advising on potential candidates and appointments.

Along with this responsibility, stringent accountability guidelines have been developed. These are concerned with board reporting to the portfolio Minister *and* public reporting to Parliament. This is currently being reinforced by the introduction of omnibus legislation (*Commonwealth Authorities and Companies Bill*)<sup>43</sup> which will articulate the principles of better practice in governance responsibility, accountability and standards of behaviour. The legislation will apply to both GBEs and to statutory authorities.

Boards with responsibilities for business units within Government departments are referred to as advisory boards.<sup>44</sup> This term acknowledges that they are advisory rather than governing. Their role is specifically to support the CEO. They operate under guidelines similar to those for GBEs in that their responsibilities and accountabilities are clearly defined. The Commonwealth advises that the principles enunciated in the new *Commonwealth Authorities and Companies Bill* will be applicable to business units and will provide them with a code of conduct by which to operate.

### 2.3 New Zealand

The New Zealand model of governance for Crown Corporations also offers simplicity, clarity and consistency in approach. It allows for board powers that approximate responsibilities and clear lines of responsibility and accountability. All State Owned Enterprises (SOEs) are registered as public companies and are bound by the provisions of the *Companies Act*.

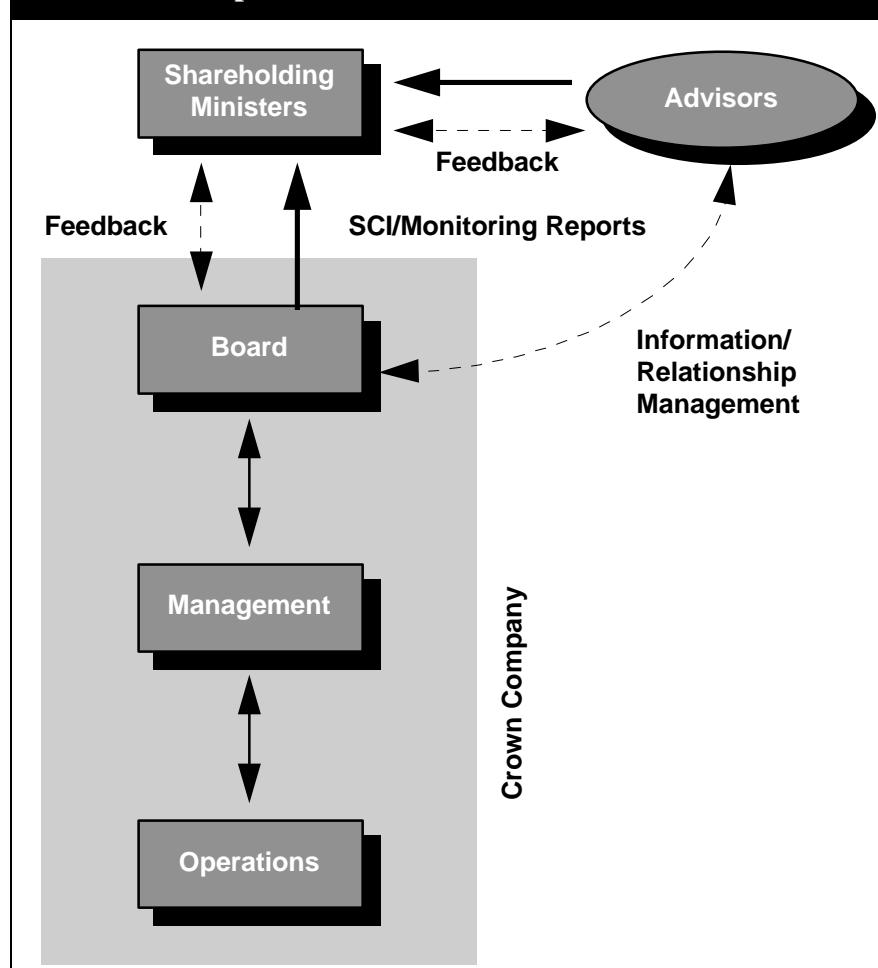
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<sup>43</sup> Being considered by the Senate at the time of preparing this Report.

<sup>44</sup> Business units of Commonwealth departments tend to be units providing support services such as Asset Services and Interiors Australia. An example of a business unit in NSW public sector is the Registry of Births, Deaths and Marriages within the Attorney-General's Department.

In this model, all companies have two shareholding Ministers, one of whom is always the Minister for Finance. The other Minister is described as the responsible Minister (and spokesperson), such as the Minister for State Owned Enterprises (SOEs) or the Minister for Crown Health Enterprises. Most of the “day to day” attention from the shareholders is provided by responsible Ministers. The advantage of this model is that having a Minister for SOEs gives consistency in the application of Government policies across SOEs and responsibility for outcomes.

**Figure 2 : The New Zealand Governance Model for Crown Corporations**



Again, like the Australian Commonwealth model, a New Zealand Crown Corporation board appoints its CEO who is responsible to it. Thus there is no clouding of lines of responsibility.<sup>45</sup>

<sup>45</sup> Crown Company Monitoring Unit letter to The Audit Office, 28 November, 1996.

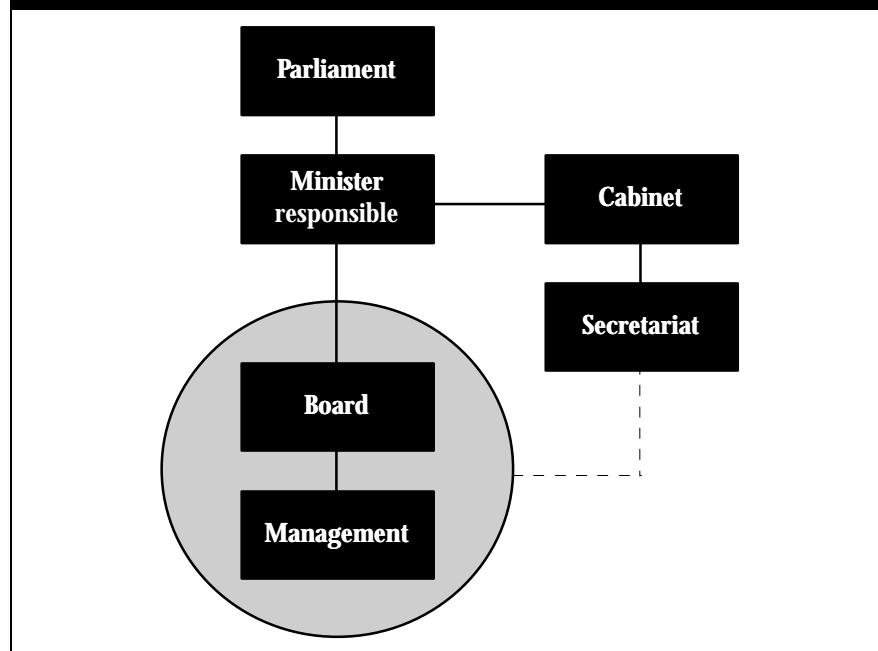
## 2.4 Federal Government of Canada

Under this model, a single Minister is responsible to Parliament for the oversight of an individual business. This is the *simplest* of the models in that there is one Minister responsible for policy/regulation and service provision functions.

Businesses are separated from Government by Parliament which is the only body with the power to create, change and dissolve a company.

Boards are responsible for presenting organisational plans and budgets to the Minister and for appointing senior management.

**Figure 3: The Canadian Governance Model for Federal Crown Corporations**



In its implementation there are constraints on a board's responsibilities. These are:

- the Governor-in-Council appointing Chairs and CEOs on the recommendation of the Minister. While this might be common practice, it reduces the extent of power a board can exercise over its own affairs. In this particular Canadian model, boards do offer advice on director appointments; and
- the Minister appointing directors with the approval of the Governor-in-Council.

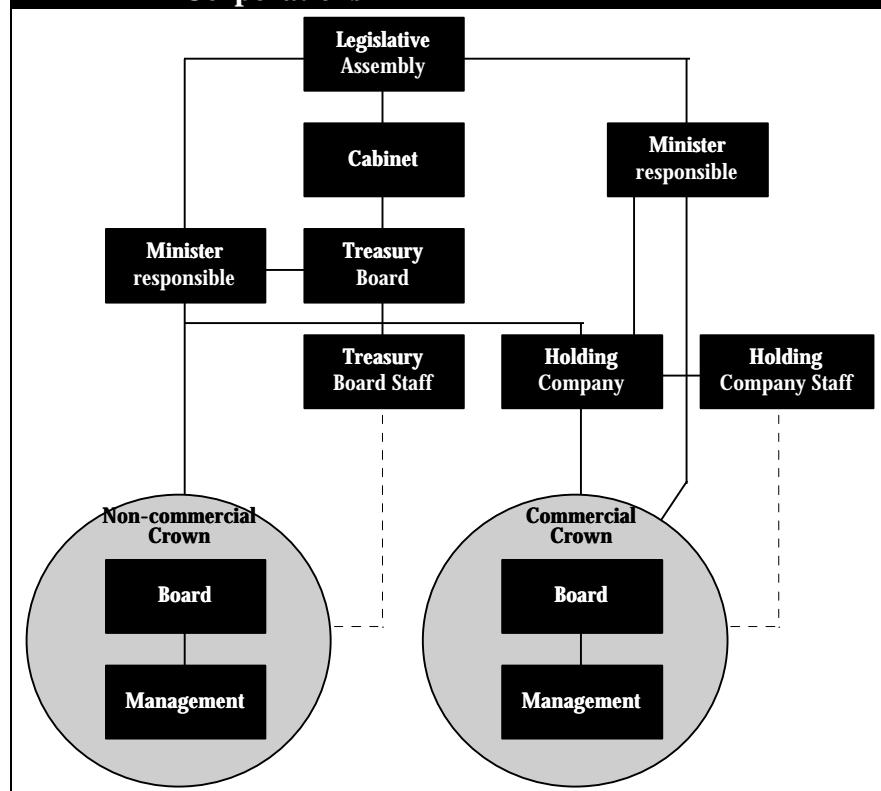
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<sup>46</sup> Auditor-General of British Columbia, *Crown Corporations Governance Study*, Office of the Auditor-General, Victoria, British Columbia, 1996, p.19.

## 2.6 Saskatchewan

This model is the most *fragmented* in terms of power and responsibilities and most *complex* in terms of public accountability. Under this model, a Crown Investments Corporation has been created as a holding company responsible for managing and co-ordinating subsidiary commercial Crown corporations. The Corporation board comprises a number of Ministers. In this way, the board of an individual Corporation is subject to control and influence by its responsible Minister and by the Holding Company.

**Figure 5 : The Saskatchewan Governance Model for Crown Corporations**



## 2.7 The Role of Parliament and Government

Compared to NSW, in other jurisdictions Parliament takes a more active role in ensuring a board's responsibilities match its accountability. For example, to secure greater independence:

- Ontario has established an all-party Standing Committee on Government Agencies whose function is to interview candidates for board positions;
- the Federal Government of Canada has:
  - ◊ created the power to call appointees before a Parliamentary Committee to review their qualifications;
  - ◊ established a Parliamentary Committee to oversight Crown corporations;
  - ◊ instituted a process of developing profiles of board needs, publishing selection criteria used in appointments and publishing board vacancies in their Government Gazette; and
- British Columbia has set up an Appointment Office for Agencies, Boards and Commissions to ensure that the best qualified candidates are chosen.

To improve public accountability of corporations, the Federal Government in Canada requires regular “value-for-money” reviews of corporations to be provided to Parliament. The Saskatchewan Parliament requires detailed reporting of Crown corporation transactions to Parliament within a given timeframe.

### Parliamentary Responsibility for Governance in NSW

The NSW Parliament has an important role with respect to statutory boards. It:

- legislates their creation and dissolution;
- legislates the conditions under which a board will operate;
- allocates their funding; and
- receives their Annual Reports.

The responsible Minister functions as a link between the board and the Parliament. Statutory Boards are ultimately accountable to the public through the Minister and Parliament.

However, the nature and extent of involvement of the NSW Parliament in overseeing and monitoring of boards is inconsistent across board models currently operating in NSW. Unlike some of the arrangements described above, accountability to the NSW Parliament is minimal, relying on tabling of an Annual Report and an audit report. This essentially is the same standard of accountability applying to government departments, yet boards should have greater accountability by virtue of their separation from Government and by virtue of their responsibilities.

## 2.8 The Role of Central Agencies

In those jurisdictions where boards have significant responsibility (and separation from Government), central agencies of Government take on a more supportive and monitoring rather than directive role. This has been achieved by separating the policy development function of central agencies from their advisory and monitoring of business functions. Having this delineation in roles avoids confusion, contradictions and conflicts about the role of central agencies such as Treasury in participating in business decisions.

The best example of this separation of roles is the New Zealand model of the Crown Corporations Monitoring Advisory Unit (CCMAU). This unit advises the responsible Minister on and monitors the achievements of an individual company. Factors monitored include:

- commercial opportunities and risk;
- environment and performance;
- potential for value enhancement;
- actions to ensure performance against objectives; and
- ownership objectives.

The New Zealand Treasury is a separate entity. It is responsible for “whole of government” advice to the Treasurer. It is concerned with:

- the Crown balance sheet, cash flow and Crown risk profile;
- opportunity cost of investment in Crown companies;
- Crown’s desire to minimise commercial risk;
- institutional difficulties facing the Crown as an owner of a commercial enterprise; and
- impact of Government policy and regulation on Crown companies.<sup>47</sup>

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<sup>47</sup> Crown Company Monitoring Advisory Unit (CCMAU), *Corporate Profile*, CCMAU, Wellington, 1996b, p.11.



### **3. Limitations on Governance Functions**

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### 3.1 Introduction

The Audit Office identified a range of factors which limit the extent to which many boards are able to exercise governance functions. These include:

- the Government's role in setting strategic directions, including the social objectives of agencies;
- the Government's ability to control and direct many boards in many situations;
- blurred roles and responsibilities between Ministers, boards and CEOs for securing organisational performance and compliance;
- limitations on the control of resources by boards;
- limitations on the extent to which public sector boards manage stakeholder relationships; and
- limitations on the extent of liability of public sector board members, including limitations on the extent to which boards actually manage risk and are therefore directly liable.

In examining impediments to governance functions, an initial basis for comparison can be taken from considering the broad corporate governance functions of private sector boards, being:<sup>48</sup>

- setting strategic directions;
- securing organisational performance;
- guaranteeing compliance with all requirements;
- managing stakeholder relationships; and
- ensuring risk management is addressed.

It is acknowledged that there are a number of complicating factors to be considered in applying corporate governance to the public sector (refer Chapter One). However, the basic elements are common, at least in principle, and provide a starting point for analysis.

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<sup>48</sup> F. Hilmer, *Strictly Boardroom : Improving Governance to Enhance Company Performance*, Sydney Institute, Sydney, 1993; H. Bosch, *Corporate Practices and Conduct*, Pittman, Sydney, 1995.

### 3.2 Setting Strategic Directions

#### **Role of the Government**

Control over an agency's direction takes place within the context of overall Government policy. Under structural reforms of the public sector, the role of translating broad Government policies into more specific strategies has been given to specific policy units in many instances. This has been part of the purchaser/provider split. For a number of boards, the board's ability to set "strategic direction" is limited in this context. The following case illustrates one such situation (further examples are given in Attachment 4.3).

#### **Case Q**

This is a statutory SOC. It is responsible for managing a service and infrastructure. The infrastructure or assets are actually owned by a Ministerial Holding Corporation. The overall portfolio policy is set by a separate policy office. This organisational arrangement is the result of a purchaser/ provider and a regulator/ policy and service provider split.

In this context the Board can only set direction for the company in terms of how to deliver services within the context of Government policy set by another agency.

#### **Ministerial Directions**

Boards can also be limited in their powers to set or implement strategic direction because of the power of the Minister to intervene through Ministerial Directions.

There are four concerns with regard to Ministerial Directions. First, is the tension created between having a responsible, separate board and having a provision for Ministerial Directions. Second, is the inconsistency across and within models as to whether and how Ministerial Directions can be applied. Third, is that legislative provisions for Ministerial control do not seem to be related to the level of risk borne by the board. Fourth, accountability fails unless the Minister is required to publish directions.

Governance models in the private sector are based on the concept that a board with responsibility and authority for decision-making also takes the risk. Unless there are clear legislative provisions regarding risk, the legislative clause that a board is subject to Ministerial Directions clouds the issue of liability. There may be confusion as to whether the organisation has crown immunity in implementing a Ministerial Direction.<sup>49</sup> It could also be argued that Ministers become defacto directors and have a conflict of interest between fulfilling a role representing the public and acting in the best interests of the organisation.<sup>50</sup> The issue of liability is further discussed in Attachment 4.4.

With regard to consistency, only universities, companies owned by agencies and created under *Corporation Law*, and some regulatory statutory authorities have legislative responsibility free of Ministerial control and direction. The SOCs have varying Ministerial controls depending on the type of SOC. Non-corporatised GTEs, which are classified as Government businesses are, unlike the SOCs, subject to Ministerial direction and control for all their functions as are most statutory bodies and authorities.

The rationale for provision for Ministerial direction and control legislation would seem to be that boards subject to these directions manage vast assets or income or have socially significant functions. However, universities, companies owned by government agencies and some regulatory bodies manage substantial assets and income and are not subject to Ministerial control.

For full accountability, the public needs to know which decisions the board is responsible for and which of its actions are the result of Ministerial Directions. To fulfil the requirement of full public accountability, such directions should be published. Only the SOCs have a legislative requirement to publish such directions.

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<sup>49</sup> P. Malam and S. Mason, “Liability Issues for Public Sector Managers”, paper presented at Public Sector Seminar *Partnering with the Private Legal Profession*, Blake Dawson Waldron, Sydney, 1996.

<sup>50</sup> B. Selway, “Legal Issues Arising from Government Roles in Business”, paper presented at *Will Private Sector Ways Lead to Better Government ?*, RIPAA Conference, Sydney, 1994.

**Role of Treasury** Treasury takes a key role in setting policy which complicates accountability. There are two difficulties:

- there is a conflict of interest between Treasury's role in maximising revenue for the State and its role in ensuring the "best interests" of the individual business in negotiating dividends; and
- their ability to influence the business policies of particular boards where the Treasurer is not the shareholder(GTEs).<sup>51</sup>

It should be noted that there has not been a central unit to monitor the performance of boards other than those "governing" Government businesses (undertaken by the Commercial Sector Division, Treasury). However, the new structure of Premier's Department does contain a board policy and monitoring unit which may take on this role.

**Control Over Resources**

To be able to set strategic direction effectively and have actual control over the implementation of decisions, boards must have control over resources. Private sector boards have control over the resources of the organisation they "govern". In this way, they can perform their governance roles of monitoring performance and compliance and managing risk.

In a number of instances in Government businesses, the boards do not in effect have control over staff or the organisation's income or investment decisions, as Cases E and A illustrate.

**Case E**

This is currently a non dividend paying GTE. In future years it will be paying dividends to Treasury and its CSO<sup>52</sup> will cease. The situation described below is not unique to this organisation.

All staff of the GTE belong to its umbrella/ portfolio department. This complicates reporting and accountability arrangements.

The General Manager is an employee of the host department and reports, in a public service capacity, to the Director-General of the Department. The Director-General is on the Board of the GTE. The General Manager also reports to the Chair of the Board. Both the Chair and the Director-General report separately to the Minister.

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<sup>51</sup> P. Azarias, "The Significance and Need for a Competent Board in GBE's and Statutory Authorities", paper presented at IRR Conference, *Public Sector Corporate Governance and Accountability*, National Convention Centre, Canberra, 23 and 24 September, 1996.

<sup>52</sup> Community Service Obligation, funded by Government.



A number of mechanisms to “manage” this arrangement have been put in place. First, a Memorandum of Understanding has been developed between the Minister, the Board and the CEO. This Memorandum was developed in early 1996 and has since been reviewed to see how well it is working.

The SFP<sup>53</sup> is used as a tool for setting performance targets and monitoring. This is agreed to by the Chair, the General Manager, The Minister and the Treasurer. There is a quarterly review of the SFP with the Minister. The GTE reports to the Board monthly.



*Among the constraints of this arrangement are:*

- neither the Board nor the GTE can dismiss staff for poor performance: they are staff of the department; and
- accountability and responsibility are “difficult” to determine as the governance role and functions undertaken by the Board vis-a-vis the host agency are unclear.

### Case A

This is a consulting company established under *Corporations Law*. It has two shareholders: the portfolio Minister and The Director-General of the inner budget “host” department. The company entered into a number of contracts on behalf of the various business units within the Department. The current arrangement means that Cabinet approval to enter into contracts is not required. The company was forced to contract or lose overseas businesses. It could not wait for formal Cabinet approval. The company is revenue neutral, and pays no tax. Income from projects is paid directly to business units of the budget sector agency to which it is attached.

As with some Government businesses, not all statutory boards have control over resources. In the case described below, the Board did not control the staff who carried out its decisions.

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<sup>53</sup> SFP refers to the Statement of Financial Performance completed by some but not all Government Trading Enterprises.

### Case W

Case W is a regulatory board attached to a Budget Sector portfolio. A large amount of revenue is collected in revenue by departmental officers in the name of Secretary of the Board. The Board has no formal agreement with the Department regarding the priority of collecting this revenue compared with other departmental priorities. Nor is there a formal agreement about the control of, and responsibilities for, revenue collection.

### 3.3 Securing Organisational Performance and Compliance

There is an absence or lack of clarity in most legislation concerning the respective roles and responsibilities of the board and the CEO for securing organisational performance and ensuring compliance. Neither are there guidelines (such as those used by the Commonwealth Government) which define these roles. There seems to be an inherent tension between current approaches to management on the one hand, and the retention of outdated or inappropriate forms of governance on the other.

There has been significant reform in the NSW public sector in recent years. Reforms have included changes to organisational structures and management practices.<sup>54</sup> The nature of management has changed from administration to leadership.

Changes to management practices include:

- the appointment of highly paid CEOs, belonging to the Chief Executive Service. This was designed to emulate the private sector. It was anticipated that through this program, highly skilled managers would be appointed to “lead” and “manage”, not simply administer programs;
- devolution of decision-making to “let the managers manage”. Chief Executive Officers were to be responsible and accountable for their decisions and actions. Tools to monitor their achievements (including Performance Agreements) were introduced; and
- decision-making was devolved to staff at all levels of the organisation. Staff were to have their performance appraisal linked to the agency’s corporate plan. Staff involvement in planning processes is expected.

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<sup>54</sup> Premier’s Department, *Delivering Better Service*, 1994a.

The extent to which boards may in fact be undertaking the role of management, both in Government businesses and other types of boards, is not clear in a number of cases. Whether in the private or public sectors, if boards are to add value it is essential for them

*which will be reserved for their own consideration and decision*<sup>55</sup>.

The case studies below illustrate this problem of blurring of roles between the board and management/CEO. The Audit Office found that this problem is made more difficult where there is:

- outdated legislation which does not take into account the CEO's new leadership/ management role, and
- an additional stakeholder in the form of a Ministry.

### Case X

Case X is a statutory body. The current Board oversees and is involved in policy. The previous Board was involved in operational decisions and did not provide strategic direction.

Under this Board, the CEO's role is to “get on with the job”.

The CEO, appointed by the Minister, takes an active role in governance issues. For example, in terms of managing stakeholders there is:

- day to day liaison between the Minister and the CEO;
- daily contact between the CEO and the Minister's staff;
- CEO attendance at regional meetings; and
- a Public Relations staff member to deal with media (the Chair does not do this).



The Chair has formally met with the Minister on one occasion. In terms of ensuring compliance and organisational performance, the Board relies heavily on the information provided by the agency, through the CEO. If external advice is needed, the Board relies on support from the host department.



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<sup>55</sup> H. Bosch, “Public Sector Corporate Governance”, paper presented at IRR Conference, *Public Sector Corporate Governance and Accountability*, National Convention Centre, 23 and 24 September, Canberra, 1996, p.3.

## Case B

Case B is a Trust which meets in the lunch hour every two months. Therefore the time available to the Trust to set organisational strategy and monitor performance is severely constrained. In regard to monitoring compliance, a field interview with the Trust's Treasurer indicated that the latter relies on the Corporate Services Manager of the agency for advice and possesses little personal knowledge of public sector accounting requirements.

In this case, the extent of value-added by the Trust could be questioned, beyond creating links to the business community which may be encouraged to provide funding for the organisation.

## Case C

Case C is another Trust which in legislation is responsible to the Minister. The CEO is responsible to the Trust but reports on performance to an officer in the portfolio. The Trust oversees management and is responsible for policy direction. Broad strategic direction is left to the Trust.

In the opinion of the Chair, there is not but should be, a direct relationship between the Minister and the Trust. If the Trust's policy ideas require Ministerial support, the issue should go from the Trust to the Minister's Office rather than to the Ministry. In practical areas concerned with funding, resources and co-ordination with other agencies, matters go from the CEO to the Ministry. Again, the Chair feels these issues should be channelled from the Trust to the Minister's Office.



The Chair believes the split in responsibilities between the CEO and Trust is a difficult one. Issues regarding roles and responsibilities which need to be resolved occur two to three times per week.

The problems are exacerbated by the fact that the CEO is responsible to the Trustees while also being responsible to an officer in the portfolio. The CEO's Performance Appraisal is undertaken by that officer.



According to the Chair, these accountability problems result in:

- difficulties in securing talented people to serve on the Trust; and
- use of the Trust for “political” ends: the Director can use the Trust to get support against the Ministry.

There is little contact between the Minister and the Trust as a whole to review the Trust’s, as opposed to the CEO’s, performance. The Minister meets with the Trustees once a year. In addition, Trustees meet with members of other trusts to discuss Government policy and priorities. The Minister attends these meetings to convey policy.

Such arrangements lead to confusion about the respective roles, responsibilities and accountabilities of the key stakeholders—the Minister, the Trust, the CEO/ Director and the Ministry.



The Trust meets for up to three hours every two months. It has taken steps to be proactive. It has its own strategic plan and reviews its own performance annually. However, the overall extent to which this Trust actually “governs” and is accountable could be questioned.

### 3.4 Managing Stakeholder Relationships

The Audit Office found that most public sector boards, with the exception of regulatory and marketing boards, do not take a proactive role in managing stakeholders (see Volume Two: *Corporate Governance in Practice*). This role is usually left to the CEO who, in particular, “manages” the public sector network (including Ministers’ Offices, central agencies, their “host” agency, other agencies in their portfolio and other line agencies). Together with their staff the CEO also manages customer relationships.

Supplier relationships are often handled through other mechanisms such as the State Contracts Control Board (for organisations other than businesses) and the issuing of “whole of Government” guidelines for purchasing in areas such as information technology. These are managed by the Department of Public Works and Services.

### 3.5 Taking Responsibility for Risks

One of the critical “drivers” behind private sector boards in adding value through proactively managing risks, is the issue of liability. The personal liability of private sector directors in the exercise of their board duties can be very substantial. Whilst insurance would usually be taken out as a protective measure, the liability issue is still a very strong factor considered in all facets of private sector corporate governance.

Risk management in public sector corporate governance operates in a significantly different context. In most instances, other than for SOCs,<sup>56</sup> it is Government that bears the risks and is ultimately accountable and responsible (the issue of liability is discussed further in Attachment 4.4).

### 3.6 Getting Value From Directors

In the private sector, boards are expected to add value by virtue of the business or other expertise directors possess. They use this expertise to set direction, monitor the organisation and direct management. This is also applicable to those public sector boards running Government businesses, if their boards are to maximise the value they add (and justify their costs). It is also relevant to the very large number of public sector boards whose organisations perform other functions, such as service delivery, regulation and marketing. Whilst non-business and/or advisory boards may be somewhat different, because of the different role and functions they perform, they still have a duty to add value by virtue of the specialist expertise and background of directors.

Another important component of value adding for boards is said to arise from board members who provide a channel for representative input by virtue of their special links with relevant community and special interest groups.

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<sup>56</sup> Company SOCs operate under *Corporations Law* with directors bearing the risk. Statutory SOCs have been given permission by the NSW Treasury to insure directors.

**Better Practice in Appointments** The appointments process is critical to ensuring boards have directors who can add value. Better practice indicates that, among other things, appointment principles and processes should:

- ensure directors are appointed on merit;
- specify merit criteria;
- guarantee directors have the time to devote to board duties; and
- be transparent.

The Audit Office considered evidence available to support, or otherwise, the proposition that directors of NSW boards were given the opportunity to add value by virtue of these fundamentals.

**The Need for Specific and Clear Appointment Criteria**

These and other better practices in regard to appointments are discussed in Volume Two: *Corporate Governance in Practice*. The relevance of the background or specialist expertise of individual directors was not examined in detail by The Audit Office. The existence of specific, clear and public criteria against which to assess whether appointments are made on merit would necessarily provide a strong value adding base.

In some cases, it was clear that certain board members were particularly well suited to the task required. In a few cases, there appeared to be some incongruity, perhaps even potential for conflict, between various board appointments for particular directors. However, in most cases information from the Premier's Department database was generally insufficient to draw any conclusion.

Better practice also stipulates that directors should have the time available to devote to director's duties.

**Multiple Directorships and Time Available**

The Audit Office identified that even where directors possess particularly relevant expertise and/or community links, and are hence well equipped to add value, time available in which to exercise this expertise effectively may be a factor limiting the extent of value adding by boards.

The Audit Office found that in relation to positions that attracted a director's fee:

- \$13 million in directors fees was paid to approximately 1,586 positions and 1,451 people;
- 1,332 people received one directorship fee each, on average this fee being \$ 7,526;
- 119 people (8%) held more than one paid directorship and received 22 per cent of total fees paid, averaging \$ 25,000 each; and
- 604 people (13%) held more than one directorship on paid and/ or unpaid boards.

In total, there are 649 boards and tribunals comprising 6,615 positions and 5,175 people. Of the 6,615 positions 990 (16%) were held by people who occupied more than one position on boards and/or tribunals. Of these 5,175, 717 (14%) held more than one position.<sup>57</sup>

The National Association of Corporate Directors<sup>58</sup> has recommended that individuals should hold no more than five or six directorships where they otherwise do not have full-time employment (fewer than five or six in the case of CEOs, senior executives and those with full-time employment). The reason for this suggested policy is that directors can become over-committed. They are therefore restricted in the amount of time available for keeping up-to-date with organisational issues, being able to offer advice and attending meetings. In addition, "director interlocks" create the potential for reduced director independence and for conflicts of interest.

As discussed in detail in Volume Two: *Corporate Governance in Practice*, The Audit Office survey also showed that most boards meet for less than half a day per month. This may impose a further practical limitation on the extent to which directors are able to actually apply their expertise and add value.

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<sup>57</sup> PEO Circular 96-42 to Ministers and CEOs directs that appointees to boards not be overcommitted by virtue of being appointed to too many organisations.

<sup>58</sup> NACD Report of the *NACD Blue Ribbon Commission on Director Professionalism*, NACD, Washington.

Given the prominence with which this issue of directors' appointments and expertise is regarded as a key tenet of how boards add value, it would be preferable that there were closer guidance and monitoring on this issue. This monitoring and review would draw upon information on the relevance of the credentials of each board member of *all* boards.<sup>59</sup> The collection of such information in a standard and concise format, would provide a solid basis for establishing that board members were in a sound position to add value. It would also serve as a means of preventing criticism that board appointments may not have been made with sufficient regard to merit.

To improve accountability, it would also be useful if summary reports of board profiles could be published. This would require databases being kept complete and up to date and being upgraded to include relevant information such as number of directorships held on both public and private boards. At the board level, it would also be helpful if consolidated reports were available to provide information concerning the full costs to operate and support the board.

**Alternate Ways  
of Obtaining  
Expert Advice**

In many cases, it is possible that the function of obtaining expertise and representative input may be obtained in other less expensive ways. For example, expert advisers can be engaged at short notice for most specific matters.

For matters which are of general relevance and concern to all boards, experts could be engaged by the central agencies to provide consistent guidance in an efficient and economic manner.

A range of liaison mechanisms are available, such as Customer Councils (already in use for a number of agencies), which may adequately provide for community input and consultation in many cases.

If a function requires a board (discussed in Chapter One) and "expert" directors are appointed, then public accountability requires that boards should adopt "better practice" in the way they operate. These issues are explored in Volume Two: *Corporate Governance in Practice*.

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<sup>59</sup> Currently, not all boards provide information on directors.

## **4. Attachments**

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## 4.1 The Audit Process, Costs and Acknowledgements

### Audit Objectives

The basic objectives of the audit were to assess:

- the efficiency and effectiveness of board operations across the NSW public sector; and
- the adequacy of the *supporting* framework for corporate governance, in the form of models, legislation, policies, structures and conventions, to support “better practice” for board operations.

### Audit Criteria

The Audit Office reviewed corporate governance in the NSW public sector from the following perspectives:

- the Government and Ministers should determine the value to be added in having a governance arrangement utilising a board;
- *supporting* and/or *enabling* legislation should clearly define roles, responsibilities and relationships of key stakeholders;
- the Government and Ministers should provide boards with written guidance setting out how their model, legislation, policies, administrative arrangements and conventions affect the board’s decision-making ability;
- governance models, legislation, policies, administrative arrangements and conventions which affect the board’s decision-making should be consistent with one another and with best practice and should provide adequate guidance on governance issues;
- measures of performance for boards should be established and board performance reported publicly; and
- Ministers should communicate to boards and ensure boards understand the nature and extent of authority delegated.

A series of detailed sub-criteria were employed to address the specific aspects of independence and public accountability. Those criteria are provided in full in Volume Two: *Corporate Governance in Practice*.

## Audit Scope

The scope of the audit extends to all boards (and committees) operating in the NSW State public sector, with the exception of tribunals, similar bodies exercising a quasi judicial function and executive management boards.

The scope thus extended to such bodies as:

- State Owned Corporations
- Non-corporatised Government Trading Enterprises
- Universities
- Statutory Authorities
- Area Health Boards
- Regulatory Bodies
- Registration Boards
- Marketing Boards
- Trusts
- Budget Sector Companies
- Subsidiary Companies
- Other non-statutory bodies

## Methodology

The audit approach included a mail-out self completion questionnaire to a cross section of around 210 boards. Expert assistance was engaged for the questionnaire design, and the detailed data analysis was contracted out. Data obtained from the survey were supplemented by personal visits to 28 boards, covering each of the major board types. Based on these visits, case study material was compiled by The Audit Office to place emphasis on best practices and problem situations of a generic nature.

The Audit Office also undertook an extensive literature review and attended a range of seminars on the topic, compiling a large volume of international reference material. A list of references is provided at Attachment 4.6.

## Audit Costs

The cost of the audit totalled \$322,901 and comprised of the following:

Direct salaries costs	\$218,008
Overheads charged on staff time	61,059
Value of unpaid overtime (at standard rates only)	29,754
Printing	11,000
Consultants (survey design)	1,500
Contractors (survey processing/analysis)	1,580
<b>Total Cost</b>	<b>\$322,901</b>

## Acknowledgements

The Audit Office acknowledges the excellent co-operation and assistance extended by all boards to The Audit Office generally, and in particular to those officers responsible for the conduct of the audit, namely: Stephen Horne (Controller), Tania Sweeney (Project Manager) and Sonia Danzo. Assistance with the survey was also provided by Chris Bowdler, Alison Yelland and Ric Battaglia.

The Audit Office would particularly like to acknowledge the excellent co-operation provided from the Premier's Department, the Treasury and The Cabinet Office.

## 4.2 Criteria for Assessing the Ongoing Need for Boards

The Audit Office has recommended that:

Boards other than those of Government businesses and regulatory bodies, in each Portfolio should be reviewed against a set of criteria to assess the continued relevance and effectiveness of the board (in terms of value-added and future needs), and action be taken to rationalise boards as appropriate.

To assist in this process, some suggested general criteria for assessing the ongoing need for, and value of, individual public sector boards<sup>60</sup> are provided below:

1. Is the statutory function still relevant?
2. Does the statutory duty still need to be separated from government?
3. To what extent does the board fulfil the corporate governance roles of:
  - setting strategic direction?
  - securing agency performance and compliance?
  - liaising with stakeholders?
  - managing risk?
4. Do the skills and knowledge of the board members reflect the needs of the function/organisation?
5. Is the size and cost of the board reasonable relative to the function/organisation (and similar bodies elsewhere)?
6. Is board performance measured and reported against predetermined criteria?

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<sup>60</sup> This list is offered as a starting point only. It is not intended to be exhaustive.

### 4.3 Analysis of Governance Models in the NSW Public Sector

The following analysis provides further details, including actual case study examples, to the summary given in Chapter One.

#### Introduction

Better practice in governance requires two conditions. First, if boards are to be efficient and effective in their decision-making processes they need to have clear powers to match their responsibilities. Second, if boards are to be given these powers, they must be accountable.

These two essential conditions, sufficient and appropriate powers and accountability, need to be built into governance models. The analysis below examines the current board models used in the NSW public sector and evaluates the extent to which they meet these two principles.

To guide the analysis, The Audit Office developed detailed criteria relating to board powers and accountability. These criteria were developed through consideration of best practice as defined in the literature - including relevant codes and standards both here and overseas; and from reviews of public sector governance elsewhere. The criteria are set out in Chapter One.

The seven NSW governance models examined are:

- Universities;
- Statutory, regulatory authorities;
- Budget sector companies;
- Company SOCs;
- Statutory SOCs;
- GTEs; and
- Other Statutory and Non-Statutory Bodies and Authorities.

## Model One: Universities

A university is governed by a university council. The university governance model provides a university council with powers that generally match their responsibilities. However, there is relatively low public accountability.

### Responsibilities and Powers

Universities are dependent on Commonwealth funds but operate under State legislation. The university council is the governing body with responsibility for the overall governance and performance of the University. Neither the Commonwealth or State Parliaments nor Government Ministers can direct or control the decision-making of a Council. The role of the Governor is specified in legislation as a ceremonial one. The Minister's powers are limited to some appointments (which does not allow control) and some decision-making powers regarding land transactions.

The composition and method of appointment of a university council ensures that their powers match their responsibilities. Each Council consists of:

- Parliamentary members nominated by each respective House of the NSW Parliament;
- official members: the Chancellor, the Vice-Chancellor and members of the Academic Board;
- appointed members from fields of expertise appointed by the State Government Minister;
- members elected by academic staff, non-academic staff, students and post-graduates; and
- members who may be elected under university by-laws (Convocation).

The universities are also independent in terms of their Chair and CEO appointments. The Chair of the Council (The Chancellor) and the equivalent of the CEO (The Vice-Chancellor) are appointed by the Council itself.

This independence is underpinned by individual accountability. The CEO's performance is reviewed by the Council, although this is not a formal Performance Agreement as such. Nor is the outcome publicly reported as it is with the Performance Agreements of Ministers' reviews of CEOs in NSW State Government departments.

**Accountability** The major avenues for public reporting are:

- the student profiles which universities must provide to the Commonwealth Minister for Education; and
- publication of an Annual Report.

The major public accountability is to the Commonwealth in the form of completing an agreed student profile. This specifies the number of students a university will take for an agreed funding level. There are also significant reporting requirements regarding expenditure.

The University of NSW (UNSW) has recognised the need for greater individual accountability in order to underpin the public accountability they believe they have.

## UNSW

UNSW is a \$600 million a year business and has a large number of controlled entities. Using the broader definition of internal control contained in the 1995 NSW Treasury Statement of Best Practice, it has undertaken reviews of internal control, legal compliance, business risk, fraud control along with the ongoing process of updating its corporate direction and planning.

The University is the first to have Deans and the Executive sign letters of representation underpinning the annual financial statements.

They have evaluated various management control tools that might be used to underpin governance and improve individual accountability procedures. These include compliance assurance packages and control self assessment following visiting universities in the USA to research particular management methodologies and practices.

## Model Two: Regulatory Statutory Authorities

A number of boards of statutory authorities and bodies have a governing role in relation to regulatory functions. That is, in the exercise of their regulatory function as a board, they also “govern” that carries out the regulatory tasks on behalf of the board.

### Responsibilities and Powers

These boards have considerable powers and responsibilities. In most cases, these are derived from the inability of the Minister to “control and direct” the board. This inability is specified in legislation. For example, the *Motor Accidents Authority Act 1988 No. 102*, p.55 specifies:

The Board of Directors of the Authority and the General Manager of the Authority are not, in the exercise of their respective actions, subject to the control and direction of the Minister, except as provided by this section or otherwise expressly provided by this Act.<sup>61</sup>

The Audit Office found that in other cases where regulatory authorities were subject to Ministerial control and direction and/or the board provided “advice” on regulatory matters, the Minister usually chose not to exercise control, except in extreme circumstances, such as when a Chair had conflicts of interest.

Where legislation specifies that a board is not subject to Ministerial direction and control, board powers may still be constrained by two features of the model:

- board appointments (and removals) including the Chair are made by the Governor on the recommendation of the Minister; and
- CEO appointments are made by the Minister.

In these cases, the Minister can influence decision-making and, in reality, has ultimate control as Case F illustrates.

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<sup>61</sup> *Motor Accidents Act 1988 No. 102*, p.55.

**Case F**

Case F is a regulatory board with the Board and the CEO appointed by the Minister. The Board is independent in its decision-making. At one point, the Board did not have clear rules regarding conflicts of interest and its access to organisational information and staff. The Chair's own conflict of interest on a matter and poor handling of access to information and staff led to the Minister suspending board operations for nine months after a complaint from a director. Eventually the Minister removed the Chair. The Minister sought the CEO's assistance with the dismissal process.

**Accountability**

All regulatory boards in The Audit Office case studies provided an Annual Report to Parliament and have their financial statements audited annually. Beyond these minimum requirements, public scrutiny and accountability varies according to the initiatives of the board and the interest of the Minister and other stakeholders. The Liquor Administration Board is an example of "better practice". It has adopted a variety of strategies to improve its accountability.

**Liquor Administration Board**

The Liquor Administration Board is responsible for the issuing of licences and for collection of a significant amount of revenue for the State. It has sought to be more open and publicly and individually accountable.

First, it has sought to be accountable to stakeholders by regularly meeting with industry associations and by always being available to deal with customers as matters arise.

The Board has no stated criteria for measuring its performance. The Board has sought greater evaluation of its performance with the Minister, but feedback had not been forthcoming. The Chair, on his own initiative, provides quarterly reports to the Minister. While the Chair receives feedback on these reports, the Board receives little feedback from any quarter on its Annual Report.

### Model Three: Budget Sector Companies

Some government departments have established subsidiary entities in the form of companies. The Audit Office's case studies included two such companies.

**Responsibilities and Powers** These companies, operating under *Corporations Law*, have considerable responsibilities and powers, although both are managed by boards comprised principally of public sector employees.

**Accountability** There is limited "Parliamentary scrutiny and ... accountability"<sup>62</sup> with such subsidiaries, and they were therefore considered undesirable. This was particularly so for subsidiary companies in the form of proprietary companies, companies limited by guarantee or incorporated associations.

Ministerial approval is needed to establish these subsidiaries. While the two proprietary limited companies in The Audit Office's case studies have this approval, neither reported to the NSW Parliament, except if their activities were included in the Annual Report of their portfolio agency.

### Models Four and Five: SOCs

NSW has had a policy to commercialise and corporatise its major government businesses since 1988. Government businesses include State Owned Corporations (SOCs) and non-corporatised Government Trading Enterprises (GTEs). There are significant variations between and within these types of businesses.

**SOC Legislation** **The State Owned Corporations**

State Owned Corporations operate under their own *supporting* legislation as well as their individual *enabling* legislation. The *supporting* legislation is known as the *State Owned Corporations Act 1989 (SOC Act)*. This was amended by the *State Owned Corporations Amendment Act 1995 No. 32*. The stated purpose of the amendment was to improve accountability.<sup>63</sup>

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<sup>62</sup> Premier's Memorandum 91-2 "Guidelines for the Formation and Operation of Subsidiary Companies by Departments and Statutory Authorities".

<sup>63</sup> Treasurer's Financial Statement, NSW Treasury, 1995a.

The fundamental intent of the *SOC Act* is to establish SOCs within an environment which promotes their efficient performance. The amended *SOC Act* allows for the establishment of two types of SOCs: company SOCs and statutory SOCs. Previously the *SOC Act* only provided for the establishment of what are now known as company SOCs. Company SOCs are incorporated under the *Corporations Law*. Sydney Water Corporation and the Hunter Water Corporation are the only company SOCs currently scheduled under the *SOC Act*.

Statutory SOCs are established as corporations under a separate part of the legislation. Unlike company SOCs, the provisions of the *Corporations Law* do not apply to a statutory SOC, except as expressly provided by the *SOC Act* or any other Act. The Government has indicated that future SOCs will be established under the statutory SOC model. The Premier has stated that SOCs are an alternative to privatisation.<sup>64</sup>

All SOCs have the following governance features. They have:

- a board;
- Voting Shareholders, who are the Treasurer and one other Minister;
- under the *SOC Act* the portfolio Minister (regulator) may, with the written approval of the Treasurer, issue a written direction to the Board. The type of direction which can be given varies according to the type of SOC.

## Company SOCs

### Responsibilities and Powers

There are two features which distinguish the company SOC model from the statutory SOC model. One feature relates to board powers, the other to accountability.

In terms of powers, the legislation specifies the regulator (portfolio Minister) may issue directions to the board of a company SOC in relation to non-commercial activities.<sup>65</sup>

Beyond nominating general areas for Ministerial Directions, the legislation for company SOCs is not specific as to what constitutes a non-commercial activity.

To help clarify the board's relationship with the Minister, the board of one company SOC has developed a Memorandum of Understanding (MOU) with the Minister.

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<sup>64</sup> R. Carr, "Labor's Public Sector Administration Reforms", Press Release, 23 August, 1994, p.42.

<sup>65</sup> The SOC legislation refers to the regulator as the portfolio Minister.

The MOU describes the role of the Minister, the board and the CEO, defining who will carry out certain functions and tasks and how reporting will be undertaken. There are quarterly meetings with the portfolio Minister to review the agenda, assess how the regulatory model is working and to determine compliance against the model.

This mechanism is similar to that adopted in Ontario for Crown Corporations. They must, at least once every five years, prepare a MOU between the Chair and the responsible Minister. The MOU is to include details of:

- their respective roles;
- the agency's objectives, priorities, performance expectations, and reporting requirements;
- auditing arrangements; and
- accountability relationship.<sup>66</sup>

In company SOCs the board appoints the CEO, and the CEO's Performance Agreement is with the board. In statutory SOCs, the powers of the portfolio Minister, Voting Shareholders and board in relation to CEO appointments vary depending on the type of statutory SOC (see Table 1).

Confusion has arisen as to the relative powers and accountabilities of the Minister and the board of a company SOC.

### Case Y

Case Y is a company SOC with a subsidiary. The SOC legislation specifies that this form of SOC may not acquire or dispose of assets or investments without the written approval of the Voting Shareholders.

The subsidiary of the SOC acquired an investment without the Minister's written approval. The Minister directed the Board to dismiss the CEO of the subsidiary. The nature of the direction was outside the legislated Ministerial powers. In company SOCs, the Minister can issue directions only in regard to non-commercial activities.

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<sup>66</sup> Auditor-General of British Columbia, op. cit., p.31.

**Accountability**

Public accountability requirements for all SOCs are set out in Part 4 of the *SOC Amendment Act 1995*. The entire Statement of Corporate Intent must be agreed between the board and the Minister and must be reported upon in Parliament. In addition, other forms of public accountability are specified in legislation. These include Customer Contracts which set out the terms and conditions under which the Corporation will supply services to customers. The Articles of Association of individual SOCs may also contain other accountability requirements.

Individual company SOCs have also adopted additional public accountability mechanisms (see Hunter Water Corporation below).

### Hunter Water Corporation

This company SOC believes it needs to be accountable to its customers. To do this it:

- holds community forums to update customers on Board activity;
- allows public and media access to a segment of every monthly Board meeting; and
- reports its performance regularly in local newspapers.

### Statutory SOCs

Two forms of statutory SOCs have been created:

*Type One:* In this model (used to date in ports) the board is appointed by the Governor on the recommendation of the Voting Shareholders; the CEO is appointed by the Governor on the recommendation of the Portfolio Minister. The appointment cannot be effected unless recommended by the board; and

*Type Two:* In this model (used to date in electricity and rail) the board is appointed by the Voting Shareholders while the CEO is appointed by the board after consultation with Voting Shareholders<sup>67</sup>.

There are other variations regarding appointments as the models of corporatisation are still evolving. These variations are outlined in the *enabling* legislation rather than in the *supporting* SOC legislation.

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<sup>67</sup> Refer for example to the *Energy Services Corporations Act 1995*.

**Responsibilities and Powers** The statutory SOC model provides the board with less power to acquit its responsibilities than does the company SOC model, both in terms of Ministerial directions and in terms of CEO appointments.

As outlined earlier, the regulators (portfolio Ministers) of statutory SOCs are able to issue directions over a greater range of issues, on the condition that the direction is given in writing. There are three areas where the portfolio Minister can issue directions, with the Treasurer's approval: (a) non-commercial activities; (b) public sector policies; and (c) matters in the public interest. These are not defined in the SOC legislation. The Minister must consult the board where directions relate to (b) and (c).

Ministerial power over decision-making is quite broad in the case of Ports Corporations. The *enabling* legislation states that, despite the Corporation holding an operating licence, the Minister's own capacity to exercise ports safety functions or of delegations is not limited. In addition, the Governor can vary the licence at any time if satisfied that the Corporation has failed to perform the service to the standard required in the licence. This interventionist strategy rather than the removal of the board is defined in legislation.

The statutory SOC model used in the Ports Corporations gives the portfolio Minister the power to appoint the CEO. This is not so for company SOCs and Type Two (energy) SOCs. Under the *Energy Services Corporations Act 1995*, for example, the CEO is appointed by and can be removed by the board. The board can also determine the CEO's remuneration.

A Performance Agreements of a CEO in each SOC model is with the board.

No SOC model allows the board to elect its own Chair. In the case of the company SOCs, directors including the Chair are appointed by the Voting Shareholders. In the case of the Ports Corporations, the Chair is appointed by the Governor on the recommendation of the Voting Shareholders (those being the Treasurer and the Minister for the Olympics).

The *enabling* legislation for the energy corporations empowers the Voting Shareholders to select the Chair.

**Accountability** Statutory SOCs are publicly accountable through the Statement of Corporate Intent provided to the Minister and Parliament in the same manner as for company SOCs.

Beyond this, there is less public accountability in that the *enabling* legislation specifies for energy corporations instances where the board does not have to supply information on an ad hoc basis to the regulator (portfolio Minister).

A strength of the energy corporations legislation is that it provides accountability in the longer term. It provides for a planned review of the Act to determine whether the policy objectives of the Act remain valid. The outcome of the review, to be undertaken within five years of the date of assent to the legislation, must be reported to Parliament.

### Model Six: GTEs

By contrast with the SOCs, the characteristics shared by non-corporatised GTE governance models include:

- a CEO usually being appointed by the Governor on the recommendation of the portfolio Minister and/or the board, in most cases; and
- the portfolio Minister having discretionary power to direct the board on matters relating to non-commercial activity, public policies and matters in the public interest.

Where there is a board, directors are usually appointed by the Governor on the recommendation of the portfolio Minister, in most cases.

Not all GTEs have a board. Where they do, the board may take the form of:

- a board which adopts a governance role;
- an advisory committee;
- an executive management committee.

Boards of GTEs which are business units and are attached to inner budget agencies are less likely to have a “governing” board. An example is the Registry of Births, Deaths and Marriages, a GTE which pays dividends but is attached to the Attorney-General’s Department.

There is a lack of consistency in approach to the governance of GTEs. This is because GTEs do not have overarching *supporting* legislation. Each GTE operates under its own *enabling* legislation. In some cases, such as that of the Broken Hill Water Board, current legislation is modelled on legislation which was drafted many years ago (1938).

<b>Responsibilities and Powers</b>	The exercise of power by GTEs is limited by virtue of the Minister having powers to direct and control a board and powers to appoint and remove both a board and the CEO.
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Under specific GTE *enabling* legislation, the portfolio Minister has powers to direct the board. Treasury has advised that under proposed corporate governance policy, the portfolio Minister should, when directing a board, take into account the policy of allowing boards to exercise managerial authority and autonomy. However, corporate governance policy cannot override *enabling* legislation.

It would seem that disputes regarding board decision-making fall into two key areas, namely where:

- there is a tension between commercial and social objectives, especially where a board wants to give priority to one objective over another (see Case S); and
- there is a conflict between a board's decisions about economic activity and Treasury's view about economic management and dividend payment (see Case R).

The tensions seem more pronounced for GTEs because there is no *supporting* legislation to specify how boards should "manage" the different economic and social objectives. Yet GTE boards are expected to operate as businesses and they deal with socially, economically or politically sensitive matters like SOCs.<sup>68</sup>

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<sup>68</sup> Bosch, op. cit., p.9.

**Social Objectives**

Social objectives for GTEs are achieved through non-commercial activities known as “Social Programs”,<sup>69</sup> for which there must be:

- clear social policy objectives;
- a statement about what outcomes are expected;
- accountability to Parliament. A GTE does not have discretion of these expenditures;
- responsibility residing with the portfolio Minister and GTE managers;
- efficient use of resources;
- clear standards of service to clients; and
- a client focus. Thus if a service can be better provided by the private sector, then this option is available to the portfolio Minister.

A major form of Social Program is known as “Community Service Obligations” (CSO). To qualify as a CSO, a program must:

- not be pursued by a GTE operating on a purely commercial basis;
- have a specified social objective;
- have an explicit Government directive to the GTE that the activity should be pursued; and
- be funded from the Budget (Consolidated Revenue) if approved.

The NSW Treasury has a proposed, staged implementation plan for the management and funding of Social Programs:

- Stage 1 specifies that agency proposals for Social Programs must be assessed by Treasury and The Cabinet Office. Only then will funding be provided if approved; and
- Stage 2 proposals, planned for implementation in 1996-97, will involve the relevant social policy portfolio entering into a service agreement with the GTE/regulator (portfolio Minister). The Minister will contract with the GTE for delivery of the Program.<sup>70</sup>

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<sup>69</sup> There are two other forms of CSOs : ”quasi-CSOs” (these have no funding arrangement); and “Community Service” (a non-commercial activity which has a social objective but which is not subject to an explicit Government directive).

<sup>70</sup> Treasury advises that this staged implementation will also apply to SOCs.

**Tension between Economic and Social Objectives** The Audit Office case studies found instances of conflicts between the non-corporatised GTEs and the Government in regard to the relative priority of social and economic objectives. Examples of these conflicts are outlined in case studies below. The reasons for these conflicts appear to arise from factors such as:

- the lack of *supporting* legislation giving the board a commercial focus;
- the *enabling* legislation not dealing with how conflicts regarding the priority of social and economic objectives should be resolved;
- the board not considering it has the skills to deal with both objectives. It may see the objectives as conflicting or totally incompatible;
- differences in viewpoint between the Minister and the board as to what constitutes a social project or program; and/or
- uncertainty as to whether the agency will receive reimbursement from Treasury for implementing a Ministerial Direction in regard to a “social obligation”.

#### Case S

The GTE provides an agreed annual return to State Treasury based on profits generated, and receives funds for CSO activities.

The organisation was transformed from a costly, inward looking bureaucratic Government department to a commercially viable, customer focused agency. A Board was appointed to provide commercial direction and advice. Directors were appointed on the basis of their proven directorships of commercially viable private companies and their qualifications.

A shift in Government policy has required this board to have a stronger “social obligation” focus. The Board saw a conflict in operating a commercial business that also had a major social agenda. As the social aspects of the organisation were increased the Board perceived that the commercial performance suffered.



The Board suffered from a number of problems:

- there was a tension between the commercial focus of the Board and the re-orientation of the Government's commercialisation policy, aimed at achieving a greater balance between social and economic objectives;
- as a GTE it did not have *supporting* legislation that specified or supported its new commercial focus. This is unlike the SOC legislation that specifies that SOCs have social, economic and environmental objectives which should receive equal weight;
- the *enabling* legislation for this organisation had been drafted before it became a Government business. Its new focus was not set down in legislation nor did the legislation relate to broader Government objectives; and
- because the *enabling* legislation was outdated the Board in fact did not have any statutory basis. With the Government's new orientation, the Board was not re-appointed. It was replaced with a representative advisory committee.

Despite the fact that this organisation was a dividend paying GTE, the tensions between its social and economic objectives are such that the Government sees them best resolved now by having an advisory committee rather than a governing board.

A board of a Government business should have the power to exercise its responsibilities in relation to setting direction for the organisation it governs. In practice, this can be difficult for GTEs as Ministers have wide ranging and usually ill-defined powers in relation to their control over statutory authorities and bodies.

### Case R

This Board is a dividend paying GTE, with plans for corporatisation. Board contact with the portfolio Minister is rare and is usually through the Managing Director.

The Board received a Ministerial Direction (re a social objective) where implementation caused the organisation some loss. No additional funds were provided to implement the decision. When the direction was given, the Board was uncertain as to whether it was required to implement it. Legal advice was sought. The Board was unaware that it could be compensated. It did, however, insist that the direction be shown in the Annual Report.

The Board is now of the view that it would insist on CSO payments before implementing a decision.

### **Case R (*Continued*)**

Treasury takes an active role in Case R just described. Treasury more than monitors; it takes a proactive role in influencing business decisions:

- in negotiating the Statement of Financial Performance (SFP), the Chair and Managing Director met once on a formal basis with the Treasurer and Minister and had two meetings with Treasury officials;
- the organisation has had a review of its commercial operations. Consultants were appointed by Treasury. The Treasury paid half the consultants fee and the organisation the other half;
- Treasury has become involved in the detail as to how to cut operating costs. It has recommended cuts on specific line items; and
- Treasury is also asking for a higher, unexpected share of dividends not allowed for in the agreed SFP.

Generally, SOCs seem to believe that central agencies do not understand the need to ensure that boards are provided with the appropriate powers to exercise their responsibilities. For example, most statutory SOCs interviewed in the case studies, expressed the view that Treasury wished to retain excessive control over detailed economic decisions. It was felt that Treasury did not understand that a CEO must consult with the board on decisions before responding to central agency requests. Often, central agencies want an immediate response. A comment was made to The Audit Office that central agencies do not understand the nature of SOCs and the role of the board. One statutory SOC visited by The Audit Office commented that central agencies treat them as though they were a department.

Likewise, it was felt that (former) Public Employment Office (PEO) and Premier's Department Guidelines regarding employment conditions of staff are often not applicable to the organisation. Company SOCs, for example, are able to determine their own employment conditions.

Some boards felt that they would like to advise their Minister more directly about their performance rather than use Treasury as a conduit. This is not to question Treasury's role in providing independent advice.

There is a conflict between Treasury's role in maximising revenue and its overseeing role of GTEs.

#### **Control Over Resources**

To be able to set strategic direction effectively and have actual control over the implementation of decisions, boards must have control over resources. Private sector boards have control, through the CEO, over the resources of the organisation they "govern". In this way, they can perform their governance roles of monitoring performance and compliance and managing risk.

In a number of instances in Government businesses, the boards do not in effect have control over staff or the organisation's income or investment decisions (see Case E, Chapter Three).

#### **Accountability**

Ministerial powers to direct and control a board of a GTE mean that, in terms of accountability, GTEs are more accountable to the Minister rather than Parliament. They publicly report through mechanisms such as a SFP and the production of an Annual Report. The SFPs are not reported to Parliament, unlike the SCI of the SOCs.

### **Model Seven: Other Statutory and Non-Statutory Bodies and Authorities<sup>71</sup>**

This last governance model covers a variety of boards charged with governance functions, such as Area Health Boards and those trusts attached to the Arts Portfolio. In these cases the boards "govern" inner budget agencies, units or functions within them.

This class of boards tends to have less power in their governance model, on the whole (with the exception of some trusts and some other statutory bodies) compared with the powers of university councils, regulatory boards and Government businesses. They also have less rigorous accountability arrangements than those for SOCs and GTEs.

#### **Legislation**

These bodies may have their own *enabling* legislation or their functions may be described within the legislation of their host agency. They do not share *supporting* legislation.

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<sup>71</sup> Most boards in this group are statutory boards. The remainder, although non-statutory, advisory boards still have an impact on the way agency functions are exercised and directors may receive fees.

Various pieces of public sector legislation affect the powers and responsibilities with which these boards operate. These bodies may be affected by:

- the *Public Finance and Audit Act 1983* which specifies financial accountability requirements;
- *Public Sector Management Act 1988* and the *Public Sector Management Amendment Act 1995* affects flexibility in staffing arrangements; and
- the *Public Authorities (Financial Arrangements) Act 1987* which gives these bodies the power to borrow funds independent of Government.

**Responsibilities and Powers**

Legislation for these boards gives the appearance that they are governing boards. For example, legislation cited for the boards visited in The Audit Office case studies specified the board's role as being:

- “The function of the Board is to control the affairs of”;
- “The Board of Directors ... has the function of determining the

“in exercising that function, the Board shall ensure that, as far as practicable, the activities ... are carried out properly and efficiently.”

However, the distinguishing feature for this group of boards is that their *enabling* legislation, while providing them with significant role, functions and responsibilities, including that of governance, significantly limits their powers. It does this by:

- specifying that the board/trust is subject to “the direction and control of the Minister”. This means that the Minister's powers are undefined. The Minister can therefore direct in terms of policy, resource management, and strategies;
- the process for the Minister giving that direction is also usually undefined, unlike for the SOCs where a direction must be in writing; and
- providing for Ministerial appointment of the CEO and Chair.

Trusts would appear to be different in that they are granted very specific and strong governance powers. The role and functions of the Art Gallery Trust as defined in the *Art Gallery Act 1980* are an example. The Trust consists of nine trustees who are appointed by the Governor on the recommendation of the Minister. At least two are required to be knowledgeable and experienced in the visual arts. The principal objects of the Trust are to:

- develop and maintain works of art;
- propagate and increase knowledge and appreciation of art;
- agree to the imposition of any condition on its acquisition of property;
- establish such committees as it wishes; and
- establish, control and manage branches or departments of the Art Gallery.

However, they too are subject to Ministerial control and direction.

Board powers are also reduced for these boards by virtue of the fact that the Governor, on the advice of the Minister, or the Minister, have powers to appoint and remove board directors, the Chair and the CEO.

#### **Accountability**

Statutory boards, authorities and trusts present a report to Parliament on the achievements of their organisation. However, there is considerable variation in the nature and extent of reporting on the achievements of the board as opposed to those of the organisation. The reporting of the activities of some boards forms part of the Annual Report of the portfolio agency.

Review of board performance by the Minister was limited. In one portfolio the Minister had delegated review of the performance of a number of boards visited by The Audit Office to the CEO of the umbrella organisation.

#### 4.4 Board Liabilities

##### Who Takes the Risk?

One of the most confused areas of responsibility is the area of liability. Boards are extremely uncertain as to who bears the risks of decision-making, the Government/Minister or the board. This uncertainty exists regardless of what either *supporting* or *enabling* legislation states in this regard.

Where companies are under *Corporations Law*, legislation such as environmental or health and safety legislation imposes duties on individuals and the “Crown”. For other boards the situation is not as clear.

The NSW Treasurer’s Directions (900.01, 900.02 and 900.03) indicate that the CEO of an authority is responsible for risk management and insurance arrangements. All Budget Sector agencies are obliged to have insurance with the Treasury Managed Fund. Non Budget agencies can participate in the Fund or make other arrangements (this includes GTEs). Non Budget agencies funded indirectly from Consolidated Revenue are deemed to be Budget Sector for insurance purposes. The Treasury Managed Fund insurance covers officers’ and directors’ liability and there are no gaps.

The South Australian Crown Solicitor has argued that the concept of government businesses’ liability limited by the extent of shareholdings is a concept not available to the public sector, because there is an implied Government guarantee. Three cases are cited where the Government has provided rescue packages or strategies to save the State’s credit rating or international business dealings. These examples include DFC New Zealand Ltd., Tricontinental and the Stirling District Council in South Australia. The South Australian Crown Solicitor concluded:

There is an inherent tension between Ministerial responsibility and commercial independence. ... if Ministers are to take responsibility for failure then they should have and ultimately will have direct control. If the nature of the business is such that it actually increases the risk by the Minister taking direct control the business must be disposed of and entirely separated from the public sector.<sup>72</sup>

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<sup>72</sup> B. Selway, “Will Private Sector Ways Lead to Better Governance?” - *Legal Issues Arising From Government Roles in Business*, paper presented at RIPAA Conference, Ramada Grand Hotel, Sydney, November, 1994, p.5.

The adoption of commercial principles in an authority such as a GTE does not necessarily increase personal exposure or risk.<sup>73</sup> In the opinion of the NSW Assistant Crown Solicitor, most public sector agencies (other than SOCs), would not be defined as “companies” or “corporations” under the provisions of *Corporations Law*. They constitute “exempt public authorities”.

Statutory authorities derive their existence directly from statute and, in most cases, are declared to represent the Crown. These authorities usually have no provision to be wound up. Therefore any financial difficulties will become a problem for the State. “Short of some forms of misfeasance its members will not normally be called on to contribute anything, though mismanagement may lead to dismissal”.<sup>74</sup>

Most statutory authorities and boards are subject to the “control . Where “such a direction results in tortious action of the corporation, the Crown may be liable as a principal and the corporation, viewed as an agent”.<sup>75</sup>

In reviewing the issue of liability, the NSW Assistant Crown Solicitor has observed that governments (at the time of writing, 1992) had not been sued for damages because of negligence of its officers. It was also noted that legislation typically provides for removal from office of an officer or board member for incapacity, misbehaviour or incompetence.<sup>76</sup>

If the issue of liability is not addressed in the legislation establishing or regulating the body, then board members are under a set of duties, established at common law, for office holders of corporations. These duties include:

- a fiduciary duty to act in a way to advance the public purpose for which the body was established; and
- the duty to use reasonable care in the conduct of the organisation’s affairs.<sup>77</sup>

Overall, it is apparent that many boards are unsure of their liabilities and are uncertain about where to go to seek assistance. Some boards seek the advice of local solicitors (who may or may not be experienced in public sector matters) while others seek (expensive) advice of larger firms.

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<sup>73</sup> G. Ross, “Exposures”, paper presented to NMEC Conference, 1992, p.1.

<sup>74</sup> Ross, ibid., p.5.

<sup>75</sup> Ross, ibid., p.3.

<sup>76</sup> Ross, ibid., p.2.

<sup>77</sup> Ross, ibid., p.2.

Because boards are unsure of whether their directors are liable for their decisions and actions, most boards visited by The Audit Office had incurred the cost of taking out insurance for their directors.

As a result of this confusion, there are inconsistencies in approach between similar types of agencies in regard to liability and insurance cover:

- the two budget sector companies under *Corporations Law* took different approaches to this matter. One had taken out insurance with the Treasury Managed fund. The other expected the Government to meet any liability since its directors act “in good faith”. This latter company had directors from two levels of government;
- both company SOCs have taken out insurance for their directors; and
- the liability of directors for statutory SOCs has been a matter of recent debate. In the view of one statutory SOC visited, corporatisation took away the shield of the Crown and the directors wanted indemnity. The shareholding Ministers must give approval to SOCs wishing to insure their directors. At the beginning of the audit the shareholding Ministers (or their departments) had not agreed to this. During the course of the audit, statutory SOCs were given approval to secure indemnity.

There is no specific indemnity for fighting action for non criminal cases, for example, cases placed before the ICAC.

The boards of GTEs visited by The Audit Office are the most uncertain, because in essence they are statutory bodies operating under Ministerial control but operating as businesses. The arrangements of three GTE boards visited as part of the field audit are described below.

#### Case R (*Continued*)

This dividend paying GTE has liability limited by legislation, but had also taken out insurance to cover directors. They were most concerned about occupational health and safety claims. Directors are covered for \$2 million each. Directors no longer have to contribute to this cover.

**Case S (*Continued*)**

This is a dividend paying GTE. Its directors' liability is not limited by legislation. The Board members were indemnified against any actions that arose against it. The Government gave formal approval to the indemnification.

**Case E (*Continued*)**

This is a non-dividend paying GTE. The liability of directors of this board is not limited by legislation. The organisation has taken out insurance on behalf of board members. This costs the organisation \$60,000 per annum.

A number of boards also raised concerns with regard to occupational health and safety, environmental legislation and, particularly, trade practices legislation. One board is currently seeking advice from private solicitors on the matter of whether they are affected by competition policy.

Premier's Department indicate that legal liability on matters such as environmental issues and worker's compensation is unclear.

#### 4.5 Estimated Fees Paid to Directors

<b>Estimated Fees Paid to Directors of NSW Public Sector Boards, 1996</b>	
	<b>Fees Paid 1996</b>
<b>SOCs</b>	\$3,160,372
<b>GTEs</b>	\$2,056,812
<b>Remainder:</b>	
<b>Annual Fee</b>	\$7,070,716
<b>Sitting Fees</b>	\$888,342 (1)
<b>Grand Total</b>	<b>\$13,133,242</b>

**Note:**

(1) Calculated on the basis of seven sitting times per year. The total sitting fees could range from approximately \$12,752,524 (assuming four sitting times per year) to \$13,513,960 (assuming ten sitting times per year).

(2) 299 boards have indicated remuneration (17 have both annual and sitting); 304 boards have indicated no remuneration (includes 1 SOC and 1 GTE)

**Source:** Premier's Department Database.

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Police Service, Department of Corrective Services, Ambulance Service, Fire Brigades and Others	<i>Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities</i>	24 September 1992
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State Rail Authority	<i>Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO Arrangements</i>	10 December 1993
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Fraud Control	<i>Fraud Control: Developing an Effective Strategy</i> <i>(Better Practice Guide jointly published with the Office of Public Management, Premier's Department)</i>	30 March 1994
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Sydney Olympics 2000	<i>Review of Estimates</i>	18 November 1994
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