

PRINCIPLES AND BETTER PRACTICES

Corporate Governance in
Commonwealth Authorities
and Companies

Discussion Paper

Auditor-General's Foreword

This discussion paper aims to assist members of Boards, Chief Executive Officers (CEOs) and executive managers of organisations (CAC bodies) governed by the *Commonwealth Authorities and Companies Act 1997* (CAC Act) to evaluate their governance frameworks and make them more effective. It is the second paper prepared by the Australian National Audit Office (ANAO) regarding the application of corporate governance principles in the public sector. The first paper entitled '*Applying Corporate Governance Principles and Practices to Budget Funded Agencies*' highlighted the benefits of budget funded agencies applying the principles and practices of corporate governance for better management performance by the Australian Public Service.

The paper outlines a framework which should help to develop robust governance practices in CAC bodies. It reviews the state of existing governance structures within the private and public sectors; outlines the potential for development of an effective corporate governance framework; and identifies better practice governance principles and processes for Boards of CAC bodies. It also summarises the general legal responsibilities of CAC Boards and compares them with those generally applying to the private sector and government agencies. As well, the paper includes a checklist for Boards and CEOs to assess the strengths and weaknesses of their organisation's current governance framework which can be a useful basis on which to assess performance and identify areas for improvement.

The ANAO does not expect, nor suggest, that all CAC bodies should adopt or embrace every aspect of the principles and practices discussed in this paper. Due to the varying circumstances applying to individual organisations, such as ownership structure and the competitive environment, each CAC body will need to tailor the approaches discussed in the paper to suit its individual needs and governance obligations.

Some CAC bodies are undoubtedly currently applying the principles and practices that are discussed in the paper. For such bodies, it is hoped that the paper should provide a useful check against which to assess their existing corporate governance systems, structures and processes. Any feedback on such a check would be very welcome as part of the ongoing identification of good practice.

I would like to thank all those agencies and individuals who have contributed to the development of this publication and responded to an earlier survey of governance practices. Particular appreciation is extended to Executives in Telstra, Australia Post, the ABC, SBS, the CSIRO and the Australian Stock Exchange (ASX) whose time and input were invaluable in preparing this discussion paper.



P. J. Barrett
Auditor-General
May 1999

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1. Introduction

Commonwealth authorities and companies (CAC bodies) play a major part in giving effect to government policy. They are a diverse range of organisations in terms of functions, institutional form, size, and not least, in respect of the particular governance processes by which such bodies are directed, controlled and held to account. The nature of the relationships between Parliament, Ministers and CAC bodies also makes proper governance an important matter for these organisations.

The principles and practices discussed in this paper are based on knowledge that has been gained from experts on corporate governance, results of a survey conducted of various CAC bodies and previous audit work and research undertaken by the ANAO. Some of the more recent related ANAO publications include a report on Government Business Enterprise Monitoring Practices¹ and a review of accountability arrangements in statutory bodies². Further relevant material is provided in the references section of this publication.

What is Corporate Governance?

Corporate Governance is not a new concept. However, it is an issue which is currently receiving a great deal of attention in Australia and overseas, both in the private and public sectors.

The importance of good corporate governance has been highlighted in the private sector by the corporate excesses of the second half of the 1980s in Australia and overseas and the need to meet the challenges of global competition, technological progress and increasingly integrated financial markets. In the public sector, recent reforms to improve efficiency and effectiveness, such as the commercialisation, corporatisation and privatisation of government organisations and the role of the Board in governing significant assets, in these transformed organisations, has focussed attention on the need for various new models of corporate governance.³

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

¹ ANAO, Audit Report No. 2 1997-98, *Government Business Enterprise Monitoring Practices; Selected Agencies*, September 1997.

² ANAO, Audit Report No. 23 1998, *Accountability and Oversight Arrangements for Statutory Bodies in the Former Industries and Energy Portfolio*, December 1998.

³ Robertson, T., *Corporate Governance, The Public and Private Sector*, Unpublished Doctoral Thesis, Macquarie Graduate School of Management.

Corporate governance is also now becoming more about formalising and making clear and consistent the decision making processes within organisations.⁴ An effective system of corporate governance will help facilitate decision making and appropriate delegation of accountability and responsibility within and outside an organisation. This should ensure that the varying interests of stakeholders are appropriately balanced; that decisions are made in a rational, informed and transparent fashion; and that those decisions contribute to the overall efficiency and effectiveness of the organisation.

Despite the various attempts to define corporate governance and its elements, there is no single model of good corporate governance. Although the general principles are widely accepted, they are not set in concrete and must be adjusted to reflect the specific circumstances and needs of individual organisations. The Business Roundtable states:

*“Good corporate governance is not a ‘one size fits all’ proposition, and a wide diversity of approaches to corporate governance should be expected and is entirely appropriate. Moreover, a corporation’s practices will evolve as it adapts to changing situations.”*⁵

The “one size fits all” approach has also been rejected by the OECD which, instead, has advocated the need for pluralism, flexibility and adaptability in corporate governance.⁶ The OECD has recently reinforced this view and stated that “to remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities”.⁷

In the private sector, corporate governance is now a familiar and well discussed concept. For example, the Australian Stock Exchange requires listed companies to include in their annual reports to shareholders the main corporate governance practices in place during the company’s reporting period.⁸ However, there is no corresponding requirement imposed by the CAC Act.

The principles of corporate governance and the commitment being applied in the private sector to strengthen governance can assist CAC bodies develop robust governance frameworks.

Who constitutes the Board?

This paper frequently refers to a ‘Board’, the existence of which is not always as formal as might be expected.

⁴ Barrett, P., Address by the Auditor-General of Australia to the Defence Audit and Program Evaluation Committee, 28 July 1998, Canberra.

⁵ The Business Roundtable, *Statement on Corporate Governance - White Paper*, USA, September 1997

⁶ OECD, *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets*, 1998.

⁷ OECD, *Draft OECD Principles of Corporate Governance*, 1999. The ANAO is aware that the final version of these principles is due for release in May 1999.

⁸ ASX Listing Rule 3C(3)(j) requires Australian companies to provide a statement of the main corporate governance practices that have been in place during the reporting period.

In the private sector, the focus of corporate governance is on the Board of directors (the Board). Shareholders of a company elect a Board to be responsible for the stewardship of company business and, therefore, for corporate governance. The Corporations Law does not, however, refer to a Board but only to directors who are expected to exercise care and diligence. The Board is a commonly accepted term for the forum in which directors meet jointly to carry out their duties.

Typically a CAC body, whether it is a Commonwealth Authority or a Commonwealth Company, is governed by a Board to which the CEO and management are accountable. The Board is in turn accountable to the responsible Minister(s).

As with the Corporations Law, there are no legal obligations imposed on the Board itself under the CAC Act⁹. Rather, the CAC Act sets out standards of conduct for directors.¹⁰ Under the CAC Act director means:

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

An individual can, in prescribed circumstances, also be deemed a director even if not formally appointed as a director. Under section 60 of the Corporations Law, the term director is defined in quite broad terms to include both directors that are formally and validly appointed to that position with a company and *de facto*¹¹ and shadow directors¹². This means that all of the obligations imposed by the CAC Act on directors of Commonwealth companies and wholly-owned Commonwealth companies apply both to directors who have been formally and validly appointed and to *de facto* and shadow directors. However, the extended definition of the term director in the Corporations Law does not apply to Commonwealth authorities.

Directors, however appointed or described, have significant obligations. It is critical for directors to clearly understand their legal obligations so that they carry out their duties with due care in accordance with the statutes. Meeting responsibly and collectively as a Board is a necessary element in acquitting these obligations.

⁹ Except as defined for the purposes of section 21. This section deals with disclosures by directors of Commonwealth Authorities of any material personal interests to the Board. Board is defined for the purposes of this section as “the directors of the authority”.

¹⁰ For example, section 22 of the CAC Act requires an officer (which includes a director) of the Commonwealth to exercise the care and diligence that a reasonable person in a like position in a Commonwealth authority would exercise in the authority’s circumstances. This is based on the existing duties in section 232 of the Corporations Law.

¹¹ Section 60(1)(a) of the Corporations Law provides that any reference in the legislation to a director, includes “*any person occupying or acting in the position of director of a corporation, by whatever name called and whether or not validly appointed to occupy or duly authorised to act in the position.*”

¹² Section 60(1)(b) of the Corporations Law provides that any reference in the legislation to a director includes “*any person in accordance with whose directions or instructions the directors of the corporation are accustomed to act.*”

In this paper, the concept of the Board is taken to apply where there are directors, authority members or any group of people whose obligation it is to oversee the activities of the organisation. The Board may vary in numbers and composition, usually depending on factors such as the size and nature of the organisation.

The absence of a formally constituted Board does not, therefore, mean the concepts in this paper are not applicable to a particular body.

A Need for Effective Governance in Commonwealth Authorities and Companies

The existence of Parliament, Ministers, Boards and CEOs creates an elaborate set of relationships in the public sector. The respective powers, roles and responsibilities of each party tend to result in greater management complexity in terms of stewardship and accountability than is the norm in the private sector.¹³

Furthermore, the very nature of public services, with their often broad objectives, variable and complex benefits and society wide impact, distinguish management of public services from management of most private services where the overriding obligation is to maximise the organisation's value, including dividends to shareholders. For example, any requirement for a CAC body to pursue particular social benefits to the community may in fact be seen to be inconsistent with its financial objectives. There is a need for these bodies to recognise clearly the wider public interest issues associated with the delivery of public services so as to avoid unnecessary tensions and difficulties for the Board, management and the responsible Minister(s).

Generally speaking, therefore, CAC bodies have to satisfy a more complex range of political, economic and social objectives, and operate according to a quite different set of external constraints and influences than do private sector businesses. In addition, the former are subject to expectations and forms of accountability to their various stakeholders, who are more diverse and likely to be more contradictory in their demands than those of, say, a private sector corporation. Nevertheless, lessons can be learnt from private sector approaches as well as from experiences elsewhere, both good and bad.

In the private sector, the existence of market competition, corporate laws and regulations, such as the Corporations Law and ASX Guidelines, and financial markets encourage rigorous approaches to corporate governance. The Annual General Meeting (AGM) is also an important component of the governance process in the private sector and helps to promote accountability in relation to Board appointments and Board performance.¹⁴ To date, public sector organisations have been largely insulated from such market related incentives and disciplines.

The current trend, however, is for government organisations to operate within more flexible and simplified industrial and employment frameworks, with management having more flexibility, less hierarchy and greater devolution of authority. As market testing and contestability are put in place, organisations will be subject to greater financial discipline and increasing levels of scrutiny of their performance.

¹³ NSW Auditor-General, *Corporate Governance*, 1997, Vol.1; p17.

¹⁴ Voting for directors usually takes place at the AGM and directors can be held to account at an AGM by the shareholders.

The impact of public sector reforms has seen the public sector increasingly adopt private sector corporate governance practices including increased visibility in decision making, standardised reporting and use of Board sub-committees to, for example, oversight the audit function, review remuneration and review the functions of the Board itself.

At the same time, through corporate awareness that environmental and societal interests can have an impact on the reputation and long-term success of an organisation, the private sector is beginning to embrace concepts of greater social and community responsibility (for example, the need for Environmental Impact Statements) thereby broadening corporate responsibilities beyond the traditional internal focus on shareholders, accounting checks and balances and financial outcomes.

Despite the growing convergence between the private and public sectors there are still some important differences between the two sectors, such as the ministerial and other public accountability aspects of governance within the public sector. Therefore, the simple transfer of private sector practices concerned with corporate governance may not provide optimal solutions for the latter. Instead, what is required is the sensible application by CAC bodies of the principles underlying private sector practices, which properly take into account the environment and context in which those practices are to be applied.

The diversity of CAC bodies, and the reforms to the public sector, are likely to require different models of corporate governance although the core components that underpin good corporate governance will be similar. Primarily, the directors or their equivalent will need to establish:

- ▶ responsibilities – who should do what;
- ▶ accountabilities – to whom those with responsibilities should account and how; and
- ▶ appropriate checks and balances – the system of supervision, control procedures and communication flows.

Against a background of systematic change, the traditional accountability and responsibility of public sector Boards has been, and will continue to be, made reasonably explicit in legislation such as the *Financial Management and Accountability Act 1997* (FMA Act), the *Commonwealth Authorities and Companies Act 1997* (CAC Act) the *Auditor-General Act 1997* and *Public Service Act* (PSA). However, such legislation has been designed to be more principles-based and aligned with better practice in both the public and private sectors.

To manage and respond to such continual and systematic change, CAC bodies will need to develop a culture of continuous improvement, timely and effective evaluation and performance assessment using models of best practice in both the private and public sectors, and inculcate such an approach across the whole of the organisation.

In an environment which will become increasingly competitive and contestable with additional demands being placed on scarce resources, Boards will need to examine continually ways to innovate, adapt and strengthen those structures and processes within their organisations which support their leadership and decision-making and ensure sound and effective governance.

2. A Corporate Governance Framework for Commonwealth Authorities and Companies

In the publication, *Applying Corporate Governance Principles to Budget Funded Public Service Agencies*, the ANAO identified that many agencies have a largely common internal structure to support their CEO's decision making. These same structures, which are shown in Figure 1, are essential building blocks to form a robust corporate governance framework in CAC bodies. Further information on these existing structures is provided in Appendix B.

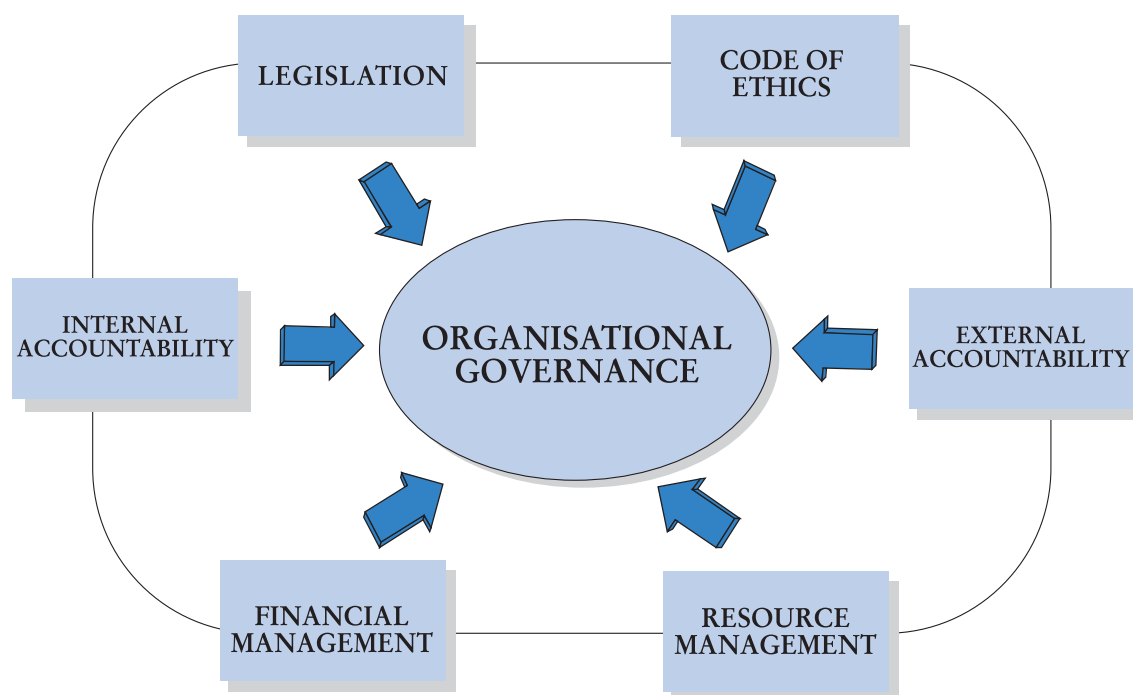


Figure 1: Existing Public Sector Governance Structures

CAC bodies however, usually differ from government departments and Agencies because the former have a separate Board which is accountable for the activities of the organisation and the safeguarding of its assets. This direct accountability by the Board poses a range of governance issues, particularly in relation to clearly defining the role of the Minister(s), of the Board itself and of the CEO. A sound governance framework will assist each party to ensure they have met their respective governance obligations.

CAC bodies are subject to scrutiny by Parliament as it is a key stakeholder and fund provider. For example, the CAC Act requires the presentation before Parliament of Annual Reports¹⁵ and the tabling of relevant Auditor-General's reports.

¹⁵ Section 9 for Commonwealth authorities and section 36 for all Commonwealth companies (whether or not wholly-owned by the Commonwealth).

Certain aspects of the governance of CAC bodies are also subject to oversight by such organisations as the Commonwealth Ombudsman, Privacy Commissioner, Public Service and Merit Protection Commission, the Administrative Appeals Tribunal and the Australian National Audit Office (ANAO), as well as by the activities of central agencies such as the Department of Prime Minister and Cabinet, the Treasury and the Department of Finance and Administration.

Sound governance requires more than committees, guidelines and reporting mechanisms to achieve the required results. It demands the understanding and commitment of all those involved as well as robust control structures designed to deliver organisational objectives. Existing internal structures may need to be reviewed and refined to support a coherent and integrated governance framework.

Corporate governance frameworks operating in the private sector can offer a systematic set of useful principles and methodology to support, sustain and strengthen the mandate of Boards and CEOs in CAC bodies as well as their accountability to their various stakeholders. However, in applying features of the private sector models to these public bodies the nature and complexities of the public sector need to be identified and taken into account in decision-making, as indicated earlier.

Obligations of the Participants

The enabling and other governing legislation of each CAC entity (for example, the CAC Act, the Corporations Law and the Memorandum and Articles of Association of a company where applicable) generally set out the obligations of the participants. It is important to ensure that there are no conflicts between the different pieces of governing legislation. This is normally done as a matter of course. But where a conflict is subsequently identified, it should be brought to the attention of the relevant Minister(s) with the objective of amending the legislation where necessary.

Nevertheless, it is likely that there will always be a level of tension between business imperatives and legislative requirements. The challenge for the Board will be to manage these tensions in the best interests of the organisation.

An effective governance framework must start with the powers, roles and responsibilities of the relevant Minister(s), Board and CEO being clearly defined. Without such definition, clear accountability for the achievement of objectives cannot be achieved.

The general obligations of the key participants is shown in Figure 2 and addressed in more detail below. While the role of the Parliament is broadly described, the emphasis is on the powers, roles and responsibilities of the Minister, Board and management, including the CEO. The role of the Government, which is responsible for setting the broad policy framework, is not discussed as its interests in a particular CAC are represented by the responsible Minister(s). However, the Board needs to be aware of the broader Government policy framework and take it into account when making strategic decisions.

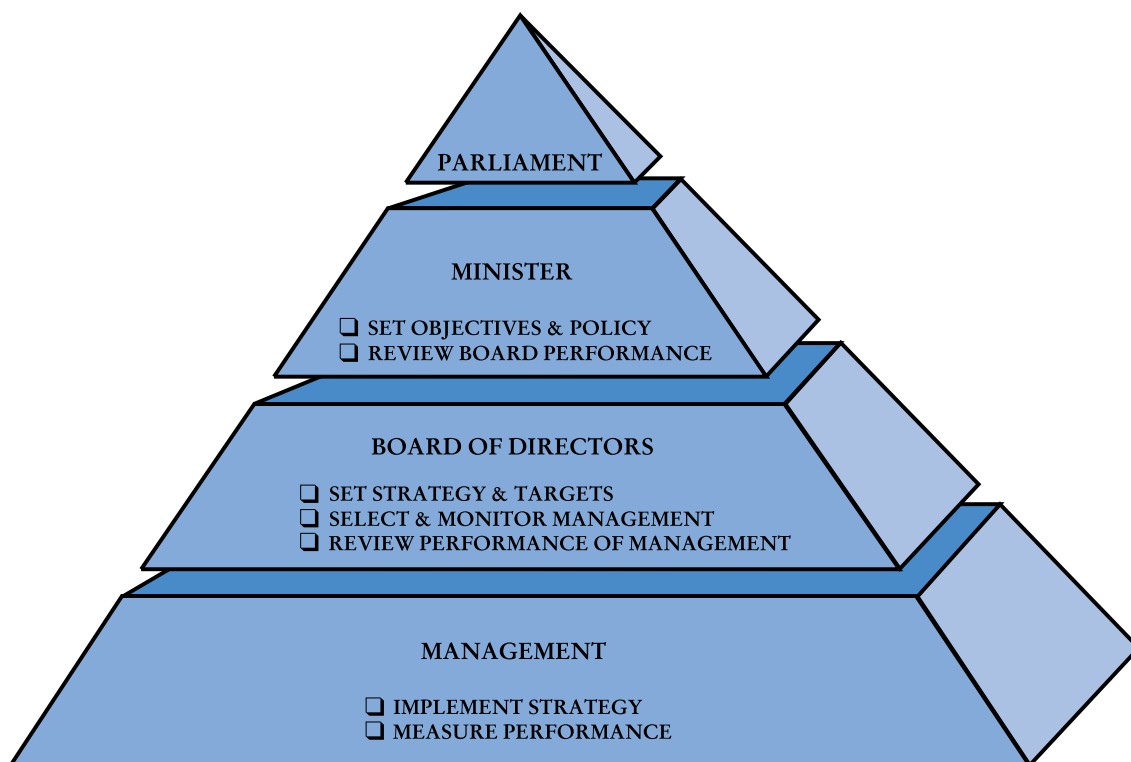


Figure 2: General obligations of the participants.

Parliament

Parliament passes legislation which underpins the operations of CAC bodies, including their functions and powers. Parliament also has an important accountability role in reviewing the performance of government entities.

Minister(s)

Under the CAC Act, it is the responsible Minister(s), who within the government, is/are given portfolio responsibility for a CAC body and its legislation. The responsible Minister(s) is/are accountable to Cabinet and Parliament for the performance of the particular organisation.

The CAC Act also prescribes certain roles and responsibilities for the Finance Minister in relation to bodies covered. In addition, there are also other Ministers that may have responsibilities for broader Commonwealth policy that impacts on the operation of a CAC body (for example, privacy and employment).

The responsible Minister(s) should exercise strategic control consistent with their accountability to Parliament and the public.

However, there is no common set of principles to guide responsible Minister(s) in their relationships with CAC Boards. There is also little guidance in the CAC Act as to the nature of the relationship between the responsible Minister(s) and a CAC body. A responsible Minister may, however, notify the directors of Commonwealth authorities and wholly-owned Commonwealth companies of ‘general government policies which are to apply to the Authority or Company’¹⁶. Directors who receive such notification must comply with that policy.

Directors of Commonwealth Authorities and wholly-owned Commonwealth companies, must also notify the responsible Minister(s) of significant events¹⁷. They must also keep the responsible Minister(s) informed of the operations of the organisation and its subsidiaries and are required to produce reports, documents and information in relation to those operations as required by the responsible Minister(s) or the Finance Minister¹⁸.

Notwithstanding, there is nothing in the CAC Act which gives either the responsible Minister(s) for the particular CAC – or the Finance Minister, central agencies or the portfolio Department – a power of direction in relation to the actual operations of the particular CAC.

While such a power of direction does not exist in the CAC Act, it may exist in some other source such as the organisation’s enabling legislation, the memorandum and articles of association of a wholly-owned Commonwealth company or simply by virtue of the fact that the Commonwealth owns all, or the majority, of the shares. Each of these sources will, therefore, be relevant, in addition to the provisions of the CAC Act, in determining the extent of the responsible Minister’s, or other government representative’s, power to intervene in the affairs of the particular CAC body.

Board of Directors

The Board is responsible for ensuring good corporate governance, determining and approving corporate strategy and providing guidance and oversight to senior management. It is responsible for approving and reviewing the overall business strategies, significant policies and structure of the organisation; has the absolute responsibility for the performance of a CAC body in meeting its stated objectives and obligations as a public body; and is fully accountable for this outcome to the responsible Minister (s).

The Board must also ensure that an effective system of controls is in place to manage, among other things, the major risks faced by the organisation; reporting performance to stakeholders; and complying with applicable laws and regulations.

Other functions of the Board include appointing, or recommending for appointment, the CEO and management team and setting remuneration appropriate for appointments; monitoring managerial performance such as ensuring that management is monitoring the effectiveness of the internal control system; evaluation of the CEO; evaluating its own effectiveness; preventing conflicts of interest; and balancing competing demands on the organisation.

¹⁶ Sections 28 and 43.

¹⁷ Sections 15 and 40.

¹⁸ Sections 16 and 41. These sections also require the CAC body to keep the Finance Minister informed.

In addition, the Board is expected to take due regard of, be responsive to, and to deal fairly with other stakeholder interests, demands and expectations, including those of employees, suppliers, creditors and the general community.

Therefore, it is critical that an appropriately selected Board is put in place and that it functions in the most effective manner possible. Collectively, Board members should possess the necessary skills, knowledge and experience to provide proper stewardship and control of the organisation.

A Board can only fulfil its responsibilities if it meets regularly and collectively with clear agendas and recorded decisions and outcomes. Regular board meetings are, therefore, an essential aspect of good corporate governance practice.

To perform effectively, it is also important that the Board has a substantial degree of independence from management. Accordingly, the Board should be comprised of a majority of independent directors. Guidelines published by the Australian Investment Manager's Association in 1996, state that an independent director is one who meets the following criteria:

- the director is not a member of management;
- ▶ the director is not a substantial shareholder of the company or an officer of or otherwise associated directly or indirectly with a substantial shareholder of the company;
- ▶ the director has not within the last three years been employed in an executive position by the company or another group member or been a director after ceasing to hold any such employment;
- ▶ the director is not a principal of a professional adviser to the company or another group member;
- ▶ the director is not a significant supplier or customer of the company or another group member or an officer of or otherwise associated directly or indirectly with a significant supplier or customer;
- ▶ the director has no significant contractual relationship with the company or another group member other than a director of the company; and
- ▶ the director is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company.

Independent directors can contribute significantly to the decision-making of the Board. For example, they can bring an objective view to the evaluation of the performance of the Board and management and can exercise independent judgement and provide additional assurance to tasks where there is a potential for conflict between the interests of different stakeholders, such as asset valuation and depreciation.

In addition, Board sub-committees should be appointed as appropriate. These sub-committees enable the Board to address certain key areas in more detail than may be possible in full Board meetings. The number and scope of Board sub-committees should reflect the specific needs of the organisation. Membership of committees should be assessed periodically and rotated to ensure the injection of new ideas and perspectives. These sub-committees may require a minimum number, or be composed entirely of, independent directors.

Frequently used committees include:

- ▶ audit committees (which are mandated under the CAC Act) – responsible for oversight of the audit function, including liaison with internal and external auditors, and reporting to the full Board on the adequacy of the organisations audit procedures;
- ▶ remuneration committees – responsible for reviewing remuneration of the CEO, Board Chair and any other director(s);
- ▶ nomination committees – responsible for considering the size and composition of the Board, criteria for Board membership and proposing candidates for Board membership; and
- ▶ corporate governance committee – responsible for reviewing the functions of the Board itself, the adequacy of Board guidelines and the organisation’s corporate governance principles.

Generally, the governance role of Boards in the public sector is not, however, as clear cut as that in the private sector. In the private sector, the Board is still primarily responsible to shareholders for the creation of wealth and dividends. The interests of other stakeholders are relevant as a derivative of this primary responsibility.

On the other hand, the Board of a CAC body needs to manage the particular interests of all stakeholders. It needs to balance the competing objectives of increasing shareholder value with meeting the broader government policy objectives and goals, such as delivering effective and ethical services at reasonable cost. In turn this should be done in accordance with expected standards of delivery, for example, equity and fair play considerations, within the framework of clear public sector values and ethics. The Board’s role is made even more complex when private shareholders are also introduced.

In many situations it will be difficult for a CAC Board to comply with all the competing requirements. The challenge for the Board will be to identify the most appropriate balance and solutions for the organisation in particular cases.

Due to increased expectations which have been imposed on directors, by the CAC Act and other public sector reforms, a planned induction program will help familiarise newly appointed directors quickly with the operating environment and business of the organisation. It will also assist them understand the public sector environment, its obligations and its interrelationships. Ongoing director education will also ensure that directors remain abreast of relevant reforms which could impact on their obligations.

The development and implementation of effective corporate governance policies should be treated by the Board as a mainstream business issue which will add value to the organisation. Therefore, the Board should aim to review and improve governance processes, structures and systems as an integral part of its overall objective of enhancing the performance of the organisation.

Audit Committee

Audit committees are a recognised and important feature of modern corporate governance. In countries such as the US, UK and Canada these committees have become mandatory requirements. In Australia, even though public companies are currently not required to form audit committees, either by statute or ASX Listing Rules, each listed entity is required to disclose in its annual report whether or not it has an audit committee, and if not, to explain why not.¹⁹

Under the CAC Act, directors of Commonwealth authorities (section 32) and wholly-owned Commonwealth companies (section 44) are required to establish an audit committee. Such a committee should assist the Board in a range of matters such as financial reporting, risk management and internal control.

An audit committee is usually constituted as a sub-committee of the Board. However, there is no one model of audit committee that will necessarily fit all organisations. Instead, the construct and functions of the committee will depend on the particular circumstances of each organisation, including its size, complexity and nature of operations. When properly structured and given a clear mandate, audit committees can provide considerable benefit to organisations.

A key characteristic of the audit committee is a degree of independence from the organisation's management. There is a strong argument that the audit committee should ideally be comprised entirely of independent directors and, where executives attend, it is by invitation of the committee.

The main role of the audit committee is to improve management reporting by overseeing audit functions, internal controls and the financial reporting process. Audit committees should be diligent in their oversight functions and should work closely with management, internal audit and external auditors to promote accurate, high-quality and timely disclosure of financial and other information to the Board and other key stakeholders, such as the responsible Minister(s).²⁰

To effectively satisfy their responsibilities, members of an audit committee require basic "financial literacy" – the ability to comprehend financial statements. Where a committee member does not have this comprehension upon initial appointment arrangements should be made to ensure that appropriate competence is attained within a reasonable period of time after appointment.

¹⁹ ASX Listing Rule 4.10.2

²⁰ Ernest & Young (1999) *Audit Committees: Summary and Analysis of the Report of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*.

Information on the audit committee structure, its roles and responsibilities and the frequency of meetings held could be provided in a CAC body's annual report to enable external assessment of the independence and effectiveness of the committee.²¹

Management

The CEO leads the management team and is ultimately responsible and accountable to the Board for the day-to-day management of the operations of the CAC body. The CEO, together with senior management, has the responsibility for implementing strategies and policies approved by the Board; developing and implementing appropriate control mechanisms to manage risks faced by the organisation; maintaining an effective organisational structure that clearly assigns responsibility, authority and reporting relationships; measuring performance; and providing regular and reliable reports to the Board which allows the directors to monitor performance of the organisation and management (these reports should be in the form of both formal Board reports and informal communication as the need arises).

The CEO should also play an active part in setting the organisation strategy and identifying any revisions that may be required for the Board's attention.

The Board collectively, and individual directors as appropriate, should have direct access to senior management. Furthermore, senior managers should report and make presentations at Board meetings as necessary.

Where a CEO sits on the Board, any apparent conflicts of interest need to be clearly identified. It should be noted, that this applies equally to all board members as well, whether executive or not.²² Ideally, the Board charter should have a clear procedure for dealing with such conflicts.

Who are the Stakeholders?

In addition to the relationship between the responsible Minister(s), Board and management of a CAC body, corporate governance is also affected by the relationships among other stakeholders in the governance system. For example, employees and other stakeholders play an important role in contributing to the long-term success and performance of an organisation.

CAC stakeholders are many and varied. However, the following key stakeholders can be readily identified:

- ▶ Parliament – represents citizens and passes legislation;
- ▶ Minister(s) – responsible to Parliament for particular CAC bodies;
- ▶ central agencies, such as the Department of Finance and Administration, often have an interest in the performance of the CAC;

²¹ In 1997 the ANAO released a better practice publication on *Audit Committees* which provides further guidance on establishing efficient and effective audit committees.

²² As directors of a company are fiduciary agents, any power conferred upon them, as a result of their position within the organisation, can not be used to obtain some private advantage, or for any purpose foreign to the power (See R Tomasic, J Jackson & R Woellner, *Corporations Law: Principles, Policies and Processes*, 2nd Ed, Butterworths, Sydney 1992).

- ▶ international interests – treaties can impose obligations on signatories;
- ▶ citizens – both the achievement of expected outcomes and financial performance of a CAC body have an impact on the general community;
- ▶ customers – commercial CAC bodies need to deliver high quality goods or services to the customers they serve;
- ▶ employees – the successful performance of the CAC impacts the job security and professional development of the employees who work within it;
- ▶ regulators – the operation of the CAC should be in accordance with any regulatory framework imposed;
- ▶ suppliers – the long term viability of the CAC can impact the business fortunes of those who supply it;
- ▶ external review bodies such as auditors and ombudsmen – effective governance enables a more efficient and reliable accountability process;
- ▶ management – by virtue of their knowledge of the organisation, they have a vital role to play in the implementation of the strategic decisions made by the Board and the daily running of the organisation; and
- ▶ the Board itself – responsible and ultimately accountable for the performance of the CAC. The directors have a direct interest in the success of the CAC from the point of view of organisational reputation and their own personal, including legal, responsibilities.

Complex interrelationships in the public sector

The relationship between a CAC body and its key participants and stakeholders is depicted in Figure 3. While the principles underlying effective governance are relatively simple, in practice the various relationships can be complex. In particular, the competing interests of each of the parties and the different priorities these can impose on the organisation such as, for example, the tension between commercial objectives and complying with government requirements such as community service obligations.

Figure 3 shows some of the complexities of the interrelationships. Among other things, the diagram highlights that the Board is subject to parliamentary and community scrutiny which creates a further dimension in the governance process.

An additional complication arises where the enabling or supporting legislation of a CAC body prescribes triangular (rather than linear) reporting arrangements whereby the CEO is responsible to both the responsible Minister(s) and the Board. This issue is discussed in more detail below.

This complex set of interrelationships should signal, at the outset, to the organisation and stakeholders the importance of good governance.

In this complex environment, good corporate governance is synonymous with robust accountability for performance and complemented by regular and open communication between the key participants directly responsible and accountable for the performance of the organisation, namely the responsible Minister(s), the Board and the CEO.

There is no prescriptive solution by which to address the complexity. The challenge for the Board is to recognise and manage the inevitable tensions involved. As a minimum, this will require a mutual understanding between the key participants of their roles, responsibilities and accountabilities in the overall governance framework as has been earlier stressed. Any approach should be based on clear and open communication and consultation between the Minister, Board, CEO and other stakeholders.

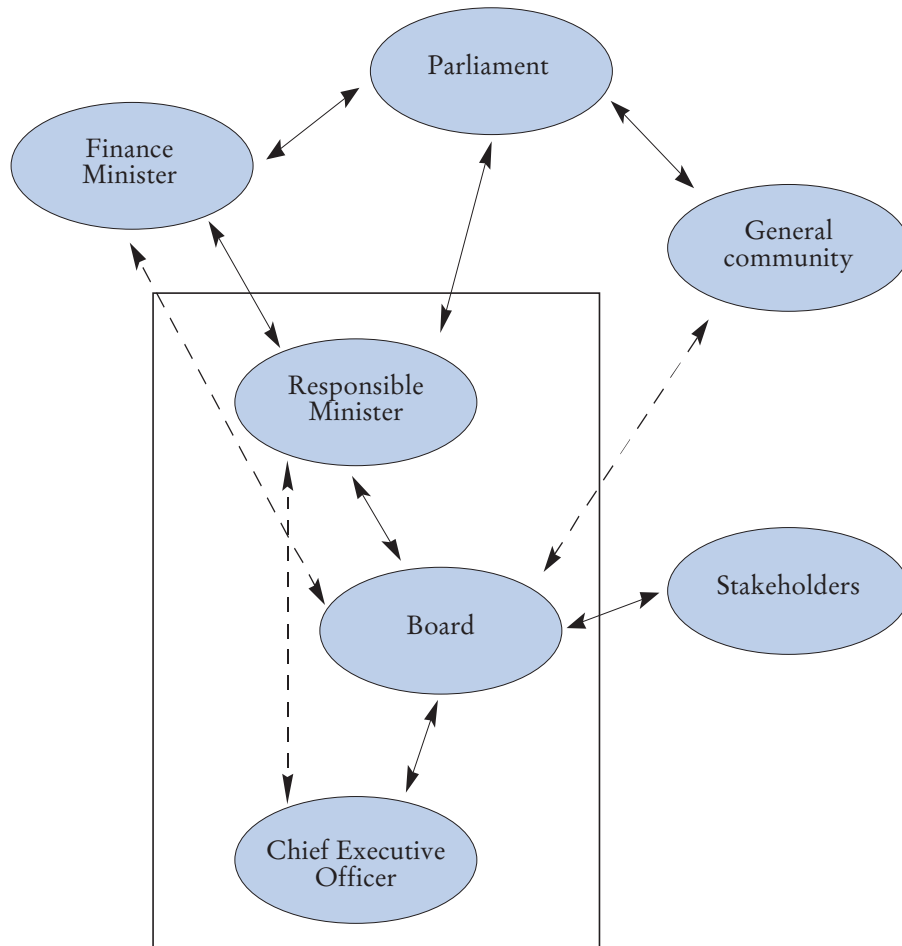


Figure 3: Relationship between a CAC body and its participants and stakeholders.

Essential Elements of Effective Governance

Effective governance in a CAC body is supported and reinforced by key operating principles, which are interdependent, in the following areas:

- ▶ legislation;
- ▶ leadership;
- ▶ management environment;
- ▶ risk management;
- ▶ monitoring; and
- ▶ accountability.

Each of these elements is discussed in detail below.

Legislation: Clear and unambiguous legislation and regulations are fundamental to effective corporate governance. This applies equally to the enabling and other governing legislation of the organisation as well as any legislation it is required to enforce.

Legislation that requires continuing legal interpretation or is just difficult to interpret on a day to day basis can be subject to both deliberate manipulation which may not be in accordance with the Parliament's and/or Government's objectives and/or lead to inadvertent misunderstanding by those involved.

Leadership: The Board's role in governance is fundamental. An indication of a CAC body's effectiveness is the way in which the organisation as a whole works together under the Board's leadership. Executive management must also have a collective ability to provide leadership; to communicate a coherent set of governance principles throughout the organisation; and to ensure the successful operation of the checks and balances which effective governance demands.

Management Environment: The management environment sets in place the broad principles under which the CAC body operates, including setting clear objectives and an appropriate ethical framework; establishing due process; defining the duty of care to the CAC body's client group; providing for transparency and clear lines of responsibility and accountability; implementing sound business planning; encouraging business risk assessment; having the right people and the right skills for the job; having sound communication, both internally and externally; establishing clear boundaries for acceptable behaviour; establishing performance measures; evaluating performance; and sufficiently recognising individual and group contributions. The Board must oversee these processes and delegate the implementation of them to the management team with appropriate control and performance requirements.

Risk Management: Risk is an important element of corporate governance. Risk management establishes a process of identifying, analysing and treating risks which could prevent the CAC body from effectively achieving its business objectives. It includes establishing links between risks/returns and resourcing priorities. Risk management includes putting appropriate control structures in place to manage risk throughout the organisation by developing sound risk management plans which cover activities as diverse as reviews of operating performance; the effective use of information technology, including for management information systems; increased competition and contestability; contracting out and outsourcing; performance management and information; professional development and staff appraisal, including client surveys; reconciliations of accounts; setting and adhering to appropriate delegations; and appropriate segregation of duties.

The Board has ultimate responsibility for identifying the major risks to the organisation, setting acceptable levels for these risks and ensuring that senior management takes the necessary steps to detect, measure, monitor and control these risks. Therefore, the Board will need to satisfy itself that there are appropriate risk management systems and processes in place to identify and manage risks. Such systems may include the organisation submitting itself to periodic external and internal risk reviews.

Monitoring and Review: Monitoring and review processes include the assessment of the quality of the control systems over time and identifies the necessary corrective action to improve them. Systems operating in a changing environment require close monitoring. Quality assurance, bench-marking and other continuous improvement tools should be effectively included as part of a monitoring process. Monitoring is most effective when it occurs in the course of normal operations (that is, aimed at prevention), rather than focusing on detection of problems after they have occurred. Effective monitoring is also dependent on having clearly defined performance measures, both financial and non-financial, which are accepted by all those who are responsible for reporting against them.

Accountability: A CAC body's line of responsibility and accountability is generally through the CEO to the Board, to the responsible Minister and to Parliament. For example, the CAC Act requires Commonwealth authorities and companies to keep the responsible Minister(s) informed, including the provision of information to that/those Minister(s) or the Finance Minister as requested. It also requires annual reports of CAC bodies to be tabled in Parliament.

However, there are instances where the lines of responsibility and accountability can become blurred, in particular, where legislation requires the CEO to be accountable to both the responsible Minister(s) and the Board. In such instances, organisations will need to develop and implement appropriate arrangements, relevant to their specific circumstances, to manage this issue. One approach may be to issue a set of formal directions to the CEO which reinforce the statutory responsibility of the CEO and clarify the role of the Board.

A robust public sector governance framework will build on existing accountability and reporting structures within the agency. It will also review, and provide the potential to address, any anomalies such as: unclear lines of authority or too many layers of authority; too many, or too complex reporting mechanisms; multiple objectives, including policy or legal requirements with no direct connection to business objectives; the tension between central control and devolution of authority; lack of clear-cut concepts of success or failure; and constraints on applying positive or negative sanctions. Under governance principles, responsible officers need to be clearly identified and held accountable for their designated responsibilities and related performance.

Each of these elements needs to be regularly reviewed for proper fit and relevance and decisive action taken as necessary to ensure an ongoing robust framework.

3. Better Practice Governance Processes for Boards of Commonwealth Authorities and Companies

CAC Boards have an obligation to ensure that a high standard of corporate governance is maintained in relation to the organisation they serve. The legal aspects of this relationship are explored in more detail in the next section of this paper. The following analysis draws on best practice standards from the private sector but also has regard to the special circumstances of CAC bodies whose major or only shareholder is the government and who may also have as their primary goal, community and regulatory obligations.

Good corporate governance is more than just prescribing particular corporate structures and complying with a number of accepted rules. Instead, it is about a range of broad principles which should be applied flexibly to the varying circumstances of individual organisations in a way that facilitates appropriate accountability and performance.

The issues discussed in this section identify some common elements of good corporate governance which may assist CAC Boards fulfil their stewardship obligations. The better practices identified are not, however, intended to be binding but instead are meant to serve as a reference point for appropriate action in the particular organisation. The areas covered are:

- ▶ Definition of Roles & Powers
- ▶ Board Skills
- ▶ Board Appointments
- ▶ Board Induction and Training
- ▶ Board Independence
- ▶ Board Resources
- ▶ Board Meetings
- ▶ Code of Conduct
- ▶ Strategy Setting
- ▶ Business and Community Consultation
- ▶ Financial & Operational Reporting
- ▶ Monitoring Board Performance
- ▶ Audit Committees
- ▶ Statutory Accountability

Definition of Roles & Powers

One of the most vexing questions facing many CAC bodies is clearly understanding and establishing the roles, responsibilities and decision-making powers of the responsible Minister(s), the Board, CEO and other relevant participants. Preferably, the functions and powers of the key participants should be defined in the enabling and other governing legislation. Alternatively, memorandums of understanding or a Board Charter could be agreed to ensure that roles and responsibilities are adequately defined.

The absence of clearly designated roles weakens accountability and threatens the achievement of organisational objectives. For example, there continue to be legitimate concerns regarding the nature and extent of a Minister's involvement in a CAC body's activities or the Board in a CEO's activities. Situations have also arisen in the past where, contrary to, or in the absence of, legislation or guidelines established between the Board and the CEO, the CEO has been asked to report directly to the Minister, bypassing the Board altogether.

In addition, the interests of the responsible Minister and Board may not always coincide, thereby creating tensions. The answer to this conundrum may lie in developing appropriate agreed procedures to follow in such circumstances as well as providing opportunities for external scrutiny of those procedures.

Boards need to also clearly understand the particular requirements and role of the Finance Minister as well as the role, if any, of central agencies.

Better Practice

There should be a clear identification of the powers, roles, responsibilities and accountabilities between the Minister, Board and CEO.

The terms of the relationships between the key participants, including those with Parliament and/or Government, should be formally recorded.

The respective lines of responsibility and accountability between the major participants should be 'mapped' to promote mutual understanding of rights and obligations.

The role of the Board should be clearly documented in a Board Charter.

The Board should have the legislative power to achieve the CAC body's objectives.

The Board should select the CEO.



Board Skills

In order to undertake its functions efficiently and effectively it is necessary for the Board collectively to have the necessary blend of qualities, skills, knowledge and experience relevant to the operations of the CAC. Therefore, each director should desirably add something unique and valuable to the Board as a whole.

Better Practice

The Board should collectively have a mix of the following skills, knowledge and experience:

- ▶ operational or technical expertise relevant to the operation of the CAC (including policy skills and executive and leadership experience);
- ▶ financial;
- ▶ legal; and
- ▶ knowledge of government and regulatory requirements.

Where the small size of a CAC body precludes this outcome, the Board should make arrangements for ready access to such skills where they are not available.

The Board should be given regular updates of the prevailing circumstances impacting on the organisation to ensure they are familiar with related industry developments and issues as well as changes in government policy and legislation.



Board Appointments

The person responsible for Board appointments is generally set out in a CAC body's enabling legislation. To ensure that the best people are appointed to the Board, Board positions should be sought through wide external search and there should be a well defined and open procedure for the appointment of new directors.

Better Practice

Appointment processes should ensure that all statutory and administrative requirements are met and a wide range of suitable people are considered. Decisions should be adequately documented.

Consideration should be given to the skill requirements of the Board, and appointments made accordingly. The Board should be consulted on the skills and experience it needs when new members are being considered for appointment.

Directors should be subject to regular renomination, say every three years.

All new directors should be provided with a letter of appointment setting out their duties and responsibilities.

Re-election should follow an agreed process to review the performance of directors.



Board Induction and Training

Directors have an obligation to develop a broad understanding of the area of operation of the business. For newly appointed directors to be able to effectively fulfil their duties they need to, among other things, attain knowledge of the context and purpose of the organisation and become familiar with corporate strategy and current issues facing the Board. In terms of particular characteristics of the public sector, they must also be aware, for example, of public sector values and standards of probity and accountability.

Continuing education and professional development programs will ensure that directors remain abreast of any developments which can impact on their corporate governance and other duties and maintain leadership in the area of expertise that contributed to their appointment to the Board.

Better Practice

Directors should undertake appropriate induction training on appointment.

Continuing education and professional development programs should be made available to directors as necessary.



Board Independence

Most commentators on corporate governance agree that an independent Board is essential to a sound governance structure. In the private sector this is achieved by having a majority of independent directors.

The independence of directors is necessary to ensure that there are no actual or perceived conflicts of interest and to ensure that the Board is effective in supervising and, where necessary, challenging the activities of management. The Board must be capable of assessing the performance of management from an objective perspective. Developing the agenda for Board meetings is a critical element in determining and reinforcing Board independence and effectiveness.

On occasion, necessary experience may only be obtained by appointing a Board member with an involvement in activities closely related to those of the organisation. This should not preclude appointment if it deprives the organisation of experience critical to its successful ongoing operation. However, it is critical that the member does not operate in a manner which is or could be seen to be in his or her personal or business best interests. The performance of executive directors should be capable of being assessed by the independent directors of the Board.

Better Practice

The majority of the CAC Board should be independent of both the management team and any commercial dealings with the CAC.

The Board Chairperson should be independent of management.

Where a Board member finds that there is a personal conflict, that member should formally declare the conflict and abstain from voting on the issue giving rise to the conflict. The Board charter should have clear procedures for dealing with these circumstances.

Directors should be actually involved in the development of the agenda for Board meetings, and not just management and the CEO.

The independent members of the Board should meet separately of the CEO and executive directors periodically.



Board Meetings

Directors must devote the time and attention necessary to fulfil their obligations. As a minimum, regular director attendance at Board meetings is important.

Board meetings are an essential element for good corporate governance and provide the forum for Board decision-making. Directors can only properly discharge their responsibilities if they meet regularly and collectively as a Board.

The effectiveness of Board meetings is dependent on carefully planned agendas and providing board papers and materials to directors sufficiently prior to Board meetings. It is also important that minutes accurately record outcomes from meetings.

Better Practice

The Board should meet regularly, say at least every two months.

Directors should be given adequate notice of meetings.

Agenda items, including availability of discussion material, should be provided prior to Board meetings to enable informed discussion by directors.

Minutes of meetings should accurately record decisions taken by the Board.



Board Resources

The Board should have sufficient resources available to it to enable it to discharge its duties effectively, including access for directors to independent legal and professional advice at the organisation's expense, within the agreed governance framework.

Better Practice

Board resources should include an Audit Committee (which is compulsory under CAC legislation) and a company secretary with the primary role of supporting the Board and the Chair.

A corporate governance committee may be appropriate in larger organisations.

Directors should have reasonable access to independent consultants for investigation and advice. These resources should be provided to the Board at no cost to individual members, although reasonable budgets (or a special fund) for such independent advice should be set and agreed as part of the budgeting process. Other filters, such as approval by the Board Chair, could also be considered as an unfettered right may be counter-productive.

The costs of supporting the Board should be transparent and reported.



Code of Conduct

CAC bodies should operate in a manner consistent with community expectations, the decisions of the Board and the relevant legislation. It is essential that the organisation's guiding ethics and code of conduct are clearly understood and followed by each member of the organisation and communicated to all stakeholders.

The Board and senior management are responsible for promoting high ethical and integrity standards. The language, attitudes and actions of directors and senior management affect the integrity, ethics, values and other aspects of the corporations culture.

Better Practice

The Board should approve a written code of conduct setting out ethical and behavioural expectations for both directors and employees. It is critical that both the Board and senior management team demonstrate, through both their words and actions, an absolute commitment to that code. Only in this manner can a culture of good governance be established within the organisation.

Adherence to the code of conduct should be periodically evaluated and intermediate action taken where necessary.



Strategy Setting

For the Board and the organisation to achieve the agreed objectives it is important that a clear and documented corporate and business strategy be developed.

Better Practice

The objectives of the CAC need to be clearly documented in a long term corporate strategy (3 year minimum, updated annually) and an annual business plan together with achievable and measurable performance targets and milestones.

The Board should be responsible for approving or rejecting the budget developed by management to achieve the agreed strategy.



Balancing Commercial Objectives and Community Service Obligations

Many CAC bodies in the public arena have a range of commercial objectives and community service obligations (CSOs) which are either core or incidental to their activities.

The nature of public services means that there will invariably be tensions between commercial objectives and government requirements like CSOs. This is further complicated because some organisations undertake commercial activities to supplement or complement their social objectives whereas, for other organisations, their main activity is inherently commercial.

The challenge for the Board is to develop flexible approaches that will assist to manage these tensions as they arise. Invariably, different approaches will be required for different organisations.

Better Practice

Commercial objectives and community service obligations should be clearly documented and approved by both the Minister and the Board.

All stakeholders need to be consulted and informed about strategies to overcome any tensions that may arise between commercial objectives and government requirements, such as CSOs.

The Board should monitor the extent to which tensions are being managed using techniques such as:

- ▶ independent surveys;
- ▶ feedback mechanisms; and
- ▶ liaison with community or business groups.



Financial and Operational Reporting

Effective reporting is fundamental to both the Minister's and the Board's ability to monitor the activities of a CAC body, the performance of management and the achievement of the objectives of the organisation.

The Board requires comprehensive, regular, reliable, timely and relevant information in a form, and of a quality, that is appropriate to discharge its function of monitoring corporate performance. This includes unlimited access to senior management.

Better Practice

Appropriate and clearly defined performance measures, financial and non-financial, should be established which enable the efficiency and effectiveness of the organisation to be assessed.

Reporting should be tailored to the particular levels of responsibility so that, for example, Board members are provided with high level data for decision purposes and management with sufficient detail for management purposes.

The reports must be sufficient to communicate the required information but not so extensive and detailed as to hamper comprehension of the key issues. Where possible, information should be provided in tabular form and/or graphical presentations to aid comprehension.

Financial information should be prepared using accrual accounting and should include year to date actual and budget, full year budget and full year forecast. Written explanation should be provided for material variances to budget.

Such reports should be provided for each Board meeting and, at a minimum, quarterly.

Reports should be available to Board members in sufficient time to allow informed decisions. Management reporting should be provided monthly.

In addition to the formal meeting reports, the Board should be briefed regularly by the management team who should also be available for any questions that arise.

An environment of open communication in which good and bad news is readily shared with the Board and senior management should be encouraged.

Reporting should include implementation status reports to monitor the progress of all significant Board approved initiatives and compliance with legislative requirements.

As with the private sector, the person with strategic financial responsibility should be included in the top management team of the organisation and have a direct reporting line to the Board. This approach should ensure effective financial management practices, including the provision of high quality information and advice, to assist the Board's decision making process.



Monitoring the Performance of the Board

A Board is responsible and ultimately accountable for the performance of the organisation and accordingly should monitor its own performance, and that of individual directors where feasible, to ensure that it adds value and is operating efficiently and effectively in accordance with its obligations and the evolving situation of the organisation. It may be appropriate to use an independent facilitator in this process.

The Board should also provide sufficient relevant and reliable information to enable its stewardship of the organisation to be independently assessed and allow those with an important relationship with it to take informed decisions concerning that relationship.

Better Practice

The Board should adopt a written statement of its own governance principles and regularly evaluate them.

The collective performance of the Board, and of individual directors where feasible, should be periodically assessed. This could be done using key performance indicators developed for this purpose but may also include ministerial and/or peer reviews.

The Board should establish an appropriate mechanism for reporting the results of Board assessments.



Audit Committees

Directors of Commonwealth authorities and wholly-owned Commonwealth companies are required to establish an audit Committee to monitor compliance with the CAC Act requirements (and other legislative requirements) and provide a ‘forum for communication’.

The audit committee is responsible for liaising with the organisation’s management and internal and external auditor; reviewing the adequacy of internal controls and of compliance with significant policies and procedures, such as the code of conduct, and relevant laws and regulations; reporting to the Board on the adequacy of audit procedures; and promoting accurate, high quality and timely disclosure of financial and other information to the Board and key stakeholders such as the responsible Minister(s).

An audit committee charter can be an effective tool to define the scope of the committee’s oversight responsibilities and ensure that the Board and the audit committee members have an understanding of these responsibilities. The charter can also serve as a benchmark to measure or assess the audit committee’s effectiveness.

The formation of an effective audit committee sends an important message to stakeholders regarding the Board’s commitment to effective reporting and control of the organisation.

Better Practice

The Audit Committee should have a charter, approved by the Board, which sets out its responsibilities, including:

- management & financial reporting;
- compliance with laws and regulations;
- maintenance of an effective audit function (statutory and internal);
- a suitable risk management and internal control framework;
- membership;
- meeting frequency and core agenda items;
- committee authority; and
- Board reporting obligations.

The Audit Committee should comprise Board members the majority of whom are independent of management.

Members of the audit committee should preferably have financial and accounting expertise. Where the member does not have the requisite expertise upon initial appointment, financial literacy should be attained within a reasonable period of time after his or her appointment. Membership should be periodically assessed and rotated to ensure the injection of new ideas.

The Audit Committee should have unlimited access to both internal and external auditors and to senior management and all employees.

Meeting frequency should usually be quarterly but can be more frequent in some circumstances.

The Audit Committee should have direct access to the CEO, Chief Financial Officer, the external auditor (Auditor-General or his agent) and internal audit.

The Committee should approve and monitor policies for reporting, risk management and internal control.

The Committee should liaise with both the internal and external auditors to ensure that they obtain the widest coverage possible.

The external auditor should attend at least one, preferably two, committee meetings each financial year.

The Audit Committee should be provided with a status report for all recommendations provided by the internal and statutory auditors for which it is agreed action is required. These reports should include accountable officers and implementation dates.



Statutory Accountability

It is critical that the CAC complies with all of its statutory obligations, not only those of its enabling legislation but also those indirect requirements which could adversely impact on its activities. A good example of the latter is the wide variety of employment legislation which impacts all organisations.

Changing regulatory and legislative compliance obligations require that the Board be regularly briefed on this area – it also generally requires an initial briefing of broad principles such as competitive neutrality, competition laws, Occupational Health and Safety, employment and environmental regulations.

Better Practice

A formal process is required to identify all of the legislation relevant to the CAC.

There must also be a continuing process to ensure that any legislative and regulatory changes are identified and their impact assessed and communicated to the Board.

Critical legislative compliance obligations, including implementation, should form part of the Board monitoring and reporting requirements.



Towards Better Practice Corporate Governance

The ANAO considers that the above principles form a sound foundation for establishing appropriate accountability between CAC Boards and their stakeholders and are, therefore, important in establishing a framework for effective corporate governance. However, they are not prescriptions to be followed in all circumstances.

The importance of the principles will, however, vary between different organisations, depending on individual organisational circumstances. Other approaches may equally – or perhaps even better – achieve the goal of a fully accountable governance structure.

Furthermore, where there are significant changes in circumstances, CAC bodies will need to innovate and adapt their corporate governance practices in order to effectively respond to new challenges and opportunities.

Importantly, the Board should not feel that it has discharged its corporate governance responsibilities just by putting in place a particular set of structures and formal processes. They must also periodically review these structures and related processes to ensure that they are achieving good corporate governance in practice.

Appendix A provides a director's checklist which can be used to assess the progress a CAC body has made towards better practice corporate governance. Clearly, all of the recommended practices may not be applicable to all CAC bodies and, accordingly, some may need to be modified to the particular circumstances of the organisation.

4. Legal Responsibilities

Legal Framework

The *Commonwealth Authorities and Companies Act 1997* (the CAC Act) is one of three Acts, which, together, replaced the *Audit Act 1901*. The other two Acts are the *Financial Management and Accountability Act 1997* (FMA Act) and the *Auditor-General Act 1997*.

These Acts are intended to provide a comprehensive scheme for the financial management, accountability and reporting requirements of Commonwealth Authorities. They came into effect on 1 January 1998.

The CAC Act

The CAC Act applies to Commonwealth authorities and Commonwealth companies. However, the CAC Act is structured so that not all of the provisions apply to all Commonwealth authorities and all Commonwealth companies (whether they are wholly or partly owned by the Commonwealth).

There are only two provisions which apply across the board to all CAC bodies. These provisions relate to the Auditor-General's mandate and to annual reports. Bodies that are affected by the CAC Act should be familiar with the Act and the accompanying Explanatory Memorandum to determine the nature and extent of their obligations.

A Commonwealth authority is a body corporate that is incorporated for a public purpose and holds money on its own account.²³ Many of the provisions in the CAC Act that apply to Commonwealth authorities are aligned with the provisions of the Corporations Law. In relation to Commonwealth authorities, the CAC Act includes detailed rules about reporting and accountability, banking and investment and the conduct of officers.

Commonwealth companies are subject to the Corporations Law. Section 34 of the CAC Act defines two types of Commonwealth companies, namely:

- ▶ a Commonwealth company which is a Corporations Law company in which the Commonwealth has a direct controlling interest. However, it does not include a company in which the Commonwealth has a controlling interest through one or more interposed Commonwealth authorities or Commonwealth companies; and
- ▶ a wholly-owned Commonwealth company, which is a Commonwealth company other than a company in which any of the shares are beneficially owned by a person other than the Commonwealth.

While subsidiaries are not CAC bodies for the purposes of the CAC Act, directors of the parent organisation have accountability obligations in relation to any subsidiary.

²³ Section 7 of the CAC Act

For wholly-owned Commonwealth companies the CAC Act includes reporting requirements and other requirements that apply in addition to the requirements of the Corporations Law. These additional requirements are generally concerned with accountability to Ministers.²⁴

The primary objectives of the CAC Act are to:

- ▶ standardise the reporting, notification and auditing requirements for CAC bodies;
- ▶ ensure that CAC bodies are appropriately accountable to the Parliament through the Minister;
- ▶ set standards for the conduct of officers of CAC bodies not incorporated pursuant to the Corporations Law; and
- ▶ provide a mechanism for the application of Commonwealth policies to CAC bodies.

Also of relevance is a paper issued by the Department of Finance entitled “*Governance Arrangements for Commonwealth Government Business Enterprises*”²⁵ which sets out governance requirements for government business enterprises (GBEs). Specifically, it sets out relationships with Ministers, reporting, Board responsibilities/ appointments/ removal, capital structure and dividend policy, risk management, financial targets, borrowings and a number of other sundry matters. It also requires a corporate governance statement and provides some guidance in this regard.

The FMA Act

The FMA Act is essentially concerned with government departments and agencies. These entities have no separate financial existence from the Commonwealth. Many of the provisions in this Act apply to Chief Executives and agency staff.

The main purpose of the FMA Act is to provide a framework for the proper management of public money and public property. This is broadly defined as money or property that is owned or held by the Commonwealth, including money or property held on trust. Many of the detailed rules about how public money and property are to be dealt with are in Finance Minister’s Orders made under section 63 and regulations made under section 65 of the Act.

The Auditor-General Act

The *Auditor-General Act* 1997 establishes an office of Auditor-General for the Commonwealth and also establishes the ANAO. The Act deals with the appointment, functions, powers etc of the Auditor-General and the ANAO. The Act also provides for the appointment of an Independent Auditor to audit the ANAO.

²⁴ For example, section 40 which requires the responsible Minister to be notified of significant events. As well section 41 requires the responsible Minister and Finance Minister to be kept informed.

²⁵ Department of Finance, *Governance Arrangements for Commonwealth Government Business Enterprises*, Canberra, 1997

The CAC Act prescribes that the Auditor-General is to be the auditor of each Commonwealth authority (s8) and of the company or its subsidiary under the Corporations Law or, in some situations to give a report on the company's financial statements (s35).

Accompanying the package of three Acts to replace the *Audit Act 1901* is the *Audit (Transitional and Miscellaneous) Amendment Act 1997* (the ATMA Act). The ATMA repeals the *Audit Act 1901* and deals with the transitional and consequential matters arising from the repeal of the *Audit Act 1901* and the enactment of the above three Acts.

Finally, there may be other relevant legislation which needs to be considered such as the *Acts Interpretation Act 1901*, the organisation's own enabling legislation, the *Freedom of Information Act 1982*, Privacy legislation and the *Administrative Decisions Judicial Review Act 1977*.

Table 1 summarises the legal requirements that are prescribed by the different legislation that may be relevant to a particular CAC. It should be noted that the definitions of the requirements in the table have been modified to enable comparison and may not exactly correspond to the wording in the specific legislation.

Duties of Directors

Some of the basic legal responsibilities of directors or their equivalents in relation to corporate governance are summarised below to provide an overview of those requirements. This analysis is somewhat generic as responsibilities will vary from organisation to organisation. Independent legal advice should be obtained by directors if they are unsure of the full extent of their governance responsibilities or any liability exposure they may have.

In the private sector, the Corporations Law and common law impose fiduciary duties on directors of companies. Among these are the requirements to act in good faith and in the best interests of the company and to exercise a duty of care.

In the public sector, the CAC Act imposes obligations on directors and officers²⁶ of Commonwealth Authorities and directors of wholly-owned Commonwealth companies. These include preparing budget estimates for each financial year²⁷ and establishing and maintaining an audit committee.²⁸

The CAC Act also contains detailed provisions regulating the conduct of officers of Commonwealth authorities and also contains penalties for misconduct. However, the CAC Act does not contain any provisions regulating the conduct of directors of Commonwealth companies due to such persons being subject to provisions of the Corporations Law.

²⁶ Officer, in relation to a Commonwealth Authority, means:

- (a) a director of the authority; or
- (b) any other person who is concerned in, or takes part in, the management of the Authority.

²⁷ Sections 14 and 39

²⁸ Sections 32 and 34

²⁹ The provisions of the Corporations Law, relating to the conduct of directors and officers, are broadly replicated and applied to directors and officers of Commonwealth authorities by Division 4 of Part 3 of the CAC Act.

The CAC Act, therefore, imposes greater personal obligations on the directors and officers of statutory authorities than was previously the case. Many of these obligations are modelled on comparable duties imposed on directors of public companies under the Corporations Law.²⁹ It is suggested that the fiduciary and other duties of directors should be drawn to their attention through correspondence offering them appointment.

In addition to the general duty of care and diligence, the provisions of the CAC Act include the duty to act honestly; not make improper use of inside information or position; and not voting on a matter in which the director has a material personal interest. These provisions are not intended to form a code and the common law and other relevant statutory provisions will continue to be applicable.³⁰

There will invariably be tensions between a director's obligation to act in the best interests of the organisation and in the best interests of the Government. For example, a commercial objective of improving returns may conflict with a policy that the government has enunciated. There can be no hard and fast rules in this situation. Where a potential conflict arises the Board should inform the Minister of the potential conflict and seek appropriate advice (for example, legal, technical or financial) and document why it chose a particular course of action to resolve the issue.

Duty of Care and Diligence

A director's duty to exercise care and diligence is central to effective corporate governance. Subsection 22(2) of the CAC Act³¹ provides that an officer "must exercise the degree of care and diligence (in the discharge of his or her duties) that a reasonable person in a like position in a Commonwealth authority would exercise in the authority's circumstances". This provision is based on subsection 232(4) of the Corporations Law.

The major requirement of the duty of care and diligence that must be exhibited by a director is that they perform their duties and functions with the requisite degree of skill. The traditional standard required that a director exhibit, in the performance of his or her duties, no greater degree of skill than may reasonably be expected from a person with the director's knowledge and experience.³²

However, more recently it has been stated that the test is 'essentially objective'. That is, it requires an assessment of whether the officer exercised the degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation's circumstances?³³ The duty of a director to exercise due care and diligence is defined by reference to the nature and extent of the foreseeable risk of harm to the company that would otherwise arise.³⁴

³⁰ Section 25.

³¹ Applies to officers of Commonwealth authorities.

³² *Re City Equitable Fire Insurance Co* [1925] Ch 407, per Romer J.

³³ *Gamble v Hoffman* (1997) 24 ACSR 369 [15 ACLC 1314] [Fed Ct], per Carr J at 373. It did not matter that the director in question had left school at the age of 14 and had no tertiary qualifications, and had spent most of his life as a fruit and vegetable picker.

³⁴ *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395 at 449-50.

A director is also required to give necessary attention to the affairs of the company, and must exercise a degree of supervision over officials of the company. A director is not, however, generally required to closely supervise all officials of a company, and may trust officials to perform their tasks honestly, unless circumstances would lead the director to suspect otherwise.

The explanatory memorandum on section 22 of the CAC Act states that the inclusion of the expression ‘a reasonable person’, in subsection 22(2) of the CAC Act, is intended to confirm that the required standard of care and diligence is to be determined objectively. It obliges the Court to place a reasonable person ‘in a like position’ with that of a relevant officer. In addition, when determining what constitutes the proper performance of an officer’s duties under subsection 22(2) reference should also be made to the ‘authority’s circumstances, including matters such as the authority’s enabling legislation, the size of the authority, the composition of the Board and magnitude of the problem concerned.

Indemnity and Insurance

Through their position, directors of a CAC body could incur a liability in relation to their organisation, the Commonwealth or another party. Provisions in the CAC Act outline circumstances in which an organisation may or may not indemnify or insure a director.³⁵

It is important that the Board of any CAC body set out clearly its position in relation to personal liability arising from the performance of the duties of directors and officers. All directors and officers need to know exactly where they stand in this respect.

Future Legal Developments

The policy of alignment between the CAC Act and the Corporations Law was emphasised in the second reading speech of the CAC Bill when the then Minister for Finance said that:

“The Government is committed to maintaining the proposed Commonwealth Authorities and Companies Act in ways that, as far as practicable, will keep it in harmony with comparable provisions of the Corporations Law, as they exist from time to time.”

Developments in the private sector will, therefore, drive much of the future development of the CAC Act. For example, the Corporations Law has been the subject of an ongoing review and progressive amendment for some time now under the auspices of the Corporate Law Economic Reform Program (CLERP). As part of this process, the Corporate Law Economic Reform Bill 1998, amongst other things, rewrites the conduct provisions relating to the duties of directors and other officers. In keeping with the policy of alignment between the Corporations Law and the CAC Act Schedule 5 of this Bill creates a new set of provisions for Division 4 of Part 3 of the CAC Act.

It follows that those who are accountable for the performance of CAC bodies will be directly affected by any future developments and should develop appropriate processes to remain informed of legal developments as they occur.

³⁵ Sections 26 and 27 clarify the powers of Commonwealth Authorities to indemnify and insure, respectively, an officer of the authority. These provisions are based on sections 241 and 241A of the Corporations Law.

Table 1: Summary of Legal Requirements that may be applicable to CAC bodies

Requirement	Commonwealth Authorities and Companies Act			Individual CAC Enabling Legislation	Financial Management and Accountability Act	Corporations Law	GBEs ³⁶
	Wholly-owned Company ³⁷	Partly-owned company	Authority				
Annual Report to stakeholder ³⁸	✓ s 36	✓ s 36	✓ s 9	✓	✓ s 49	✓ ss 314 to 317	✓ 2.11 to 2.16
Interim Reports to stakeholder	✓ s 38	✗	✓ s 13 (At request of Finance Minister)	✗	✗	✓ s 302 (Listed companies only)	✓ 2.8 to 2.10
Audit Committee	✓ s 44	✗	✓ s 32	✗	✓ s 46	✓ (Listed companies only)	✗
Audit of financial statements	✓ s 37	✓ s 37	✓ ss 8 & 12	✗	✓ s 57	✓ s 301	✗
Submit budget estimates to stakeholder ³⁸	✓ s 39	✗	✓ s 14 (Other than GBEs)	✗	✗	✓ s 301	✗
Notify stakeholder ³⁸ of significant events	✓ s 40 (and any subsidiary company)	✗	✓ s 15	✓	✗	✓ ss 1001A & 1001B (Continuous disclosure requirements for listed companies only)	✓ 2.17 to 2.19
Provide stakeholder ³⁸ with special reports, documents and information as required	✓ s 41	✗	✓ s 16	✓	✓ s 50	✓ ss 302 to 306 (Listed companies only)	✓ 2.17 to 2.19
Disclose Directors Interests	✗	✗	✓ s 21	✓	✗	✓ s 231	✓ Corporations Law – Company GBE CAC Act – Statutory Authority GBE
Prepare Corporate Plan for stakeholder	✓ s 42 (GBEs only)	✗	✓ s 17	✓	✗	✗	✓ 2.1 to 2.4
Comply with general government policies or directions	✓ s 43 (and any subsidiary company)	✗	✓ s 28	✓	✗	✗	✗
Must not make improper use of inside information or position	✗	✗	✓ s 23	✗	✗	✓ s 232 (5) & s 232 (6)	✗
Implement Fraud Control Plan	✗	✗	✗	✗	✓ s 45	✗	✗

³⁶ The requirements of “Governance Arrangements for Commonwealth Business Enterprises”.

³⁷ A wholly-owned Commonwealth company means a Commonwealth company, other than a company any of the shares in which are beneficially owned by a person other than the Commonwealth (s34(2) of the CAC Act).

³⁸ The Stakeholder would be the shareholder in the case of companies or the Minister (on behalf of the Commonwealth) for all government entities.

Table 1: Summary of Legal Requirements that may be applicable to CAC bodies

Requirement	Commonwealth Authorities and Companies Act			Individual CAC Enabling Legislation	Financial Management and Accountability Act	Corporations Law	GBEs
	Wholly-owned Company	Partly-owned company	Authority				
Pursue recovery of legally recoverable debts where economical to pursue	X	X	X	X	✓ s 47	X	X
Ability to Delegate CEO powers and functions and give instructions	X	X	X	✓	✓ ss 52 & 53	✓ s 109ZD to s 109ZF & s 226D	X
Must not misapply or improperly dispose of, or improperly use property	X	X	✓ s 22(1)	X	✓ s 41 & 42 s 43	✓ s 232(2) & s 232(6)	X
Must not falsify accounts	X	X	✓ s 22(1)	X	✓ s 61	✓ s 232(2)	X
Must not improperly use a credit card	X	X	✓ s 22(1)	X	✓ s 62	X ✓ ss 232(2) & 232(6)	X
Keep accounts and records as required and enable access to prescribed person	X	X	✓ s 20	✓	✓ s 48	✓ ss 285 - 318 Chapter 2M	X
Directors to have regard to sound commercial practice	X	X	X	✓ s 10 - Wool International	X	✓ s 232(4)	X
Managing Director not to engage in other paid employment without approval	X	X	X	✓ s 10 - Defence Housing	X	X	X
Prepare Statement of Corporate Intent for Stakeholder	X	X	X	X	X	X	✓ 2.5 to 2.7
Promote efficient, effective and ethical use of resources	X	X	X	X	✓ s 44	X	X
Keep stakeholder informed of risk management strategies	X	X	X	X	X	X	✓ 4.9 to 4.12
Act honestly in the exercise of powers and discharge of duties	X	X	✓ s 22 (1)	X	X	✓ s 232 (2)	X
Exercise care and diligence in the exercise of powers and discharge of duties	X	X	✓ s 22 (2)	X	X	✓ s 232 (4)	X
Prevent insolvent trading	X	X	X	X	X	✓ s 588G	X

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Appendix A - Public Sector Corporate Governance: A Director's Checklist

The following checklist is designed to assist Directors/Authority members to assess the strengths and weaknesses of their current governance framework. The checklist was designed to allow the respondent to analyse the effectiveness of governance processes within his/her organisation using a ranking scale with four levels:

4 – Fully effective 3 – Satisfactory 2 – Marginal 1 – Not addressed

Definition of Roles and Powers

4 3 2 1

- | | | | | |
|--|--------------------------|--------------------------|--------------------------|--------------------------|
| 1. Are the roles of the Minister, Board and CEO clearly defined? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Is the role of the Board documented in a Board Charter? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Is there a clearly defined division of responsibilities within your organisation? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Are governance responsibilities effectively communicated to individual members of the Board/ managers? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. Has management understood and accepted the responsibility for internal control? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. Is there a framework of strategic control that includes formal procedural and financial delegations to govern the conduct of the organisation's business? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7. Does the framework of strategic control include a formal schedule of those matters specifically reserved for decision by the Board? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 8. Are management processes for policy development, implementation, review and Board approval clearly documented, understood and adhered to? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Board Appointments

- | | | | | |
|---|--------------------------|--------------------------|--------------------------|--------------------------|
| 9. Are new Board members appropriately briefed on appointment regarding the organisation generally and specifically, their governance responsibilities? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 10. Is the basis for Board appointments clearly stated? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 11. Are directors subject to regular renomination, say every three years? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 12. Are Board appointments made on the basis of the skill requirements of the Board? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Board Skills, Independence and Resources

- | | | | | |
|---|--------------------------|--------------------------|--------------------------|--------------------------|
| 13. Is there a sufficient number of independent members on the Board to facilitate effective monitoring of management performance and to provide a challenge, where required? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 14. Is the Board Chair independent of management? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 15. Is there a sufficient mix of financial, operational and compliance skills within the Board to ensure it can effectively direct and monitor the organisation's activities? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

	4	3	2	1
16. Are there appropriate arrangements to ensure that the Board has access to all relevant information, to high quality advice and to the resources necessary to enable it to carry out its functions efficiently and effectively?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. Are there written procedures to address the process required where a Board member has a conflict of interest?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Code of Conduct				
18. Has the Board clearly communicated its policy in relation to Corporate Governance, including its ethical values?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19. Has the Board developed a formal code of conduct defining the standards of personal behaviour to which the members of the Board and all employees of the organisation are required to adhere?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20. Does the Board and senior management 'lead by example' in relation to the code of conduct?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21. Is adherence to the code of conduct regularly reviewed and is intermediate action taken where necessary?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22. Are there appropriate mechanisms to ensure that staff are not influenced by prejudice, bias or conflicts of interest?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Strategy Setting				
23. Are the long term objectives of the CAC clearly stated in a long term corporate strategy (3 year minimum) approved by the Board?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
24. Are annual measurable objectives set out in an annual plan approved by the Board?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
25. Is an annual budget prepared by management and approved (or rejected) by the Board?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Business and Community Consultation				
26. Has the Board:				
• clearly documented and gained approval for the organisation's community obligations?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• identified all relevant stakeholders, their needs and the business risks associated with managing these?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• established clear channels of communication with it's clients and other stakeholders?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• implemented appropriate processes to ensure that such channels operate effectively in practice?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• clearly communicated the strategic objectives of the organisation?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
27. Is there an explicit commitment to transparency and openness as far as practicable in the organisation's activities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
28. Is there a process to regularly monitor business and community satisfaction through surveys, liaison and other feedback mechanisms?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Financial and Operational Reporting

4 3 2 1

29. Does Board and management reporting include an appropriate mix of financial and operational information to facilitate comprehensive review?
30. Has the Board decided what performance reports to see, and how frequently?
31. Are the users of the reports satisfied with the amount and quality of the information provided?
32. Is there a senior executive responsible for ensuring that appropriate advice is given on all financial matters including fraud and risk management?
33. Is there a senior executive responsible for ensuring effective management, co-ordination and delivery of information (including related technology)?
34. Is the financial information reported prepared on an accrual basis?
35. Does the financial information report year to date actual and budget, full year budget and full year forecast on an accrual basis?
36. Is the Board regularly briefed on the financial situation of the organisation by the management team?
37. Does Board reporting include the status of significant initiatives determined by the Board and/or management?
38. Are there appropriate mechanisms to identify external reporting requirements?
39. Are data collection and information management systems adequate to support reporting requirements?
40. Does the Board:
- ensure that performance reporting processes directly link objectives, strategies and business operations?
 - periodically review reported information to ensure that all stakeholders are receiving what they require to meet their obligations and requirements?
41. Does the organisation:
- publish on a timely basis an objective, balanced and readable annual report?
 - include a statement of the major corporate governance practices in place?
 - include selected performance measures which are linked to the organisations business strategy and that are regularly used for internal assessment and operational purposes as well as for external performance information?

Monitoring the Performance of the Board

42. Is there a process to regularly review the effectiveness of the Board, and individual directors where possible?

Audit Committees

4 3 2 1

- | | |
|--|---|
| 43. Has an Audit Committee been established? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 44. Are there sufficient members of the Audit Committee who are independent of management? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 45. Do members of the Audit Committee have the requisite financial and accounting skills to discharge their responsibilities? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 46. Does the Audit Committee have a written charter setting out its role and responsibilities? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 47. Does the Audit Committee take responsibility for independent review of systems of internal control, risk management and maintenance of effective complementary links with the external audit process (and internal audit, where applicable)? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 48. Does the Audit Committee have sufficient resources to discharge its responsibilities effectively, including internal audit and specialist consultants, where required? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 49. Does the audit committee take steps to gain assurance that systems of internal control: | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| • are appropriate to the corporate plan or business charter? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| • provide timely and useful management information? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| • include an effective internal audit function? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| • address all existing and emerging risks? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 50. Is the audit committee satisfied that there is a formal risk management program which assists the Board to assess the effectiveness of internal control and the emergence of new threats? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 51. Is the audit committee satisfied that there are formal arrangements in place to ensure the privacy of data entrusted to the organisation? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |

Statutory Accountability

- | | |
|---|---|
| 52. Is there a senior executive responsible for ensuring compliance with the organisations legislative obligations? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 53. Is there formal reporting of compliance for critical compliance obligations and exception reporting for other compliance obligations? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 54. Is all applicable legislation, regulations etc | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| • identified? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| • readily available to all staff?; and | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| • included in staff training arrangements? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |
| 55. Are there effective arrangements to ensure compliance with all applicable statutes and regulations, and other relevant statements, guidelines and statements of sound administrative and financial management practice? | <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> |

The governance structure of a CAC body is fundamentally different to an FMA body because a Board of directors rather than a CEO is primarily accountable for the activities of the organisation. This accountability can be blurred by unclear definition of the roles of the participants. Indeed, the governance structures can vary from one CAC to another and should, particularly given the diversity in activities and size of these organisations in the Commonwealth public sector.

While CAC bodies vary markedly in their organisational complexity, size and client base, they currently have a largely common internal structure which supports their Board's decision-making processes. These same structures are essential building blocks to form a robust public sector governance framework. They include:

Legislative structures: comprehensive legislative structures generally regulate the activities of the Board, CEOs and their staff. They may also impose obligations on the stakeholders including external parties. The general requirements for CAC bodies are governed by their enabling legislation and the *Commonwealth Authorities and Companies Act 1997*.

Ethical structures: Ethical structures within agencies are ideally an integral, pro-active and educational component of fraud control and risk management. These structures provide a basis for the Board to have confidence that there is consistent ethical behaviour at all levels of the organisation and that its employees comply with public sector standards, codes of ethics and applicable codes of conduct; act with integrity in the performance of official duties; ensure due process in the use of official information, equipment and facilities; exercise consideration and sensitivity in their dealings with members of the public and employees; and identify and deal with any real or perceived conflict of interest.

Internal accountability structures: Internal accountability structures provide assurance to the Board on internal control and management of the organisation, the planning and review of its operations and progress, and ensure consultation and constructive feedback on all its activities.

Accountability structures for internal management start with the Board and can include executive and other committees set up for specific tasks at executive level. CAC bodies are also required to operate Audit Committees to assist them in financial and compliance issues. Structures for organisational planning and review include the corporate plan; business plans; risk management plans; internal delegations; quality control systems; and checks and balances, benchmarking and performance monitoring to ensure that all responsibilities under the control of the Board are carried out with due care and diligence.

Ideally, accountability will exist at an individual level where every member of the organisation understands and is committed to Australian Public Service values and those of the agency; understands their roles and responsibilities; and is clearly accountable for achieving them.

External accountability and reporting structures: External accountability and reporting structures make a CAC body's performance transparent. A CAC body, which has a clear understanding of its responsibilities and an open approach to the way in which they are discharged, will assist the Board, CEO, Minister and the Government in framing and winning support for these strategies. It will also increase general confidence in the operation of the public sector.

Financial management structures: Financial management structures within agencies provide assurance to the Board that Commonwealth resources are being managed efficiently, effectively and ethically; and, in the case of business ventures, that adequate returns are being generated. These structures include regular monitoring and reporting of progress against budgets; implementation of a fraud control plan; establishment of an Audit Committee (which is required under the CAC Act); pursuit of each recoverable debt for which the agency is responsible; assurance that appropriate accounts and records of the agency are maintained; and preparation of financial statements giving a true and fair view of all matters that are required to be disclosed.

Resource management structures: Resource management structures within agencies provide assurance to the Board that human resources, facilities, equipment and records are managed effectively, efficiently and ethically. Identification of who is responsible, and for what areas, provides assurance to the CEO that responsibilities have been delegated in a systematic manner with clear accountability for results.