

Performance Audit Report

Corporate Governance

Volume Two: in Practice

State Library of New South Wales cataloguing-in publication data

New South Wales. Audit Office.

Performance audit report : corporate governance / [Audit Office of New South Wales]

ISBN 0731306016 (set)

ISBN 0731306032 (v.2)

1. Corporate governance. 2. Corporate governance - New South Wales.
3. Corporations, Government - New South Wales - Auditing. 4. Directors of corporations. 5. Directors of corporations - New South Wales. I. Title: Corporate governance. II. Title: Corporate governance in principle. III. Title: Corporate governance in practice.

658.42209944

Table of Contents

| | |
|---|-----------|
| Foreword | 1 |
| Executive Summary | 3 |
| Recommendations | 6 |
| 1. Background | 9 |
| 1.1 Introduction | 10 |
| 1.2 The Need to Examine Corporate Governance in the Public Sector | 10 |
| 1.3 Standards and Guidelines | 12 |
| 2. The Role and Functions of Boards | 17 |
| 2.1 Introduction | 18 |
| 2.2 Board Classification | 19 |
| 2.3 Perceived Functions | 20 |
| 2.4 CEO Appointments | 21 |
| 2.5 Board Composition | 23 |
| 2.6 Board Obligations and Duties | 23 |
| 3. Board Appointments | 27 |
| 3.1 Introduction | 28 |
| 3.2 Appointments in Practice | 29 |
| 3.3 Vacant Positions | 32 |
| 4. Board Performance | 37 |
| 4.1 Introduction | 38 |
| 4.2 Monitoring Organisational Performance | 38 |
| 4.3 Compliance and Risk Management | 40 |
| 4.4 Managing Stakeholders | 43 |
| 5. Board Accountability | 51 |
| 5.1 Introduction | 52 |
| 5.2 Board Meetings Preparation | 52 |
| 5.3 The Board Meeting | 53 |
| 5.4 Providing Information | 55 |

| | |
|---|-----------|
| 5.5 Decision-Making | 57 |
| 5.6 Standards of Behaviour | 58 |
| 5.7 Liability | 62 |
| 5.8 Reporting | 66 |
| 6. Achieving Efficiency and Effectiveness | 73 |
| 6.1 Introduction | 74 |
| 6.2 Recognising Corporate Governance | 74 |
| 7. Attachments | 79 |
| 7.1 Estimated Fees Paid to Director of NSW Public Sector Boards, 1996 | 80 |
| 7.2 Criteria for Audit | 81 |
| 7.3 References | 87 |

Foreword

This report is the second of a two part report on corporate governance in the NSW public sector. The first volume examines governance models. This Report presents the findings of a survey conducted across 210 boards in the NSW public sector. A Supplement to this Report has also been produced, which provides a more detailed analysis of the survey findings.

The survey was complemented by a substantial number of case studies. These have been reported in Volume One: *Corporate Governance in Principle* to highlight specific governance issues, and in this Volume to provide examples of better practice.

The survey examined corporate governance practices and addressed the way in which boards are created as well as their operations and accountability mechanisms.

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

Executive Summary

Executive Summary

In summary, in examining the corporate governance practices of boards in the NSW public sector, The Audit Office found:

Criteria and processes for appointing directors to boards are not always transparent.

In the private sector, voting for board directors takes place openly at the Annual General Meeting.

Criteria and processes for appointing directors to boards in the public sector are not always transparent or consistent across boards. In his policy statement “Labor’s Public Administration”¹ the Premier proposed that expressions of interests would be publicly called for qualified people to serve on boards. While directors appointments are approved by Cabinet, criteria for selection are not transparent.

In addition, there is still a lack of rationale for the approach to the selection and appointment of directors. In most cases appointments to boards in the public sector, including the boards of non-corporatised Government Trading Enterprises, are made by the Governor on the recommendation of the relevant Minister. Directors of Ports Corporations (one form of statutory State Owned Corporations) are appointed by the Governor on the recommendation of the Voting Shareholders. Directors of energy and rail corporations (another form of statutory State Owned Corporations) and company State Owned Corporations are appointed by the Voting Shareholders.

A more systematic and rigorous approach to the range of corporate governance issues is required across the public sector if it is to approach better practice”.

Private sector organisations face competition and are subject to *Corporations Law* and Australian Stock Exchange Guidelines. The latter require the reporting of certain corporate governance practices. This environment encourages a more rigorous approach to and reporting of corporate governance practices. These include issues such as dealing with conflicts of interest and awareness of obligations and duties of directors.

¹ R. Carr, “Labor’s Public Administration Reforms”, Press Release, Sydney, 1994, p.8. Public expressions of interest for board membership were called for at the end of 1995.

The Audit Office found shortcomings in corporate governance practices in NSW public sector boards when compared with “better practice” as outlined in the theoretical literature and empirical research.

There is a lack of accountability for board decision making and board performance.

There is a lack of accountability in decision-making. There is also inadequate reporting of both board achievements, as opposed to organisational achievements, and of corporate governance practices. Few boards evaluate or report on their own effectiveness and efficiency.

Where boards are to serve a governance role, then a basic framework needs to be created to ensure they can operate efficiently and effectively.

Factors that appear to enhance governance practices include:

- recognition of corporate governance as an issue;
- recognition of the scope of corporate governance;
- having a Chair who promotes better practice;
- establishing written rules and procedures;
- having support for the board (role of Company Secretary);
and
- having boards of an appropriate size (where committee work can be undertaken without overloading directors).

Recommendations

To enable boards to operate according to better practice principles, boards should have:

1. a policy on better practice for board operations addressing issues such as:
 - board appointments and composition;
 - appropriate board structures, systems and processes;
 - standards;
 - board performance; and
 - board reporting.
2. a clear, written mandate regarding the roles, responsibilities and accountabilities of the board from their Minister;
3. a formal, written definition of the role, responsibilities and duties of the Chair and directors;
4. the authority to make recommendations regarding board appointments, taking into account the needs of the board and the skills and qualifications of potential candidates;
5. a process to subject re-appointments and vacancies to evaluation and review, taking into account the current and future needs of the board;
6. access to an induction program and on-going training for all directors;
7. an arrangement to meet regularly with the Minister and review board performance;
8. written rules and procedures for board operations;
9. regular meetings and provide adequate and appropriate access to the information necessary for the board to conduct its business;
10. decision-making processes which are transparent and allow for sufficient discussion;
11. a code of conduct;
12. established procedures for dealing with conflicts of interest and third party transactions;

13. a mechanism for dealing with fraud control;
14. a clear understanding of their liabilities;
15. a procedure to ensure that board performance is reviewed and reported upon regularly; the results of this review should be reported publicly; and
16. their corporate governance practices recorded in their Annual Report.

In addition, governing boards should have:

17. Ministerial powers (to give directions) defined in writing (preferably in the legislation), with a transparent process for responding to such directions;
18. an appropriate board structure, including relevant committees. Committees should include an audit committee;
19. the power to appoint their Chair; and
20. the power to appoint the Chief Executive Officer and provide them with a written charter regarding their role, responsibilities and duties.

1. Background

1.1 Introduction

Corporate Governance is a way of providing stewardship to an organisation. It is a system by which an organisation is controlled and directed by a board.

Issues of accountability, risk management and the cost of supporting board structures have increasingly become concerns in public sector corporate governance.

There are two reasons why it is important to examine governance in the NSW public sector. First, there are a vast number of boards (Premier's Department database contains information on over 600 boards) and they impose direct and indirect costs on Government. The major direct costs relate to the payment of directors' salaries and sitting fees. This is estimated to be \$13 million for 299 boards in 1996 (Attachment 1). (There are another 304 boards where no fees are paid and/or there is no information regarding fees). There are also significant costs in supporting and servicing boards.

Second, the decisions boards make can enhance or inhibit organisational performance. This is particularly the case for Government entities which now operate as businesses and control vast assets. Other statutory bodies and authorities also control assets that have economic or social significance. In some cases, "poor" decision making could affect the financial viability, possibly the State's credit rating, and have social impacts at a State and local level.

1.2 The Need to Examine Corporate Governance in the Public Sector

The Australian Institute of Company Directors (AICD),² in their *Checklist for Directors of Government Boards*, has acknowledged the complexity of corporate governance in the public sector. This is particularly so for Government agencies as they corporatise or privatise. Part of this uniqueness and the difficulties they confront relates to the nature of "conflicts" directors will face. These "conflicts" include questions about:

- who the shareholder is and how the shareholder is represented;

² Australian Institute of Company Directors, *Checklist for Directors of Government Boards*, pamphlet, AICD, Sydney, 1994.

- whether they should fulfil a commercial or a social purpose;
- maintaining confidentiality versus being responsible to Government;
- applying market pricing versus fulfilling community service obligations;
- being independent of Government versus applying Ministerial policy;
- the priorities of customers, employees and the shareholder;
- whether action which is legal for the entity expose directors to liability under common law or statute law; and
- whether the legal structure is necessarily a protection against political responsibility.³

Separation of Responsibilities and Powers

Most of the NSW public sector models of governance or the way they are implemented do not clearly define or separate the responsibilities, powers and accountabilities of the board, the Government (Ministers) and management. In the private sector, management's role is to carry out board decisions. Their performance contract is clearly with the board. With the exception of State Owned Corporations (SOCs) and some regulatory bodies,⁴ most models in the NSW public sector, provide management (as represented by the Chief Executive Officer (CEO)) with "two masters". The CEO is likely to be appointed by the Governor-in-Council on the recommendation of the Minister; they are accountable to a Minister through a Senior Executive Service (SES) performance management system; and their remuneration is determined centrally by Statutory and Other Officers Remuneration Tribunal (SOORT) and approved by the Minister and the Premier.

If these roles, responsibilities and duties are not clear, there could be:

- an inappropriate level of public accountability;
- insufficient safeguards over public money because too few or inappropriate rules and procedures govern their expenditure;
- disregard for economy and efficiency, or failure to measure and report effectiveness in an appropriate way;
- inappropriate board decisions which may not be in the best interests of the organisation or the State;

³ AICD, op. cit., p.13.

⁴ These are company and energy (Type Two statutory) SOCs.

- difficulty in recruiting board members;
- unnecessary resignations and lack of continuity of board membership arising from disputes and conflicts;
- public embarrassment arising from board decisions that are inconsistent with the Government's agenda;
- board decisions which are inappropriate or inconsistent with Government policies, directions or priorities; and
- an inability on the part of the board to act "in good faith" and

5

1.3 Standards and Guidelines

One of the key strategies to deal with these difficulties has been the development of standards or "better practice" guides. This strategy has been followed in the United Kingdom (UK), USA, Canada, Hong Kong and Australia (see References). However, most guides relate to the private sector, although some work has been undertaken by the Chartered Institute of Public Finance and Accountancy⁶ and by the AICD.

The Commonwealth Government has operational guidelines for its Government Business Enterprises (GBEs) "Accountability and Ministerial Oversight Arrangements for Government Business Enterprises: Guide to Commercialisation". It also has guidelines for business units within departments "Accountability and Ministerial Oversight Arrangements for Fully Commercialised Activities within Departments and Agencies". Non GBEs (statutory authorities) are currently guided by their own *enabling* legislation.

New Commonwealth legislation, *the Commonwealth Authorities and Companies Bill*, is currently being considered in the Federal Parliament.⁷ This will articulate the principles which should guide the actions of directors in Commonwealth statutory bodies and GBEs. Directors will be expected to act honestly, with care and diligence, not use inside information or their position for personal gain. It is expected that the standards will also be relevant for boards of business units in departments.

⁵ Provincial Auditor of Saskatchewan, "Survey Report and Examination Plan", internal paper, 1993.

⁶ Chartered Institute of Public Finance and Accountancy, *Corporate Governance: A Framework for Public Sector Bodies*, CIPFA, London, 1995.

⁷ This legislation is due to be enacted in July, 1997.

The Department of Finance will be issuing a booklet for directors as a guide to standards required. This will coincide with the implementation of the legislation, expected to be mid-1997.

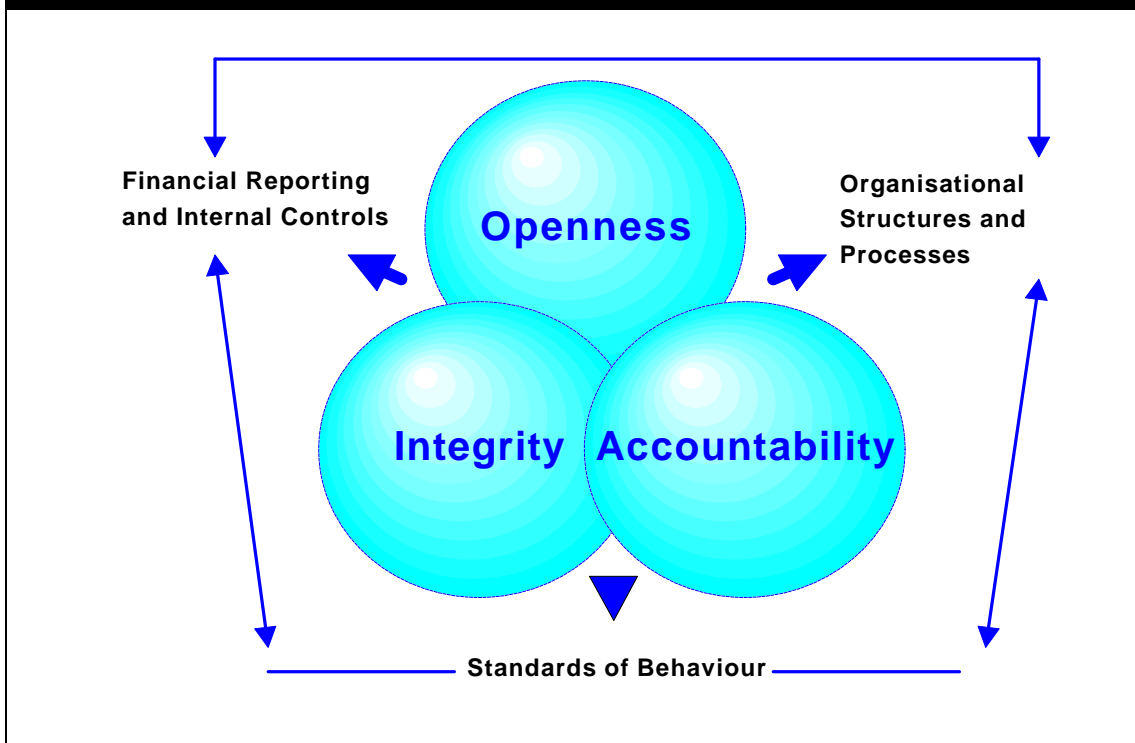
This “better practice” literature at the operational level of corporate governance, implicitly or explicitly, supports a common set of values or principles and standards upon which governance should be based. In the UK, *The Report of the Committee on the Financial Aspects of Corporate Governance* (known as the *Cadbury Report*) identified three fundamental principles of corporate governance: openness, integrity and accountability. These concepts were utilised by the Chartered Institute of Public Finance and Accountancy (CIPFA) in developing a framework for public sector corporate governance (see Figure 1.1).

The CIPFA applied these three principles of better practice to the public sector in terms of:

- organisational structures and processes;
- financial reporting and controls; and
- standards of directors’ behaviour (see Figure 1.2).

This report presents the findings of The Audit Office survey of boards and case studies and examines these results against “better practice” identified in the literature. Audit criteria are at Attachment 2.

Figure 1.1: The Framework of Corporate Governance in Public Services



Source: Chartered Institute of Public Finance and Accountancy, *Corporate Governance: A Framework for Public Sector Bodies*, CIPFA, London, 1995.

Figure 1.2: Standards of Corporate Governance in the Public Services

| Organisational Structures and Processes | Financial Reporting and Internal Controls | | |
|--|---|------------------------|---|
| <ul style="list-style-type: none"> ↻ Statutory Accountability ↻ Accountability for Public Money ↻ Communication with Stakeholders ↻ Roles and Responsibilities <ul style="list-style-type: none"> - Balance of Power and Authority - The Board - The Chairman - Non-Executive Board Members - Executive Management | <ul style="list-style-type: none"> ↻ Annual Reporting ↻ Internal Controls <ul style="list-style-type: none"> - Risk Management - Internal Audit ↻ Audit Committees ↻ External Auditors | | |
| <table border="1" style="width: 100%;"> <thead> <tr> <th>Standards of Behaviour</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> ↻ Leadership ↻ Codes of Conduct <ul style="list-style-type: none"> - Selflessness, Objectivity and Honesty </td> </tr> </tbody> </table> | | Standards of Behaviour | <ul style="list-style-type: none"> ↻ Leadership ↻ Codes of Conduct <ul style="list-style-type: none"> - Selflessness, Objectivity and Honesty |
| Standards of Behaviour | | | |
| <ul style="list-style-type: none"> ↻ Leadership ↻ Codes of Conduct <ul style="list-style-type: none"> - Selflessness, Objectivity and Honesty | | | |

Source: Chartered Institute of Public Finance and Accountancy, *Corporate Governance: A Framework for Public Sector Bodies*, CIPFA, London, 1995.

This report examines the following issues:

- what is the role of a board? (Chapter Two)
- how are directors appointed? (Chapter Three)
- how well does corporate governance work? (Chapter Four)
- how accountable are boards? (Chapter Five)
- what factors help boards function efficiently and effectively? (Chapter Six)
- summary of findings against the audit criteria (Chapter Seven).

2. The Role and Functions of Boards

2.1 Introduction

The role of a board is to provide stewardship to an organisation. The authority of a governing board means that it has “total accountability for all corporate activity.”⁸ Its authority is⁹

In the NSW public sector, the authority, autonomy and accountability vary according to the type of governance model under which the board operates. Models include universities, companies, statutory regulatory authorities, company SOCs, statutory SOCs, Government Trading Enterprises (GTEs), other statutory and non-statutory bodies and authorities.¹⁰ The differences between these models are outlined in Volume One: *Corporate Governance in Principle*.

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

In the exercise of these powers, governing boards are expected to represent the interests of “shareholders”, that is, the public. At the same time, they are regarded as an agent of government.¹¹ Indeed, in most governance models, the definition and separation of responsibilities and powers of boards, Ministers and CEOs are not clear, even in legislation. Thus, how boards define their governance roles and what functions they perform varies considerably, even for government businesses (see Volume One: *Corporate Governance in Principle*).

⁸ J. Carver, *Boards that make a Difference: A New Design for Leadership in Non-profit and Public Organisations*, Jossey Bass, San Francisco, 1990, p.2.

⁹ *ibid.*, p.2.

¹⁰ These include statutory authorities that provide services, trusts, area and economic development boards.

¹¹ NSW Treasury, “Monitoring Policy for NSW Government Trading Enterprises”, NSW Treasury, Sydney, 1992, p.12.

This chapter examines survey results in terms of how boards see their roles. Boards have been classified into four groups based on the legislation governing their accountabilities (see Attachment 2).¹² For ease of reading, they have been given abbreviated labels, but Groups 1, 3 and 4 encompass a wider range of agencies than the label would suggest. The groups are:

Group 1: health boards and trusts (but also includes a wide range of statutory bodies and some statutory authorities)

Group 2: GTEs and SOCs

Group 3: university councils (and university subsidiaries)

Group 4: most registration and marketing boards (and some regulatory boards)

A small group of private companies owned by Government formed part of the total statistics but was too small to be analysed as a separate group.

2.2 Board Classification

A board's role in theory, can be:

- **governing** - legislation may or may not specify that these are under the “direction and control” of the Minister
- **advisory** - legislation specifies that the board may provide advice to the Minister on the management of the organisation but the Minister retains unfettered right to control and direct.

The results of the survey indicate that there is confusion as to whether boards are governing (controlling) in the true sense or are advisory. Of the 137 boards responding to The Audit Office survey, 101 (73.7%) classified themselves as controlling boards. Only boards in SOCs and a few statutory authorities are “controlling” in the sense that there is usually no direction from, or control by, a Minister. In the case of SOCs, any Ministerial direction must be in writing.

¹² This legislation includes the *Public Sector Management Act 1988*, the *Public Finance and Audit Act 1983* and the *Public Authorities (Financial Arrangements) Act 1987*. This excludes *enabling* legislation for specific boards.

2.3 Perceived Functions

Despite the differences in the real authority and autonomy of boards, most boards in The Audit Office survey perceived their most important functions as: ensuring proper resource management; monitoring and reviewing corporate strategy; and establishing and communicating objectives, corporate strategy and visions (see Table 2.1).

Table 2.1: Most Important Functions perceived by NSW Public Sector Boards

| | % of Responses |
|---|----------------|
| ■ ensuring proper resource management | 84% |
| ■ monitoring and reviewing corporate strategy | 58% |
| ■ establishing and communicating objectives, corporate strategy and visions | 57% |
| ■ compliance | 44% |
| ■ monitoring management's performance | 32% |
| ■ facilitating communication with Ministers | 11% |
| ■ manage boardroom processes | <10% |
| ■ selection of top executive management | <10% |
| ■ day to day management | <5% |
| ■ managing conflicts of interest | <5% |
| Note: Responses are not mutually exclusive | n=137 |

Health boards and trusts, GTEs and SOCs, and universities (Groups 1, 2 and 3) perceived their governance roles to be mainly in the areas of resource management, corporate strategy and communicating objectives. In most registration and marketing boards (Group 4), compliance with legal requirements was relatively more important than corporate strategy and communicating objectives.

The results would suggest that there is a blurring of roles between boards and management. There are two problems here:

- “modern management” is expected to provide leadership to an organisation and involve staff in organisational development through processes such as corporate and strategic planning. However, the structure of agencies and roles of staff are often based on legislation drafted in an era when CEOs were expected to be “administrators” and not managers or leaders. Little or no staff involvement was expected.¹³

¹³ F. Hilmer, and L. Donaldson, *Management Redeemed*, Free Press, Sydney, 1996.

- agencies which are now expected to operate commercially also have legislation drafted in an era when there were no such expectations. *Supporting* legislation has been drafted for SOCs and specific *enabling* legislation has also been drafted to give them a new focus and help to clarify the roles of Ministers and the board. In contrast, GTEs, statutory authorities and statutory bodies operate only under their *enabling* legislation. In many cases the legislation is outdated. This does little to help boards operate commercially. Ministers still have substantial control under these pieces of legislation but at the same time, are expected to devolve their decision-making powers to a board with expertise in business. According to the Director-General of The Cabinet Office, there is confusion between devolution and divesting of decision-making powers.¹⁴ This issue is discussed further in Volume One: *Corporate Governance in Principle*.

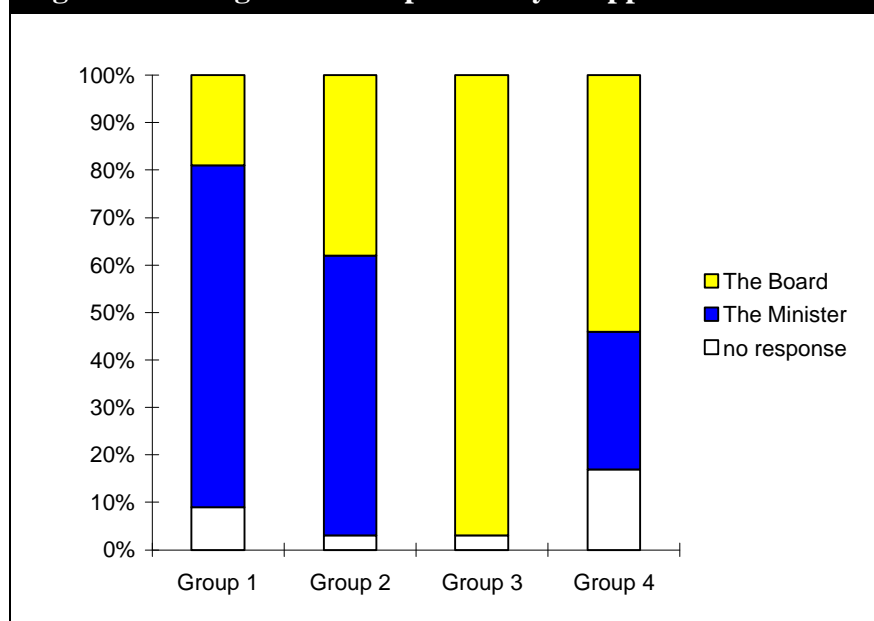
2.4 CEO Appointments

Boards in the private sector have other key responsibilities. These include responsibility for appointing the CEO and determining their remuneration. Except for some SOCs, this is not the case in the public sector. The Audit Office survey found that boards stated they appointed the CEO in 53 per cent of cases. The university councils appointed their own CEO (Vice-Chancellor) and thus this increases the instance of appointments made by the board for the sample as a whole (Figure 2.1).

The boards of SOCs and GTEs seem to be unclear about responsibility for appointment of the CEO as opposed to giving of advice about appointments. Inconsistency in the practice of Ministers seeking board advice about CEO approvals may account for this confusion.

¹⁴ R. Wilkins, “Adapting to a Devolved Environment: NSW Perspective”, talk presented to Governance in Transition seminar, RIPAA, 31 October, Sydney, 1996.

Figure 2.1: Legislative Responsibility to appoint CEO



In the survey, Ministers appointed the CEO in 39 per cent of boards. In 59 per cent of SOCs and GTEs (Group 2) the Minister appointed the CEO. However, the SOC legislation allows for board appointment of the CEO in the case of company SOCs (there are only two). This practice has also been followed for the electricity and rail corporations (Type Two SOCs). With these exceptions, appointment of the CEO in statutory SOCs is made by the Governor on the recommendation of the portfolio Minister and the board. It seems that in some cases, the board has considerable influence in board appointments and, in others, there is little or no influence (see below).

**Selection/
re-appointment
of CEO**

Where the Minister is believed to have legislative responsibility for appointing the CEO, the boards were asked whether the Minister seeks advice on the selection or re-appointment of the CEO. Two-thirds of these boards indicated that the Minister did consult the board in these matters. There appeared to be little differences between the groups (except for universities (Group 3) where the Minister has no legislative power). Of note is that 28 per cent of GTEs and SOCs (Group 2) indicated that the Minister did not consult them.

2.5 Board Composition

Are Boards Independent?

In the private sector, having a majority of non-executive directors is regarded as a way of achieving independent judgement in stewardship of the organisation. However, in the public sector the situation is not as clear. There are still instances of the CEO also being or acting as Chair of the board. This is an historical legacy from the time in which legislation for that particular board was developed. This situation still exists despite the policy of the Government that “boards will be structured with part-time Chairpersons and separate full-time Chief Executives”.¹⁵

Most boards (85%) in The Audit Office survey had a majority of non-executive directors. The Chair was filled by a non-executive in 71 per cent of boards.

2.6 Board Obligations and Duties

Whom does the board represent?

Many boards in the public sector have been established to fulfil functions in addition to, or other than, those traditionally associated with governance. A board can:

- act as a buffer between the organisation and the Minister, so that the Minister can focus on broad strategic issues at a “whole of Government level”;
- be an advocate for issues concerning the sector, community, profession; and
- be representative of “interests” in the community.

In a number of instances, *enabling* legislation requires that boards have a certain representation or mix. Representation may be from particular professions, industry, agriculture, community or unions. Recent SOC legislation specifies that SOCs must have a staff director. This is often a union representative.

Four issues are relevant here:

- When making decisions, directors are supposed to act in the best interests of the board and the organisation, not in the interests of the group they represent. This is difficult to achieve and can lead to conflicts of interest. This is especially the case where board directors may be from another level of Government.

¹⁵ Carr, op. cit., p.9.

- There can be high and unrealistic expectations placed on the director by the group he or she represents.
- The “best interests” of the organisation as perceived by the “representative” directors may not be consistent with the “best interests” of the Government as perceived by Ministers or central agencies.
- Whether a board is the most appropriate avenue for achieving “ends” other than “governance”.

“Better practice” regarding board composition and duties indicates that:

- the composition of the board should be such that “no one individual has unfettered powers of decision-making”;¹⁶
- non-executive members of boards of public service bodies should provide independent judgement on issues of strategy, performance, resources and standards of conduct;¹⁷
- non-executive directors should be independent of management and free from any other relationships which materially interfere with their roles;¹⁸ and
- a director has a fiduciary duty to the company. A “fiduciary” duty has been defined by the High Court as the duty to act with fidelity and trust to one another. That is, the director must act honestly, in good faith, and to the best of his or her ability in the interests of the company. The director must not allow conflicting interests or personal advantage to over-ride the interests of the company. The company must at all times come first.¹⁹

The following case studies indicate that the “governance” role in the public sector is not as clear cut as that in the private sector. Boards perform other functions in addition to governance. Real conflicts can arise when boards have directors who are selected because they represent certain interests or have certain backgrounds and experiences.

¹⁶ CIPFA, op. cit., p14.

¹⁷ CIPFA, op. cit., p15.

¹⁸ CIPFA, op. cit., p15.

¹⁹ AICD, op. cit., p6.

Case Z

Case Z is a foundation whose role is to facilitate industry and community sponsorship of the organisation through gifts and donations. The directors have been carefully selected not only for their business expertise but also for the networks they bring to the Board.

Case H

Case H is a GTE in the rural sector with a financial turnover of several hundred million dollars per year. It has substantial reserves. The role of the organisation is to manage trading and farmers' pools of stock. The Board includes farmers in the industry.

While the Board has a Code of Ethics and set procedures for declaring conflicts of interest, real conflicts can arise. For example, the Board wants to be privatised to take full advantage of market opportunities. There is now a dispute between the organisation and Treasury over who owns the reserves. The Board regards the reserves as belonging to the Board. The Treasury believes the reserves belong to the Government because Treasury financed a deficit incurred in earlier years by boards which were forerunners to the current Board.

Case M

Case M is an organisation with ten directors including members of the Commonwealth and State bureaucracies. Commonwealth members have membership on this Board because the organisation receives Commonwealth funds.

The inclusion of Commonwealth membership on a State board has caused problems in a time when the Commonwealth is cutting funding to the organisation. The Board has had to discuss strategies to deal with Commonwealth cutbacks. This means that Commonwealth members on the Board have divided loyalties and this has caused tensions. The probability of their reporting Board decisions back to their Minister is very real.

3. Board Appointments

3.1 Introduction

To achieve accountability, board appointments and re-appointments should be conducted with openness and integrity. Once directors are appointed, attention needs to be given to their induction and training, if they are to perform their roles effectively.

Better Practice “Better practice” indicates that appointment processes and principles should:

- be transparent and should be reported publicly. Names and interests or other directorships of board members should be published;²⁰
- be formal and should “ensure that such appointments are made

21

- be based on the overriding principle of merit;²²
- take into account the need to have a balance of skills and backgrounds in board membership;²³
- be a matter for the board as a whole;²⁴
- ensure directors have the time to devote to board activities (therefore number of directorships should be limited); and
- specify the terms of a non-executive director’s appointment in a letter. This letter should include details of:
 - duties and rights of the director;
 - orientation system for directors;
 - special skills and experience expected to be contributed by the director;
 - time expected to be devoted to the board;
 - limitation on other directorships, if appropriate;
 - rights to obtain independent advice, resources and information; and
 - relevant policies, including director, board and CEO evaluation.

²⁰ CIPFA, op. cit., p.24.

²¹ CIPFA, op. cit., p.14.

²² Committee on Standards in Public Life (Nolan Committee),1995 cited by CIPFA, op. cit., p55.

²³ F. Hilmer, *Strictly Boardroom: Improving Governance to Enhance Company Performance*, Sydney Institute Sydney, 1993 p.75.

²⁴ CIPFA, op. cit., p.24.

**NSW
Government
Policy**

In a policy statement “Labor’s Public Administration Reforms”²⁵, the Premier stated that the following principles will apply to board appointments:

- expressions of interests will be publicly called for qualified people to serve on boards;²⁶ and
- membership of boards will be determined by the relevant Minister and require the approval of the Premier.²⁷

3.2 Appointments in Practice

In the private sector, voting for board directors takes place openly at the Annual General Meeting (AGM). Processes for appointing directors to boards in the public sector are not as clear and open nor is there a consistent approach across different types of boards.

In most cases, appointments to boards in the public sector are made by the Governor on the recommendation of the relevant Minister. In the case of GTEs, the recommendation is made by the portfolio Minister. In the case of Type One statutory SOCs (Ports Corporations) directors are appointed by the Governor on the recommendation of the Voting Shareholders. For Type Two statutory SOCs (rail and energy) and the two company SOCs, board appointments are made directly by the Voting Shareholders.

There is a view that the reasons or criteria for appointment are not always transparent.²⁸

Boards were asked whether the portfolio or shareholder Ministers seek advice from the board on the appointment of new board members. Excluding 11 per cent of boards that did not answer the question, half indicated that ministers did consult them. Most boards in GTEs and SOCs (Group 2, 64%) indicated that the Minister sought advice. The Minister sought advice in fewer cases in health boards and trusts (Group 1, 45%), universities (Group 3, 24%) and most registration and marketing boards (Group 4, 55%).²⁹

The Audit Office field visits discovered examples of agencies attempting to make their director appointment processes more rigorous and open. These instances are described below.

²⁵ Carr, op. cit., p.8.

²⁶ This was done in November, 1995.

²⁷ Government policy is that board appointments must be approved by Cabinet.

²⁸ NSW Parliament Hansard, 31 October 1996, pp.10-11.

²⁹ With the exception of a few members, university councils have the power to appoint their own members without consultation with a Minister.

Home Care Service of NSW

This is a statutory authority which has an Advisory Board. The Board provides advice not only on policy matters but is increasingly being involved in setting the strategic directions of significance for the organisation.

Appointments are made using a detailed selection process. The process aims to achieve a team whose experience and skills complement one another.

Once criteria for Board membership are determined, advertisements are placed in newspapers calling for expressions of interest from individuals. Additionally, lists held by the Premier's Department of individuals interested in Board membership are accessed. While positions are not quarantined, people in the field of interest areas relevant to the organisation's mandate are encouraged to apply. In particular, approaches are made to organisations representing "special needs" groups to put forward the names of potential candidates. However, the process is also broad enough to identify individuals beyond the human services industry who may potentially provide a valuable contribution.

Applicants are short listed according to the advertised criteria. An interview panel is then convened. The panel consists of the Director-General, who is Chair of the Advisory Board, the General Manager of the organisation and an independent.

Even if applicants are not successful in the first round, names of individual are maintained. This "pool" of names may be referred to if their application is still relevant when the terms of current members expire or individuals retire early.

University of Wollongong Foundation

In this case, the Board which is a limited company, has nine members. There are six sub-committees.

At the Annual General Meeting, members nominate to be part of one committee. The committees meet and then each elects their Chair. The Chair of each committee becomes a member of the Board. The Chair and Deputy Chair are elected from the floor at the AGM.

All members are fully informed about the Board prior to nominating. They receive a financial report, a nomination form and other relevant documentation prior to the AGM.

3.3 Vacant Positions

Better Practice in Re-appointment Processes

“Better practice” in managing vacancies and re-appointments indicates that:

- appointments should be for fixed terms and re-appointments should not be automatic;³⁰
- re-appointments should be “subject to a formal appraisal by the chair against a set of specific objectives given on appointment”;³¹ and
- re-appointments and the filling of vacancies should take into account “the current and future needs of the board”³². The mix of skills, background and experience needed should be taken into account.

Re-assessment of Positions in Practice

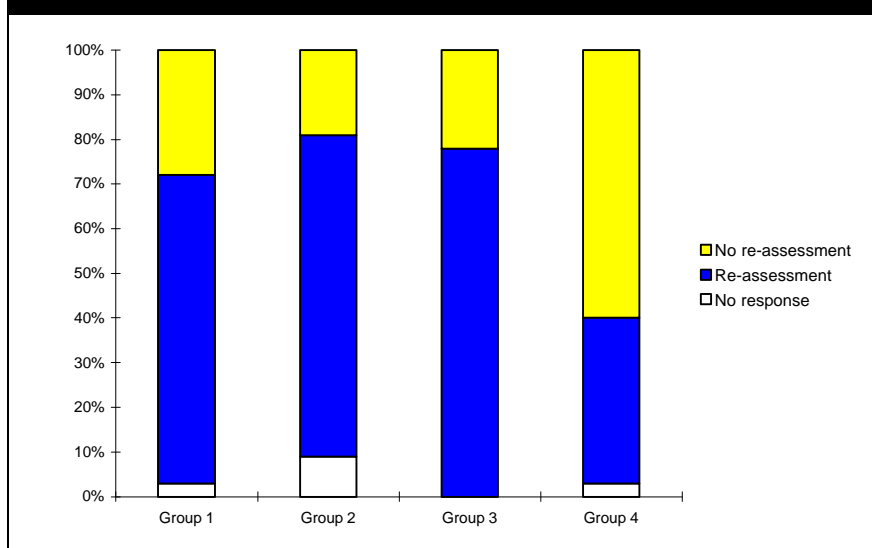
The Audit Office survey found that there was considerable variation in the way boards dealt with vacancies. Positions were re-assessed before a new appointment in 65 per cent of boards when a vacancy occurred. Most health boards and trusts (Group 1, 69%), GTEs and SOC's (Group 2, 72%) and universities (Group 3, 78%) undertook this re-assessment compared to most registration and marketing boards (Group 4, 37%). Figure 3.1 illustrates the differences between the groups.

³⁰ CIPFA, op. cit., p29.

³¹ loc cit.

³² loc. cit.

Figure 3.1: Re-assessment of Board Position



Re-assessment was generally carried out by: the board as a whole (39%); the Minister on advice from the board (25%); and the Minister only (10%).

The Board predominantly undertook re-assessment in universities (Group 3, 68%) and most registration and marketing boards (Group 4, 46%). In health boards and trusts (Group 1), the Minister was the main decision maker, acting either alone (32%) or on advice of the board (32%). In GTEs and SOCs (Group 2), the board (35%) or the Minister on the advice of the board (30%) was the main decision maker.

Succession Planning

A few boards raised the issue of having a more systematic response to filling vacancies through succession planning. The example of the Home Care Service of NSW has already been provided. The example below illustrates an approach which involves “training” directors to take over when former members retire.

University of Wollongong Foundation

In this case, the Chair and CEO are working with the Board to develop succession planning strategies. For example, when members visit industry they will be accompanied by staff members and other longer standing Board members. In effect, this operates as a support system.

**Better Practice
in Induction**

“Better practice” indicates that:

- newly appointed members should make a commitment to undertake induction training. This should include an awareness of public sector values, and standards of probity and accountability;³³ and
- the induction process should also include “orientation and education in respect of the business(es) ... and the workings of the board and its committees. The system should be both documentary and practical and include meeting appropriate executives”.³⁴

**Induction in
Practice**

In terms of inducting new members, The Audit Office survey found that most boards had “procedures” for providing information on roles and responsibilities. Procedures included: provision of a copy of the relevant legislation (15% of all boards); briefings (20%) or a combination of both (53%). New members in university councils (Group 3) tended to be informed of their roles/responsibilities via briefings (50%).

The survey was unable to test the adequacy or effectiveness of these strategies. However, the field visits revealed a need for better targeted induction programs for directors. Directors often had experience as directors in the private sector and many are members of AICD. However, there was a perception that new directors had other training needs. These included the need to:

- understand the public sector;
- promote an understanding about the director’s roles and responsibilities in the public sector;
- understand the roles, responsibilities and duties of directors in a board which regulates professions; and
- ease directors into the job as director where they are new to the role.

A variety of innovative strategies had been adopted to address these needs.

³³ Nolan Committee, op. cit., p.55.

³⁴ AIMA, op. cit., p20.

Nurses' Registration Board

This Board has developed the following training strategies. It:

- has had the Crown Solicitor's Office develop a pilot education program on the roles and responsibilities of directors (usually referred to as members), especially for regulatory boards. This is being trialed and will draw to a close around May 1997.
- provides an "orientation day" together with a comprehensive package of material including legislation, code of conduct, a list of current issues in the field and details of administrative arrangements for the Board.

The Board of the Ambulance Service of NSW encourages directors to attend a course provided by a line agency on director's roles and responsibilities.

Home Care Service of NSW

This Board identified other needs of new members and developed strategies to meet these needs. These included:

- assisting new members to learn about one another in the interests of team cohesion. They provided new members with a "pen portrait" of other directors; and
- helping new directors understand the organisation. This Board introduced field visits to branches to meet staff and customers. Directors are encouraged to visit branches periodically; Branch Managers are aware of their responsibility should a director contact them to arrange a visit.

Better Practice in Training

Better practice indicates that directors should have more guidance and training.³⁵

Training in Practice

Skills were developed mainly through: briefings conducted by experts (59% of all boards); technical seminars (18%) and courses on roles and responsibilities (11%). Health boards and trusts (Group 1, 66%) and boards of GTEs and SOC's (Group 2, 78%) tended to utilise briefings relatively more often than university councils (Group 3, 44%) and most registration and marketing boards (Group 4, 49%).

³⁵ Nolan Committee, op., cit., p.27.

4. Board Performance

4.1 Introduction

This chapter examines three key aspects of corporate governance:

- monitoring organisational performance;
- managing compliance and risk; and
- managing stakeholders.

4.2 Monitoring Organisational Performance

Better Practice

A major function of corporate governance is monitoring and reviewing organisational performance. Hilmer³⁶ recommended that a board should:

- “ensure that corporate management is continuously and effectively striving for above-average performance, taking account of risk”;
- “clearly define what is meant by sustainable, above-average performance in its particular situation”;
- monitor performance in these defined terms; “the strength of the monitoring should reflect the strength of the board’s reasons for scrutinising performance of an issue, as well the importance of the issue to the corporation”;
- define their roles in goal setting and monitoring of:
 - appointment of the CEO and human resources issues;
 - strategy and policy;
 - budgeting and planning;
 - reporting to shareholders and regulatory compliance; and
 - ensuring regulatory effectiveness.

Monitoring in Practice

In the NSW public sector, in recent years there has been closer monitoring of organisational performance, especially financial performance. Boards of Government businesses, particularly SOCs, have more specific monitoring requirements compared with other types of organisations. The particular planning and monitoring tools and procedures developed for government businesses are known as the Statement of Financial Performance (SFP) for GTEs and the Statement of Corporate Intent (SCI) for SOCs. Not all GTEs provide SFPs. The SFPs are not reported in Parliament. Budgetary approval processes for other types of agencies are being reviewed to tie budgets to performance.

³⁶ Hilmer, op. cit., pp.71-73.

In addition, the introduction of program evaluation, Program Statements and recently, Service Efforts and Accomplishments (Office of the Council on the Cost of Government (OCCG)) are concerned with performance across all types of agencies.

The Audit Office survey asked boards whether they reviewed organisational performance against strategic objectives and whether they used key indicators to measure performance. The survey found that 65 per cent of boards did review organisational performance against strategic objectives of the organisation.³⁷ This was highest for GTEs and SOCs (Group 2, 88%) and health boards and trusts (Group 1, 78%). Half of boards in registration and marketing agencies (Group 4) reviewed the organisation's performance while only 41 per cent of university councils (Group 3) did so.

The survey also found that 80 per cent of boards had specified what information it would like from management on performance. The proportions were higher for GTEs and SOCs (Group 2, 91%) and health boards and trusts (Group 1, 88%) compared with most registration and marketing boards (Group 4, 63%). Fifty-nine per cent of boards used key performance indicators to judge performance. The proportion was much higher for GTEs and SOCs (Group 2, 84%).

4.3 Compliance and Risk Management

Compliance in Practice

In the private sector, compliance is dictated by legislation. For companies under *Corporations Law* there are detailed compliance requirements. Directors must ensure that procedures are in place for monitoring compliance. Part of the compliance function is supported by the Company Secretary (see Chapter Six).

Public sector legislation spells out certain compliance arrangements. However, in the absence of legislative or administration guidelines on compliance matters, how compliance is achieved and the quality of compliance processes can vary between agencies. Only 44 per cent of boards thought ensuring compliance was an important board function.

³⁷ Reviewing organisational performance does not mean that boards necessarily reviewed their own performance as a board (see Chapter Five).

**Risk
Management**

Two-thirds of boards indicated there were internal systems in place to provide performance information to the board and that these systems were independently and regularly reviewed by internal audit. This was much higher for health boards and trusts (Group 1) (84%) and GTEs and SOCs (Group 2) (81%) compared with university councils (Group 3) (53%) and registration and marketing boards (Group 4) (43%).

Where reviews were undertaken, they most often included financial information (97% of boards). Fewer boards (74%) reviewed non-financial information.

The Audit Office survey also asked boards how they allocated roles and responsibilities. Specifically they were asked whether they allocated them to individuals and whether they had established committees.

Roles and responsibilities had been allocated to individual board members in only 45 per cent of cases. In most registration and marketing boards (Group 4), 60 per cent had allocated roles and responsibilities to members, while only 28 per cent of boards in GTEs and SOCs (Group 2) had done so.

**Board
Committees**

Seventy-four per cent of the surveyed boards had committees. The most common committees were: audit, finance, remuneration and marketing.

Of those boards with committees, 27 per cent did not have any terms of reference or charters which clearly documented their authority and duties. Approximately half (52%) of these boards indicated that all of their committees had charters. Twenty per cent indicated that only some of their committees had charters.

The Ambulance Service of NSW illustrates the scope of committee charters.

The Ambulance Service of NSW

This is a statutory body with a Board comprising the Chief Executive Officer of the organisation and no fewer than six and not more than 11 directors.

At the time of interview, the Board had three key “governance” committees in addition to professional committees: a Corporate Governance Committee, an Audit Committee and a Finance Committee. Each of these committees had a Charter covering their composition, meetings, primary function, and duties the committee will perform to fulfil their function. These charters had been drafted in the context of a *Statement of Corporate Governance Principles*.

Audit committees

Forty-four per cent of boards had audit committees. Seventy-five per cent of GTEs and SOCs (Group 2) had an audit committee compared with less than 50 per cent of the other groups.

Half of the health boards and trusts (Group 1) had a finance committee compared with less than 35 per cent of the other groups. Thirty-eight per cent of GTEs and SOCs (Group 2) had a remuneration committee compared with less than 25 per cent of the other groups.

About 65 per cent of audit committees met less often than once every 2 months. Sixty-three per cent met for 2 hours. Almost all (92%) were attended by internal audit while 88 per cent were attended by a Chief Finance Officer. External audit attended in 68 per cent of cases.

Statement of Responsibility

The NSW Treasury has asked boards or CEOs to sign a “Statement of Responsibility”. This states, in part:

The Agency’s Board members, Chief Executive Officer, senior management and other employees have effected an internal control process designed to provide reasonable assurance regarding the achievement of the Agency’s objectives. The Internal Audit function conducts a program of review to assess these controls.

To the best of our knowledge this system of internal control has operated satisfactorily during this year.

Half of the boards in the survey were unsure as to whether they proposed signing the Statement. A further 24 per cent stated it was their intention to do so. Twenty per cent indicated it was not their intention to sign.

Half of GTEs and SOCs (Group 2) indicated they were proposing to sign the Statement compared to 13 to 22 per cent of boards in other groups.

4.4 Managing Stakeholders

Better Practice Better practice regarding board communication with stakeholders states that boards of public service bodies should “establish clear channels of communication with their stakeholders on the body’s roles, objectives and performance, and appropriate procedures to ensure that they operate effectively in practice”.³⁸

Managing Stakeholders in Practice An important indicator of the relationship between key stakeholders is the communication between them. The Audit Office survey examined the frequency of meetings between the Minister and Chair/Board/CEO as one element of this communication. (This question was not applicable to Group 3 since it consists of universities which have no direct Ministerial accountabilities.)

Overall, 70 per cent of surveyed boards (excluding universities and their subsidiaries, Group 3) provided a response. Of these, most contact was made with the Chair, either with or without the CEO (Table 4.1).

| | |
|---|-----|
| Minister met with Chair | 57% |
| Minister met with CEO | 43% |
| Minister met with Chair & CEO | 50% |
| Minister met with Board | 32% |
| Note: Responses are not mutually exclusive | |

Relatively more boards in the group consisting of GTEs and SOCs (Group 2) had contact between the Minister and the stakeholders, compared with the remaining groups (health boards and trusts, Group 1 and most registration and marketing boards, Group 4). This is illustrated in Figures 4.1 and 4.2.

³⁸ CIPFA, op. cit., p.22.

The Minister met with the Chair in 81 per cent of GTEs and SOCs (Group 2) compared with health boards and trusts (Group 1, 56%) and most registration and marketing boards (Group 4, 40%). The Minister met with the CEO in 63 per cent of GTEs and SOCs (Group 2) compared with health boards and trusts (Group 1, 44%) and most registration and marketing boards (Group 4, 29%).

Figure 4.1: Relationship between Minister and Chair, CEO

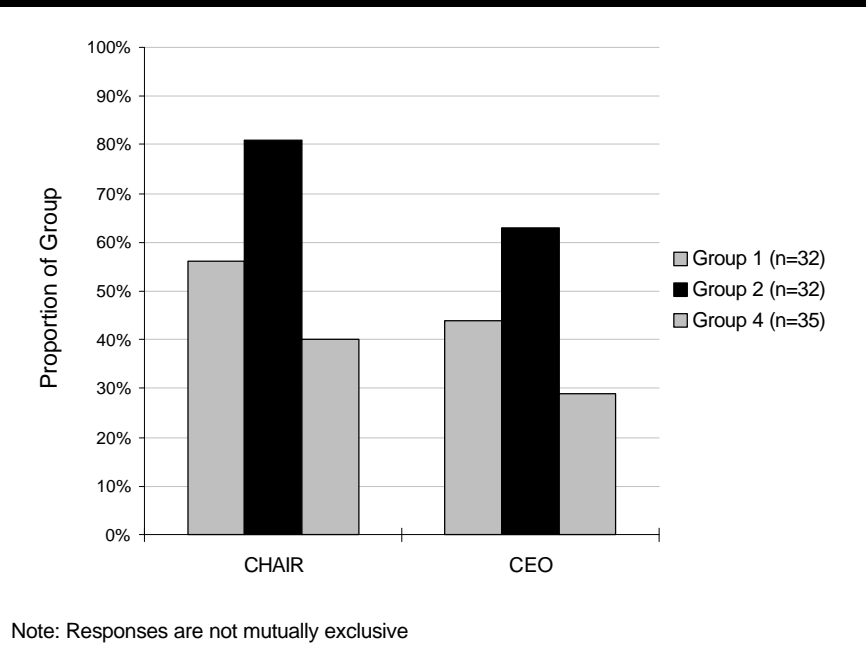
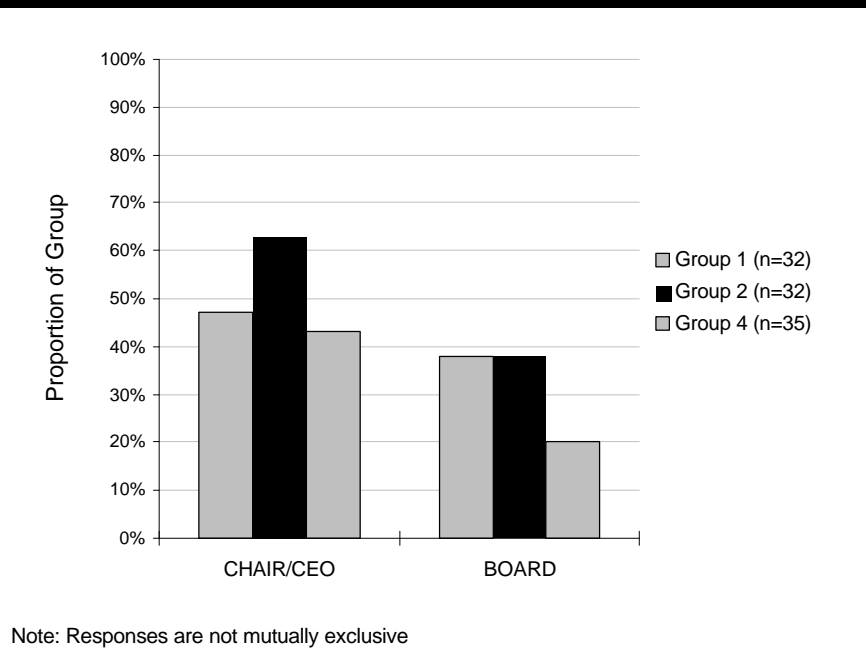


Figure 4.2: Relationship between Minister and Chair/CEO, Board

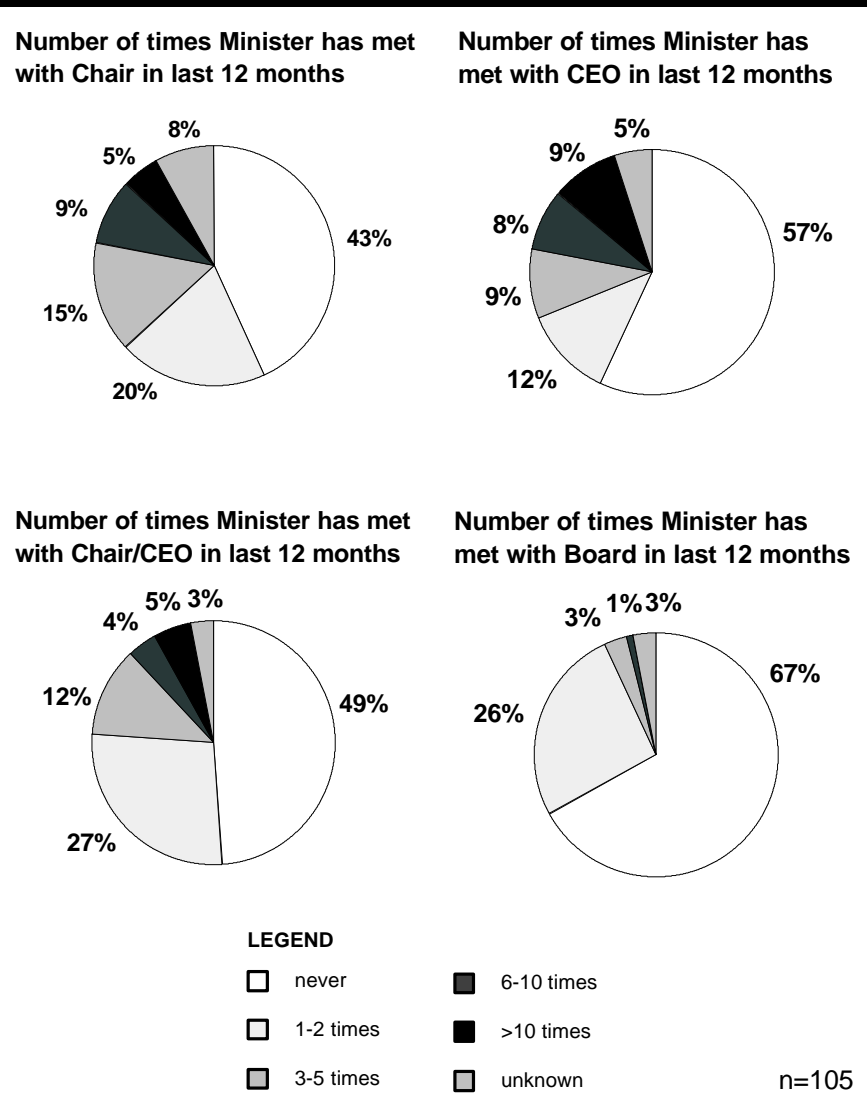


Similarly, the Minister met with both the Chair and CEO in 63 per cent of GTEs and SOCs (Group 2) compared with health boards and trusts (Group 1, 47%) and registration and marketing boards (Group 4, 43%). The degree of contact between the Minister and the board was relatively low for all groups. The Minister met with the board in 38 per cent of health boards and trusts (Group 1), 38 per cent of GTEs and SOCs (Group 2) and 20 per cent of registration boards and marketing boards (Group 4).

Frequency of contact

Where contact between the Minister and key stakeholders occurred, most contact was one or two times during the last 12 months (Figure 4.3).

Figure 4.3: Frequency of meetings between the Minister and key stakeholders



Minister Seeking Advice Eighty-seven per cent of boards (excluding universities, Group 3) indicated that the Minister sought advice from them on specific issues. The Minister never sought advice in eight per cent of cases. Five per cent of boards did not respond to this question.

The extent that the Minister sought advice ranged from: frequently (12%), occasionally (55%) to hardly ever (20%).

Ministerial Directions Ministerial Directions were provided to the board in 87 per cent of boards (excluding universities, Group 3). Directions were provided either: in writing (54%), verbally (7%) or a combination of both (26%).

Ministerial Directions were reported in the Annual Report by only 23 per cent of boards (excluding Group 3). Sixty per cent of cases did not report Ministerial Directions in the Annual Report (17% did not respond).

Ministerial Relationship The questionnaire contained an open-ended question whereby boards could suggest improvements to the relationship with their Minister. Only 57 per cent (excluding universities, Group 3) provided responses. Of these, 37 per cent indicated that they were satisfied with the relationship. Of the suggestions made by the remainder, the most common was to increase the frequency of meetings.

Liaison with Other Stakeholders The survey asked the boards to nominate the types of groups with whom they have regular contact. One quarter of boards stated that they had established no regular liaison with any party. The remainder had established liaison with staff (60%); clients (51%); unions (17%); major suppliers (14%); and constituents/ sponsors (12%).

A greater proportion of GTEs and SOCs (Group 2, 38%) had no regular liaison compared with health boards and trusts (Group 1, 13%), university councils (Group 3, 25%) and most registration and marketing boards (Group 4, 20%).

Health boards and trusts (Group 1) and university councils (Group 3) tended to have regular liaison with staff. Most registration and marketing boards tended to have regular liaison with clients. Boards of GTEs and SOCs met with both staff and clients equally.

The case study below reveals one of the most planned and comprehensive approaches to the management of stakeholders found in the field audit.

Hunter Water Corporation

Hunter Water Corporation was referred to above when examining relationships between boards and Ministers. This Board also has formulated a strategy to develop its relationship with other stakeholders.

The Board regards its relationship with other stakeholders, particularly the local community, as very important. It believes managing the “social contract” with the community is “an art” and that the private sector does not have the same social contract or obligation.

The Board believes it needs to interact with the community, to listen to their views and to gain support for their commercial objectives. The Board holds a quarterly Community Forum (involving representation of all major stakeholders) to provide a public update on Board activity.

Briefings are also given to Ministers and to local members of Parliament.

Information is provided to the community in other ways, such as the Board having a section of their monthly meetings open to the public and the media and having its performance regularly reported in the local newspaper.

In the case below, the physical location of the Board in one building together with other strategies, provide stakeholders with an accessible and flexible service.

Liquor Administration Board

This Board is readily accessible to stakeholders. All Board members are located within one building. This has a number of advantages:

- Board members are available to deal with matters as they arise;
- it makes it easier for the customers and the Board Secretary to communicate with the Board;
- it shortens response time, especially if the Board needs to meet at short notice; and
- the Board meets once a month but has weekly informal meetings.

Apart from being geographically accessible, the Board has adopted other strategies to improve liaison with and customer service to stakeholders. They have an open door policy and regularly meet with industry associations. In addition, each Board member has a delegation. An individual Board member can re-assess a matter quickly and can bring the matter to the full Board immediately and without formality if desired.

The case below is a typical example of the CEO rather than the board managing the public sector network.

Case M *(continued)*

In Case M the Board has statutory independence. However, the CEO meets monthly with the Minister. These meetings help identify and manage key issues. The Minister addresses the Board once a year.

5. Board Accountability

5.1 Introduction

This chapter discusses a number of aspects of decision-making which affect board efficiency, effectiveness and transparency. They are:

- preparation for board meetings (including distribution of the agenda and how the board receives information);
- how decisions at board meetings are made; and
- how decisions are reported.

The chapter then considers who is liable for decisions and actions and how boards set standards for behaviour. Finally, it examines issues regarding the reporting of agency and board performance, whether boards assess their own performance and whether they report their governance practices publicly.

5.2 Board Meetings Preparation

Two issues are important in regard to the preparation for meetings and for decision-making generally. The first relates to the preparation of agendas. The second is a broader issue about how board members obtain access to information.

The Agenda

Better practice suggests that the board be given:³⁹

- agendas and board papers in advance of meetings;
- adequate notice of meetings; and
- access to board papers and materials.

The Audit Office survey sought detailed information about the circulation of agenda papers, the number of agenda items for meetings and the extent of carry over of items.

The questionnaire asked how long before a meeting (in days) agenda papers were distributed to members. Fifty per cent of the boards distributed their agenda papers four or five days before a scheduled meeting. Thirty-five per cent of boards distributed their papers more than five days before a meeting, while 15 per cent distributed their papers less than four days before a meeting.

³⁹ Hong Kong Code cited by H. Bosch, *Corporate Practices and Conduct*, Pittman, Sydney, 1995, p.27.

More GTE and SOC boards (Group 2, 72%) distributed agenda papers no more than five days before a meeting. This was relatively more than health boards and trusts (Group 1, 53%), universities (Group 3, 31%) and most registration and marketing boards (Group 4, 43%).

Accordingly, more university councils (Group 3, 56%) and boards of most registration and marketing agencies (Group 4, 49%) distributed agenda papers more than five days before a scheduled meeting compared with GTEs and SOCs (Group 2, 13%). (The figure for health boards and trusts, Group 1, was 22%.)

It is important, to note, however, that GTE and SOC boards (Group 2) met more often than boards in other groups. This may account for the shorter time for distribution of their papers.

5.3 The Board Meeting

Attendance Attendance at board meetings was generally high. In 35 per cent of the boards, about 90 per cent of members attended meetings. In about half of the boards, all members typically attended meetings.

Frequency Most boards met once per month (62%) or once every two months (19%). Boards of GTEs and SOCs (Group 2) tended to meet monthly for half a day (63%). Health boards and trusts (Group 1) tended to meet monthly for: 2 hours (13%), 3 hours (31%) and half a day (16%). Boards of most registration and marketing agencies (Group 4) tended to meet monthly for: 2 hours (14%), 3 hours (34%) and half a day (17%).

University councils (Group 3) conducted meetings relatively infrequently. Thirteen per cent met every 2 months for 2 hours; 16 per cent met every 2 months for 3 hours, and 34 per cent met “less frequently”.

One of the criticisms of board agenda papers is that there are a large number of agenda items and board papers are large. As a consequence, it is considered that the board cannot possibly absorb the information and cannot make informed decisions.

The field audit did find instances where board papers were extremely bulky. This tended to happen in regulatory boards where all of the information on cases was presented to directors. In one case (not a regulatory board) the board needed to consider the history of a particular agenda item. This required 11 volumes.

Case F

Case F is a regulatory body which considers compensation matters. Its agendas are, on average, 400 pages. The Board meets for 3 hours every month. The CEO believes the length of Board meetings allows little time for important decision making and the extent and the detail and complexity of items means that there is difficulty in reaching consensus.

In contrast, the field audit found “better practice” examples of boards managing agenda items and papers to assist a board in identifying and understanding the most significant issues. Some boards used techniques such as highlighting new items on agenda papers to draw directors’ attention to the fact that new matters were being raised.

Case S

Case S is a GTE whose Board was disbanded during the period of the audit. In order to increase efficient management of Board meetings, the Chair imposed a strict regime for Board meeting logistics. The Secretary of the Board would produce a proposed agenda ten days before a scheduled meeting. Once the Chair authorised the agenda, the Secretary would prepare and distribute agenda papers one week before the meeting. Each agenda item was supported by a paper (summaries only, not full reports) which stated the purpose, issue, options and recommendations. This approach meant the paper was focused, meetings were efficient and effective and subsequently facilitated the writing of minutes. The Managing Director provided a five to six page report based on the Corporate Plan’s Key Result Areas and reported against set performance measures. Detailed papers on all items were available from the Secretary if directors wished to investigate matters further.

Carrying Items Forward

Most of the boards (85%) carried over up to three agenda items to another meeting. Only 10 per cent carried over more than three items to another meeting.

There are varying views about the carry over of agenda items. On the one hand, carry over may indicate that the board has too many items with which to deal. On the other, some boards visited in the field audit indicated they deliberately left items on the agenda till matters were fully resolved.

5.4 Providing Information

Better Practice Better practice guidelines⁴⁰ indicate that a board should be entitled to obtain:

- independent professional or other advice at the cost of the organisation; and
- any other resources and information they need.

Providing Information in Practice The Audit Office survey found that most boards (80%) receive information through CEOs while half receive information from unit heads. One-third receive information from other sources.

Although the vast majority of boards (82%) receive presentations on regular business activity, two-thirds also receive presentations on an exception basis focussing on a particular issue. Almost half of the boards receive presentations in regard to less regular business activity.

More GTEs and SOCs (Group 2, 84%) receive exception reports compared with other groups.

The field audit revealed that the matter of directors' access to staff for information is a point of contention. If the "rules" on access to staff and information provided by staff, are clear and accepted, then the matter is likely to be less contentious. Some case studies are provided here to illustrate the different ways in which boards have managed this issue.

⁴⁰ AIMA, op. cit., p.5.

Case F *(continued)*

The question of directors' access to staff has been a contentious one for this Board. In a previous Board, a director was unhappy about information being provided to the Board and felt the Chair was withholding information. The director approached staff directly requesting information. Staff felt the requests became too time consuming. Still unhappy, the director approached the Minister. Board operations were suspended for nine months. This complaint by the director, together with other matters regarding a conflict of interest, ultimately led to the Chair being sacked.

In the present Board, directors are not free to talk to staff in order to inform themselves on particular issues. This is subject to the Chair's approval. In the opinion of the CEO, guidelines on directors' access to staff still need clarification

Case M *(continued)*

There has also been some concern over the interaction between directors and staff in this Board. Staff used to attend Board meetings. A previous Chair began excluding staff from meetings. This policy is now endorsed because it is felt staff cannot disengage themselves from their "public servant" role. That is, staff may leak information to the media when they feel strongly about particular issues.

The Board has improved communication to staff by issuing a bulletin by the CEO on Board decisions. Staff are aware of the rules concerning Board/ staff interaction and are discouraged from "lobbying" directors when there is informal interaction or when directors approach staff for information.

Hunter Water Corporation *(continued)*

This SOC has a section of every Board meeting open to the public and the media. As part of its efforts to use meetings to promote accountability and openness, the Board has senior executives provide briefings to the Board. The Board regards this as a good management tool to provide “practice” for the senior executives.

The Board also expects that management will bring issues forward to the Board.

Sydney Water Corporation

This is a SOC where the Board is very active in governance. The directors are active in making field visits in groups and making sure they are fully informed on issues. Interaction is open and frank. “Rules” regarding director's access to staff and information are clear.

5.5 Decision-Making**Better Practice**

A major issue in governance is transparency of decision-making. Better practice indicates that boards should:

- vote on all material issues;⁴¹
- establish formal procedures to govern the conduct of its business;⁴² and
- ensure that minutes of meetings accurately record decisions taken, and where appropriate, the views of individual board members.⁴³

Boards in the private sector tend to formalise their decision-making through voting. Much of the better practice literature assumes this to be the case and extends guidelines to cover matters such as proxy voting.

⁴¹ AIMA, op. cit., p.12.

⁴² CIPFA, op. cit., p.50.

⁴³ CIPFA, op. cit., p.29.

Decision Making in Practice The Audit Office survey found that boards finalised their decisions by consensus (77%) or by formal vote (21%). Health boards and trusts (Group 1) and GTEs and SOCs (Group 2) finalised their decisions mainly by using consensus (at least 80%). University councils (Group 3) and most registration and marketing boards (Group 4) finalised their decisions by formal vote (about 30%) relatively more often than health boards and trusts (Group 1, 19%) and GTEs and SOCs (Group 2, 6%).

Although most boards did not raise the issue of whether decision-making processes should try and achieve consensus, one Chair felt that consensus leads to “compromise”, which was not always the best outcome.

The survey also found that minutes of board meetings showed the basis for decision-making usually/always (74%), sometimes (19%) and seldom (7%).

Dissent on an agenda item was recorded in the minutes by most (61%) boards.

For those boards that recorded dissent in board meeting minutes, 58 per cent had not had an instance of dissent during the past year. Thirty-one per cent of such boards had only recorded one or two instances of dissent during the past year.

Distribution of Minutes Minutes were distributed to the executive management either in full (77%) or the relevant extracts only (15%). Health boards and trusts, university councils and most registration and marketing boards (Groups 1, 3, and 4) tended to distribute the full board meeting minutes (at least 75% of cases) to executive management. Thirty-eight per cent of GTEs and SOCs (Group 2) distributed only relevant extracts.

5.6 Standards of Behaviour

Better Practice There is a wealth of literature regarding the values and standards of behaviour that boards should adopt. Essentially, they cover codes of conduct and conflicts of interest, especially pecuniary interest and fraud control.

In relation to these matters, the better practice literature specifies that boards should:

- “develop a formal code of conduct defining the standards of personal behaviour to which individual board members and all employees of the body should be requested to subscribe”;⁴⁴
- directors must act in the interests of the company as a whole;⁴⁵ and
- full disclosure of a conflict or a potential conflict must be made to the board.⁴⁶

Standards in Practice

The Audit Office survey found that over half of the boards (53%) did not have a register of conflicts of interest. This applied to 31 per cent of GTEs and SOCs (Group 2) through to 71 per cent of most registration and marketing boards (Group 4).

Sixty-one per cent of boards did not have a code of ethics adopted and endorsed by the board. This was highest for university councils (Group 3, 72%) with GTEs and SOCs (Group 2, 66%), most registration and marketing boards (Group 4, 51%) and health boards and trusts (Group 1, 50%).

Boards were asked if a conflict of any kind had arisen for a member, or members, whether the board has consistently restricted the member’s access to discussions or papers. Half of the sample believed there had been no conflict of interest, including just over half of health boards and trusts (Group 1), university councils (Group 3) and most registration and marketing boards (Group 4). By contrast, only one third of the GTEs and SOCs (Group 2) felt there had been no conflict of interest. Of the remaining 21 of this group, 16 boards had restricted access to discussion or papers and 5 had not done so.

Of the 66 boards where a conflict had arisen, half had experienced the conflict on one or two occasions. One-fifth had experienced this conflict more than twice.

Sixty-one per cent of boards did not have any formal procedures for disclosures of transactions with firms in which directors have an interest. The respective figures were 77 per cent for most registration and marketing boards (Group 4), 63 per cent for university councils (Group 3), 56 per cent for health boards and trusts (Group 1) and 50 per cent for GTEs and SOCs (Group 2).

⁴⁴ CIPFA, *op. cit.*, p.40.

⁴⁵ CIPFA, *loc. cit.*

⁴⁶ Bosch, *op. cit.*, p.44.

For the 37 per cent of boards that did have formal procedures, most (86%, 44) had some method of disclosure, but 14 per cent did not.

More university councils (Group 3, 75%) used the annual report for disclosure compared with 25 per cent of GTEs and SOCs (Group 2), 17 per cent of most registration and marketing boards (Group 4) and 14 per cent of health boards and trusts (Group 1). More of the GTEs and SOCs (38%) tended to use board minutes compared with health boards and trusts (Group 1) (21%).

Two-thirds of boards had not endorsed a fraud control strategy. Seventy-five per cent of university councils (Group 3) and 69 per cent of most registration and marketing boards (Group 4) had not done so compared with 56 per cent of health boards and trusts (Group 1) and 53 per cent of GTEs and SOCs (Group 2).

The degree to which legislation deals with standards varies considerably. Some pieces of legislation do not deal with the issue at all, others give it brief treatment and others are very detailed. According to Parliamentary Counsel, this situation simply reflects the era in which legislation was drafted.⁴⁷

Problems can arise when there are no formal rules and procedures for dealing with conflicts of interest as Case F illustrates.

Case F *(continued)*

The Chair of this board was also a Chair of another Board. That Board had a claim for compensation before the regulatory board. The Chair refused to absent himself from Board meetings when the matter was being discussed. Eventually, the Chair was removed from Board meetings so that the matter could be resolved. This conflict of interest was one factor in the Minister finally dismissing the Chair.

A number of “better practice” examples for managing code of conduct and conflict of interest issues were identified in the field audit.

⁴⁷ Field visit by The Audit Office to Parliamentary Counsel.

University of NSW

While the University Council as yet has no register for conflicts of interest, it has a code of conduct and strict procedures for dealing with the issue. For this Council, the first item of business in meetings is the issue of pecuniary interests. If a Council member has a real or perceived conflict of interest, he/ she must declare it at that point. They are then expected to withdraw from the meeting, at least while the agenda item is being discussed.

The organisation is also to issue guidelines covering potential conflict of interest that may arise in staff employing direct family members, or individuals they are in a same sex relationship with.

Hunter Water Corporation *(continued)*

This Board, which has a code of ethics, has a three pronged approach to dealing with conflicts of interest:

- Board members do not receive the relevant section of the Board papers;
- the conflict of interest of the director is noted in Board papers; and
- the director leaves the meeting when the issue in which they have a conflict of interest is being discussed.

Prior to sending Board papers out, the Chair and CEO discuss any matters where there could be a conflict of interest. In deciding to eliminate the matter from a director's Board papers, they "err" on the side of caution, especially if there is likely to be a commercial advantage to the individual director concerned.

Harness Racing NSW

This Board has an extensive code of conduct for Board members. It covers matters such as: directors' duties; best interest of the Board; conflicts of interests; notification of suspected corrupt conduct; dissent; needs of members; confidentiality of information; the Board's role; and improper or undue influence. This code was developed with the assistance of the Independent Commission Against Corruption. It is published, along with a separate code of conduct for staff, in the Annual Report.

Motor Accidents Authority of New South Wales

This organisation has a role in the licensing and control of insurers. Certain decisions (such as the granting of licences to conduct business and the imposing of conditions on licences) can only be made by the Board of the organisation.

Where an issue before the Board involves a specific licensed insurer, Directors who are nominated by or have a direct relationship with an insurance company leave the meeting. The remaining directors constitute a quorum to deal with the business.

5.7 Liability

Who Takes the Risk?

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

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

The NSW Treasurer’s Directions⁴⁸ indicate that the CEO of an authority is responsible for risk management and insurance arrangements. All Budget Sector agencies are obliged to have insurance with the Treasury Managed Fund. Non Budget agencies can participate in the Fund or make other arrangements (this includes GTEs). Non Budget agencies funded indirectly from Consolidated Revenue are deemed to be Budget Sector for insurance purposes. The Treasury Managed Fund insurance covers officers’ and directors’ liabilities and there are no gaps.

⁴⁸ NSW Treasury “General Directions” 900.01, 900.02, 900.03.

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

...There is an inherent tension between Ministerial responsibility and commercial independence. ...if Ministers are to take responsibility for failure then they should have and ultimately will have direct control. If the nature of the business is such that it actually increases the risk by the Minister taking direct control, the business must be disposed of and entirely separated from the public sector.⁴⁹

Nor does the adoption of commercial principles in an authority such as a GTE necessarily increase the personal exposure or risk.⁵⁰ In the opinion of the NSW Assistant Crown Solicitor, most public sector agencies (that is organisations other than SOCs), would not be defined as "companies" or "corporations" under the provisions of *Corporations Law*. They constitute "exempt public

Statutory authorities derive their existence directly from statute, and in most cases are declared to represent the Crown. These authorities usually have no provision to be wound up. Therefore any financial difficulties will become a problem for the State. "Short of some forms of misfeasance, its members will not normally be called on to contribute anything, though mismanagement may lead to dismissal".⁵¹

Most statutory authorities and boards are subject to the "control and direction" of the Minister. Where "such a direction results in tortious action of the corporation, the Crown may be liable as a principal and the corporation viewed as an agent".⁵²

⁴⁹ B. Selway, "Will Private Sector Ways Lead to Better Government?" - *Legal Issues Arising From Government Roles in Business*, paper presented at RIPPA Conference, Ramada Grand Hotel, November, 1994, p.5.

⁵⁰ G. Ross, "Exposures", paper presented to NMEC Conference, 1992, p.1.

⁵¹ Ross, *ibid.*, p.5.

⁵² Ross, *ibid.*, p.3.

In reviewing the issue of liability, the Assistant Crown Solicitor has observed that governments (at the time of writing, 1992) had not been sued for damages because of negligence of its officers. He notes that legislation typically provides for removal from office of an officer or board member for incapacity, misbehaviour or incompetence.⁵³

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

- a fiduciary duty to act in a way to advance the public purpose for which the body was established; and
- the duty to use reasonable care in the conduct of the organisation's affairs.⁵⁴

Despite this perspective, boards are unsure of their liabilities and are uncertain about where to go to seek assistance. This results in two costs to the organisation. First, some boards seek the advice of local solicitors (who may or may not be experienced in public sector matters) while others seek the expensive advice of larger firms.

Second, because boards are simply unsure of whether their directors are liable for their decisions and actions, most boards visited by The Audit Office had taken out insurance for their directors.

In the absence of clear legislative and Government policy direction on the issue of indemnity, a number of boards of statutory authorities, GTEs and statutory SOCs have sought legal advice from private solicitors and/or have taken out insurance. In a number of cases, insurance premiums are paid for by the organisations concerned.

The Audit Office survey found that fifty-six per cent of all boards had personal liability of board members limited by legislation while 42 per cent did not. Limited personal liability occurred more frequently in most registration and marketing boards (Group 4, 80%) and health boards and trusts (Group 1, 63%) compared with university councils and GTEs and SOCs (Groups 3 and 2, 41%).

⁵³ Ross, *ibid.*, p.2.

⁵⁴ Ross, *loc. cit.*

Where personal liability was not limited by legislation (57 boards), 46 (81%) had taken out insurance to limit the personal liability of board members. This had occurred in 80-90 per cent of boards in GTEs and SOCs, university councils and most registration and marketing boards (Groups 2, 3 and 4) but only 60 per cent of boards in health boards and trusts (Group 1).

As a result of this confusion, The Audit Office case studies found that there are inconsistencies in approach between similar types of agencies in regard to liability and insurance cover:

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

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

More difficult liability questions arise in the case of SOCs and companies governed totally by *Corporations Law*.⁵⁵ According to the Assistant Crown Solicitor, the wording of legislation such as that relating to the environment and occupational health and safety, imposes duties on individuals as well as binding “the

⁵⁵ Ross, op. cit., p.1.

At the same time, the field audit found that:

- Statutory SOCs have recently been given permission (shareholder approval) to provide indemnity for their directors (that is, the SOC takes the risk and needs to insure its directors); and
- the companies believe they have Crown protection as long as they act “in good faith”.

The AICD⁵⁶ listed the following aspects of liability which ought to be clear for directors of public sector boards, that is, whether:

- the liability is specified in *enabling* legislation;
- there is the benefit of Government indemnity and the degree of legal representation;
- indemnity provisions specify certain exclusions or conditions;
- there is provision for payment of the premium and whether insurance covers defence costs;
- personal Directors’ and Officers’ insurance covers individual board members in cases where insurance is not provided;
- there are environmental liabilities which cannot be underwritten or avoided at a personal level;
- “no regrets” policy applies;
- a continuous declaration of private interests is required;
- special risks are addressed (for example, ICAC); and
- copies of relevant documents on liability are available.

5.8 Reporting

In order to demonstrate proper accountability for the stewardship of public money, boards need to establish effective reporting and control arrangements.

The following section examines accountability on a broader level, that is whether boards assess and report on their own performance as opposed to assessing and reporting on their organisation’s performance. It also examines whether boards publicly report their corporate governance practices.

The Audit Office survey found that boards tend to report on organisational performance rather than their own performance.

⁵⁶ AICD, op. cit., p.4.

Better practice states that “boards should publish on a timely basis an annual report presenting an objective, balanced and understandable account and assessment of the body’s activities and achievements, and of its financial position and performance”.⁵⁷

In the NSW public sector there are clear requirements for reporting of most organisations. These arrangements are determined by the *Annual Reports Act*, the *Public Finance and Audit Act 1983* and the *Public Authorities (Financial Arrangements) Act 1987*. Reporting by SOCs is also determined by the *SOC Amendment Act 1995*. This specifies an extensive range of items which must be reported upon.

Agencies are also required to provide a range of financial reports to the Treasury, although these are not made public. A greater degree of detail and more frequent reporting is required for Government businesses.

There is concern that reporting of the activities of subsidiaries may not be as public and “may become removed from the usual Parliamentary scrutiny and the accountability process”.⁵⁸ Premier’s Memorandum 91-2 sets out Guidelines for the formation and operation of subsidiary companies by departments and statutory authorities. These include an instruction that subsidiary companies are not to take the form of exempt proprietary companies, companies limited by guarantee or incorporated by association. The reason given was that these types of entities have limited reporting requirements and are “unsuitable for the public sector”.

The Premier’s Memorandum also indicates that “it is anticipated that it will not be necessary for Budget Sector organisations to establish subsidiaries”.

The audit found two instances where Budget Sector organisations had established companies. There were more instances identified in the survey. In one case in the field audit it was a company limited by guarantee, in the other a company limited by shares. Neither reports publicly.

⁵⁷ CIPFA, op. cit., p.32.

⁵⁸ NSW Premier’s Department (1991) Memorandum 91-2 “Guidelines for the Formation and Operation of Subsidiary Companies by Departments and Statutory Authorities”.

The literature on better practice recommends that boards should assess and report on their own performance. Specifically, it is suggested that:

- “non-executive directors should meet on their own at least once annually to review the performance of the board” (as well as the organisation and management);⁵⁹
- “there be a regular and independent review of the performance⁶⁰
- boards of public sector bodies should include in their annual report a statement confirming that they have complied with relevant standards or codes of corporate governance”;⁶¹ and
- “such ‘compliance statements’ should normally be reviewed by the external auditors”.⁶²

The Audit Office survey found that 31 per cent of boards did not have any formal arrangement to review their own performance. This was highest for university councils (Group 3, 50%) and most registration and marketing boards (Group 4, 46%) but much lower for health boards and trusts (Group 1, 19%) and GTEs and SOCs (Group 2, 9%).

Thirty-four per cent only reviewed the organisation’s performance against strategic objectives. The remainder (35%) reviewed board performance (most of these also reviewed the organisation’s performance).

Where boards did evaluate their performance, it most often took the form of evaluating relationships with stakeholders (37%) and reviewing the effectiveness of the board as a team (16%).

This lack of self-assessment of the board’s performance was confirmed in the field visits.

Sixty-six per cent of boards did not have some form of performance agreement with the Minister. The figures were higher for health boards and trusts (Group 1, 75%) and most registration and marketing boards (Group 4, 71%) but much lower for GTEs and SOCs (Group 2, 28%). A further 10 per cent (all of the universities) felt the issue was inapplicable to them.

⁵⁹ AIMA, op. cit., p.20.

⁶⁰ AIMA, op.cit., p.33.

⁶¹ CIPFA, op. cit., p. 33.

⁶² CIPFA, loc. cit.

Where agreements were in place, they took the following forms (Table 5.1):

Table 5.1: Forms of Performance Agreements”

| Form of Agreement | Number of Boards |
|---|------------------|
| Minister formally assesses board’s achievements against targets | 10 |
| Agreement similar to CEO Agreement | 9 |
| Annual Report/ Performance Report | 7 |
| Other | 17 |

Three boards visited in the field audit had performance agreements with their Minister outside of “normal” agreements contained in SFP for GTEs and SCI for SOCs. The most systematic approach to the management of stakeholder expectations and to accountability was found at Hunter Water Corporation.

Hunter Water Corporation *(continued)*

In addition to the normal agreements, Hunter Water Corporation has developed agreements with other agencies whose policies affect their commercial viability, and with their Minister.

The Board has a five year agreement with regulatory bodies. Part of the agreement with one body has allowed for a series of studies to be undertaken on certain issues. This has allowed the Board to function and helps Ministers understand the direction certain issues are taking.

The Board has also developed a Memorandum of Understanding which defines the relationships of key stakeholders. It describes the roles of the Minister, CEO and the Board. It defines who will do what and how reporting will be undertaken.

There are quarterly meetings with the Portfolio (Regulating) Minister (Operating Licence) to review the agenda, assess how the regulatory model is working and to determine compliance against the model.

**Reporting
Corporate
Governance
Practices in
Practice**

The majority of boards (83%) report some form of corporate governance practices in the Annual Report although there is considerable variation as to the type of practices reported. The most common practices reported were: role and composition of committees (65%); remuneration details of directors (47%); ethical practices and standards (42%); and operation of internal control (33%).

⁶³ AIMA, op. cit., p.15.

⁶⁴ CIPFA, op. cit., p.16.

6. Achieving Efficiency and Effectiveness

6.1 Introduction

This chapter examines factors which affect the efficiency and effectiveness of boards. These issues were raised in the field audit. They include:

- recognition of corporate governance as an issue;
- recognition of the scope of corporate governance;
- establishing written rules and procedures;
- having a Chair who promotes better practice;
- having support for the board (role of Company Secretary); and
- having boards of an appropriate size (where committee work can be undertaken without overloading directors).

6.2 Recognising Corporate Governance

Most boards, whether or not they are “governing” in the strictest sense of the term, recognise the importance of corporate governance in the public sector. Two boards visited placed such importance on the issue that they had established a “corporate governance committee”. They believed that having these committees help sharpen the focus on, and assists in clarifying, what constitutes governance issues.

Hunter Water Corporation *(continued)*

Hunter Water Corporation has a Corporate Governance Committee which is concerned with “bigger” issues. These include environmental, commercial and probity matters. This Committee also oversees the work of other committees, including the Audit Committee and acts as a quality control mechanism.

The Ambulance Service of NSW *(continued)*

This board has all of its directors sitting on the Corporate Governance Committee. The primary function of the Committee is to “ensure that there are in place appropriate arrangements to support the Board in the fulfilment of its functions, and that the statutory functions of ... are being effectively and efficiently performed”.



Its Charter covers issues such as:

- corporate planning and monitoring;
- education and training;
- public awareness;
- customer service;
- information technology use;
- occupational health and safety;
- compliance with statutory delegations and regulations;
- quality assessment;
- code of conduct and ethics; and
- review of the effectiveness of the Board.

The Scope of Corporate Governance

While many boards visited in the field audit had addressed particular aspects of governance, few had identified and dealt with the full spectrum of governance issues. One particular board stands out in this regard and has been referred to throughout this report. Its features are summarised below.

Hunter Water Corporation *(continued)*

Hunter Water Corporation has developed a package of strategies to “manage” governance issues. These include:

- taking an active role in helping develop its *enabling* legislation. This meant that governance issues were more rigorously dealt with than might otherwise be the case;
- developing a Memorandum of Understanding between the Minister, the Chair and the CEO to clarify roles, responsibilities and expectations;
- forming agreements with key stakeholders who can affect their commercial viabilities;
- developing ways to listen and respond to the local community;
- managing relationships with Parliamentarians;
- having an “open door” policy in regard to public access to a segment of the monthly Board meetings;
- adopting explicit and comprehensive procedures for dealing with conflicts of interest;
- ensuring Board members are fully informed and regarding Board meetings as a way of training staff to present information and ideas to the Board ; and
- having a procedure for planning Board strategy and reviewing their performance.

The Role of Chair

Most of those interviewed in the field audit emphasised the role of Chair as being critical to the effective and efficient working of the board. The Chair's role is to:

- provide leadership to the board and develop the board as a cohesive team;
- ensure key and appropriate issues are discussed by the board;
- arrange for adequate support to the board;
- ensure that the board takes proper account of its statutory and other requirements; and
- arrange for the board to meet at regular intervals and that minutes are accurately recorded.

Written Rules and Procedures

Having written rules and operational procedures serves to clarify expectations of the board and provides a yardstick against which to measure board performance.

It is evident from the case studies that not having written rules and operational procedures can at best lead to confusion. At worst there can be lack of accountability for actions and possibly fraudulent activity that may go unnoticed for some time if there is no Ministerial or public scrutiny. Broken Hill Water Board is an example of better practice.

Broken Hill Water Board

Broken Hill Water Board has drafted its own extensive procedures and standing orders for the operation of the board. They have been developed as part of their quality assurance program. The procedures include information on:

- the Board's constitution, purpose, charter;
- induction materials;
- roles, responsibilities and activities of key stakeholders;
- reporting;
- standards;
- responsibilities of the Board to key stakeholders;
- processes, methods and responsibilities of the Board for the management of the organisation ;
- processes, methods and responsibilities of managers for reporting to the Board; and
- record keeping.

The Standing Orders deal with how the Board functions, for example, how meetings will be conducted.

The Need for Support for the Board

The field audit revealed that boards found the role of the Company Secretary invaluable. This role can take various forms. Organisations under *Corporations Law* are required to have a Company Secretary. The audit also revealed that statutory regulatory bodies usually have a “Company Secretary” or an equivalent position.

The role and function of the Company Secretary specified in *Corporations Law* include the requirements to:

- lodge statutory returns;
- lodge financial statements;
- keep registers up to date;
- ensure proper procedures are followed; and
- ensure the board is fully informed and that they are able to act as directors.

In concept then, boards require more support than simply preparing board papers, which is time consuming in itself. While the scope of the role of Board Secretary may be different for different types of boards, the role is regarded as critical to efficient and effective board functioning. As CIPFA explain:

senior executive, whether a member of the board or not, should be made responsible to the board for ensuring that board procedures are followed and that all applicable statutes and regulations, and other relevant statements of best practice are complied with.⁶⁵

The Audit Office survey found that various staff members acted as Board Secretary. In half the surveyed boards, a member of management acted as Secretary.

More boards in GTEs and SOCs (Group 2, 69%) had a member of management as the Secretary compared with boards in other groups. While members of management still played this role in these other groups, more boards had clerical staff perform this function.

⁶⁵ CIPFA, op. cit., pp.30-31.

Board Size

NSW Government policy has been to reduce board size. The Premier in his policy statement “Labor’s Public Administration Reforms”⁶⁶ noted that boards will generally be limited to seven members.

The Audit Office survey found that 57 per cent of boards had between seven and 12 members. Twenty-eight per cent of boards had less than seven members while 14 per cent had more than 12 members.

In some instances, having a small board led to difficulties of insufficient numbers to form all the sub-committees required. This was particularly the case for regulatory boards where certain duties had to be performed, under legislation. Having only a small pool of people from which to draw meant that board members were experiencing “burnout”. In some instances where this problem has been experienced, board size is being increased.

⁶⁶ Carr, op. cit., p.8.

7. Attachments

7.1 Estimated Fees Paid to Director of NSW Public Sector Boards, 1996

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

Note:

- (1) Calculated on the basis of seven sitting times per year. The total sitting fees could range from approximately \$12,752,524 (assuming four sitting times per year) to \$13,513,960 (assuming ten sitting times per year).
- (2) 299 boards have indicated remuneration (17 have both annual and sitting); 304 boards have indicated no remuneration (includes 1 SOC and 1 GTE)

Source: Premier's Department Database.

7.2 Criteria for Audit

| Criteria for Evaluation | Methodology | Findings |
|---|--|--|
| Legislation, policies, structures and conventions should support “best practice” | Analysis of legislation Field Audit | Legislation, policies, conventions do not support best practice in terms of board formation and operations |
| <i>Sub Criteria</i> | | |
| Government and Ministers should determine the value to be added by having a governance arrangement utilising a board | Analysis of Government policy documents Field Audit | Issue of whether board there to provide expertise, represent sectional interests or represent shareholders (government) needs to be resolved Issue of extent to which board can or should be at “arm’s length” also needs resolution |
| <i>Supporting</i> and / or <i>enabling</i> legislation should clearly define roles, responsibilities and relationships of key stakeholders | Analysis of <i>supporting</i> legislation (eg SOC Act), <i>enabling</i> legislation of case studies Review of central agency policies, guidelines Field audit interviews | <i>supporting</i> legislation unclear re: roles, accountabilities and responsibilities of key players considerable variation in <i>enabling</i> legislation re: roles, accountabilities and responsibilities of like entities and lack of clarity re: roles and responsibilities of key players Structures do not allow for responsibilities to be clearly attributable to key stakeholders |
| Government and Ministers should provide boards with written guidance setting out how legislation, policies, administrative arrangements and conventions affect the board’s decision-making ability | evaluation of available written material from central agencies | some material available for GTEs and SOCs - in disparate and complex documents no “ready” guide available no guides for state. authorities, trusts etc |
| Legislation, policies, administrative arrangements and conventions which affect the board’s decision-making should be consistent with each other and with best practice and should provide adequate guidance on governance issues | evaluation of legislation and written material from central agencies | often inconsistent inconsistent with best practice little guidance on “best practice” |
| Ministers should establish measures of performance for boards | Analysis of survey results Field Audit | Performance measurement focuses on organisational rather than board performance |
| Ministers should communicate to boards and ensure they understand the nature and extent of authority delegated to a board | Analysis of comments on survey returns Field Audit | Extent of board authority and autonomy not clear nor consistent across like agencies |

| Criteria for Evaluation | Methodology | Findings |
|---|--|--|
| Boards and management should understand their roles, responsibilities and duties and these should be clearly articulated in legislation | Analysis of survey results Analysis of legislation Field Audit | Some boards confused as to what type of entity they are Boards confused about their roles and relationships with other stakeholders Variation in the extent to which boards seek to resolve such confusion |
| <i>Sub Criteria</i> | | |
| Boards should clarify and interpret their corporate mandate to provide effective strategic direction | Analysis of survey results Field Audit | Boards often “rubber stamp”, ratify CEO decision, or provide effective liaison with other stakeholders rather than provide strategic direction to organisation as such |
| Training and orientation programs should be provided to all board members | Analysis of survey results Field Audit | Nature and extent of training and orientation variable Need for specific training re: public sector governance framework and issues |

| Criteria for Evaluation | Methodology | Findings |
|---|--|--|
| The board should be comprised of people with necessary knowledge, ability and commitment to fulfil their responsibilities | Survey results Field Audit | Directors often chosen for expertise Significant proportion from private sector with knowledge of how boards operate in that sector |
| <i>Sub Criteria</i> | | |
| Government needs to define necessary qualifications of a board | Analysis of legislation | Some legislation identifies kind of expertise, representation needed, other legislation does not |
| Government needs to consider collective skills, ability, expertise of a board | Analysis of legislation Field Audit | Some legislation identifies kind of expertise, representation needed, other legislation does not Extent to which board considered a “team” is mixed |

| Criteria for Evaluation | Methodology | Findings |
|--|---|---|
| The board should ensure that standards, structures, systems and processes are in place to be confident the operations of the agency are managed in accord with "best practice" | Analysis of survey results Field Audit | Variation in extent to which systems are in place and evaluated and monitored |
| <i>Sub Criteria</i> | | |
| Boards should have a code of conduct and standards relating to issues re: conflict of interest and pecuniary interests | Analysis of survey results Field Audit | Considerable variation in practice |
| Boards should have an appropriate structure including an audit committee | Analysis of survey results Field Audit | Considerable variation in practice |
| Boards should have effective and efficient operational systems and processes | Analysis of survey results Field Audit | Considerable variation in practice |
| Internal Control systems should be in place and independently monitored and evaluated by board | Analysis of survey results Field Audit | Variation in extent to which systems are in place and evaluated and monitored |

| Criteria for Evaluation | Methodology | Findings |
|--|---|--|
| Boards should be accountable for their performance | Analysis of Survey results Field Audit | Considerable variation in reporting practices |
| <i>Sub Criteria</i> | | |
| Boards should report publicly on their performance | Analysis of Survey results Field Audit | Considerable variation in extent and form of reporting Many do not report at all Others report on organisation's performance but not the board's |

Audit Approach A survey of boards in the NSW public sector was undertaken by The Audit Office in early 1996. A self-administered questionnaire was drafted by The Audit Office. Final survey design was reviewed by an external consultant. The questionnaire was sent to 210 boards.

The Questionnaire

The questionnaire covered three main areas:

1. Board Creation

- the roles and responsibilities of key stakeholders
- perception of the most important board roles and functions
- structure
- liability issues / legal obligations
- composition/ membership/ appointments
- skills and training of board members
- internal controls
- standards/ codes of conduct/ conflict of interest

2. Board Operations

- frequency of meetings and attendance
- decision making and management of agendas
- information provided to the board

3. Assessment, Reporting and Performance Assessment

- performance agreements
- avenues for reporting
- methods of assessing the Board's performance

One hundred and forty questionnaires were returned to The Audit Office. Three were substantially incomplete and were therefore excluded from the analysis. This left 137 (representing a 65% response rate).

Coding, processing and statistical analysis of the questionnaire was contracted out.

To allow for meaningful analysis of the survey data, advice was sought from the former Public Employment Office, Treasury and Premier's Department on the most appropriate way of grouping boards. Five groups were created:

- Group 1:** Statutory authorities, statutory bodies, trusts tied to inner budget agencies and Area Health Services (AHS)
- Group 2:** Government Trading Enterprises (GTEs) and SOCs
- Group 3:** Universities and their subsidiaries
- Group 4:** Agencies listed only as Schedule 2 under the *Public Finance and Audit Act 1983* (PFAA) and not affected by the *Public Authorities (Financial Arrangements) Act 1987* (PAFA) or the *Public Sector Management Act 1988* (PSMA). This group includes professional registration bodies and some regulatory and marketing boards.
- Group 5⁶⁷:** Government owned companies.

Case Studies

The survey was complemented by field visits to 28 agencies. These agencies included:

- 10 agencies in Group 1
- 9 agencies in Group 2
- 4 agencies in Group 3
- 3 agencies in Group 4
- 2 agencies in Group 5

The range of agencies included SOCs and GTEs, statutory bodies and authorities, marketing and regulatory boards, trusts and universities.

The following people were interviewed:

| | |
|--------------------------------|-----------|
| CEO | 7 |
| Secretary to the Board only | 4 |
| Chair, Secretary and/ or staff | 4 |
| CEO (or deputy) and staff | 3 |
| Chair, CEO and staff | 3 |
| Chair and CEO | 2 |
| Chair only | 2 |
| Senior staff only | 2 |
| Other Board member | 1 |
| TOTAL | 28 |

⁶⁷ Numbers in this group were too small to analyse as a group but are analysed as part of the total sample.

Interviews covered two key areas: issues relating to the context within which agencies were operating; and issues relating to operational matters, mirroring questions in the survey form.

These interviews helped in understanding issues raised by the survey, provided insights into differences between boards, and identified areas of “good practice”. Material from this phase of the audit is presented as case studies.

7.3 References

Australian Institute of Company Directors, *Checklist for Directors of Government Boards*, pamphlet, AICD, Sydney, 1994.

Australian Investment Managers' Association, *Corporate Governance: A Guide for Investment Managers and a Statement of Recommended Corporate Practice*, AIMA, Sydney, 1995.

Bosch, H., *Corporate Practices and Conduct*, Pittman, Sydney, 1995.

Carr, R., "Labor's Public Administration Reforms" Press Release 23 August, 1994.

Carver, J., *Boards that make a Difference: A New Design for Leadership in Non-profit and Public Organisations*, Jossey Bass, San Francisco, 1990.

Chartered Institute of Public Finance and Accountancy, *Corporate Governance: A Framework for Public Sector Bodies*, CIPFA, London, 1995.

Committee on Standards of Conduct in Public Life (Nolan Report), 1995.

Commonwealth Government

"Accountability and Ministerial Oversight Arrangements for Government Businesses", Department of Finance, Canberra, 1996a.

"Accountability and Ministerial Oversight Arrangements for Fully Commercialised Activities within Departments and Agencies", Department of Finance, Canberra, 1996b.

Guide to Commercialisation in the Commonwealth Public Sector, Department of Finance, Canberra, 1996c.

Hilmer, F. *Strictly Boardroom: Improving Governance to Enhance Company Performance*, Sydney Institute, Sydney, 1993.

Hilmer, F and Donaldson, L. , *Management Redeemed*, Free Press, Sydney, 1996.

NSW Parliament Hansard, 31 October, 1996.

NSW Treasury

“General Directions” 900.01, 900.02, 900.03

Monitoring Policy for NSW Government Trading Enterprises, NSW Treasury, Sydney, 1992.

“Statement of Responsibility”.

NSW Premier’s Department, Memorandum 91-2 “Guidelines for the Formation and Operation of Subsidiary Companies by Departments and Statutory Authorities”, 1991.

Provincial Auditor of Saskatchewan

“Survey Report and Examination Plan: Board of Directors Audit”, internal paper, 1993.

Report of the Provincial Auditor to the Legislative Assembly of Saskatchewan, 1995.

Report of the Committee on *The Financial Aspects of Corporate Governance* (Cadbury Report), Gee and Co. Ltd., London, 1992.

Ross, G., “Exposures:” paper presented to NMEC Conference, 1992.

Selway, B., “Will Private Sector Ways Lead to Better
Legal Issues Arising From Government Roles in Business”, paper presented at RIPAA Conference, Ramada Grand Hotel, November, 1994.

Wilkins, R., “Adapting to a Devolved Environment: NSW Perspective”, talk presented to Governance in Transition seminar, RIPAA, 31 October, Sydney, 1996.

A

appointment, CEO, 21
appointments, board, 29
audit committee, 14

B

better practice, 12
board appointments, 29
board positions, vacancies, 31
board, classification, 19
board, perceived role, 20
board, role, 23

C

Cadbury Report, United Kingdom, 13
CEO, appointment, 21
classification of boards, 19
committees, 38
committees, audit, 14
compliance, 37
corporate governance, 1, 10, 12, 13, 14, 18, 21, 39, 66, 68, 69, 81, 82

I

independence, 23
induction, 33

O

organisational performance, 36

P

perceived role of board, 20

R

risk management, 14, 37, 38
role of board, 23
roles and responsibilities, stakeholders, 40

S

separation of powers, 11
stakeholders, roles and responsibilities, 40
succession planning, 32

T

training, 34

U

United Kingdom, Cadbury Report, 13

V

vacancies, board positions, 31

Performance Audit Reports

| Agency or Issue Examined | Title of Performance Audit Report or Publication | Date Tabled in Parliament or Published |
|--|---|--|
| Department of Housing | <i>Public Housing Construction: Selected Management Matters</i> | 5 December 1991 |
| Police Service, Department of Corrective Services, Ambulance Service, Fire Brigades and Others | <i>Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities</i> | 24 September 1992 |
| Public Servant Housing | <i>Rental and Management Aspects of Public Servant Housing</i> | 28 September 1992 |
| Police Service | <i>Air Travel Arrangements</i> | 8 December 1992 |
| Fraud Control | <i>Fraud Control Strategies</i> | 15 June 1993 |
| HomeFund Program | <i>The Special Audit of the HomeFund Program</i> | 17 September 1993 |
| State Rail Authority | <i>Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO Arrangements</i> | 10 December 1993 |
| Ambulance Service, Fire Brigades | <i>Training and Development for the State's Disciplined Services: Stream 2 - Skills Maintenance Training</i> | 13 December 1993 |
| Fraud Control | <i>Fraud Control: Developing an Effective Strategy</i> <i>(Better Practice Guide jointly published with the Office of Public Management, Premier's Department)</i> | 30 March 1994 |
| Aboriginal Land Council | <i>Statutory Investments and Business Enterprises</i> | 31 August 1994 |
| Aboriginal Land Claims | <i>Aboriginal Land Claims</i> | 31 August 1994 |
| Children's Services | <i>Preschool and Long Day Care</i> | 10 October 1994 |
| Roads and Traffic Authority | <i>Private Participation in the Provision of Public Infrastructure</i> <i>(Accounting Treatments; Sydney Harbour Tunnel; M4 Tollway; M5 Tollway)</i> | 17 October 1994 |
| Sydney Olympics 2000 | <i>Review of Estimates</i> | 18 November 1994 |
| State Bank | <i>Special Audit Report: Proposed Sale of the State Bank of New South Wales</i> | 13 January 1995 |
| Roads and Traffic Authority | <i>The M2 Motorway</i> | 31 January 1995 |
| Department of Courts Administration | <i>Management of the Courts: A Preliminary Report</i> | 5 April 1995 |

| Agency or Issue Examined | Title of Performance Audit Report or Publication | Date Tabled in Parliament or Published |
|--|---|--|
| Joint Operations in the Education Sector | <i>A Review of Establishment, Management and Effectiveness Issues (including a Guide to Better Practice)</i> | 13 September 1995 |
| Department of School Education | <i>Effective Utilisation of School Facilities</i> | 29 September 1995 |
| Luna Park | <i>Luna Park</i> | 12 October 1995 |
| Government Advertising | <i>Government Advertising</i> | 23 November 1995 |
| Performance Auditing In NSW | <i>Implementation of Recommendations; and Improving Follow-Up Mechanisms</i> | 6 December 1995 |
| Ethnic Affairs Commission | <i>Administration of Grants (including a Guide To Better Practice)</i> | 7 December 1995 |
| Department of Health | <i>Same Day Admissions</i> | 12 December 1995 |
| Environment Protection Authority | <i>Management and Regulation of Contaminated Sites: A Preliminary Report</i> | 18 December 1995 |
| State Rail Authority of NSW | <i>Internal Control</i> | 14 May 1996 |
| Building Services Corporation | <i>Inquiry into Outstanding Grievances</i> | 9 August 1996 |
| Newcastle Port Corporation | <i>Protected Disclosure</i> | 19 September 1996 |
| Ambulance Service of New South Wales | <i>Charging and Revenue Collection (including a Guide to Better Practice in Debtors Administration)</i> | 26 September 1996 |
| Department of Public Works and Services | <i>Sale of the State Office Block</i> | 17 October 1996 |
| State Rail Authority | <i>Tangara Contract Finalisation</i> | 19 November 1996 |
| NSW Fire Brigades | <i>Fire Prevention</i> | 5 December 1996 |
| State Rail | <i>Accountability and Internal Review Arrangements at State Rail</i> | 19 December 1996 |
| Corporate Credit Cards | <i>The Corporate Credit Card (including Guidelines for the Internal Control of the Corporate Credit Card)</i> | 23 January 1997 |
| NSW Health Department | <i>Medical Specialists: Rights of Private Practice Arrangements</i> | 12 March 1997 |
| NSW Agriculture | <i>Review of NSW Agriculture</i> | 27 March 1997 |
| Public Service wide | <i>Redundancy Arrangements</i> | 17 April 1997 |

Performance Audit Reports and Related Publications

| Agency or Issue Examined | Title of Performance Audit Report or Publication | Date Tabled in Parliament or Published |
|---------------------------------|---|---|
| NSW Health Department | <i>Immunisation in NSW</i> | June 1997 |
| Public Service wide | <i>Corporate Governance</i> | June 1997 |



NSW Government



THE AUDIT OFFICE MISSION

To improve public sector performance
by providing the best auditing and
related services and advice.

For further information please contact:

The Audit Office of New South Wales

Street Address

Level 11
234 Sussex Street
SYDNEY NSW 2000
Australia

Postal Address

GPO Box 12
SYDNEY NSW 2001
Australia

Telephone (02) 9285 0155
Facsimile (02) 9285 0100
Internet <http://www.audit.nsw.gov.au>
e-mail mail@audit.nsw.gov.au

Office Hours: 9.00am - 5.00pm Monday to Friday

Contact Officer: Stephen Horne
Director, Performance Audit
(02) 9285 0078

To purchase this Report please contact:

The NSW Government Information Service

Retail Shops

Sydney CBD

Ground Floor
Goodsell Building
Chifley Square
Cnr Elizabeth & Hunter Sts
SYDNEY NSW 2000

Parramatta CBD

Ground Floor
Ferguson Centre
130 George Street
PARRAMATTA NSW 2150

Telephone and Facsimile Orders

Telephone

Callers from Sydney metropolitan area 9743 7200
Callers from other locations within NSW 1800 46 3955
Callers from interstate (02) 9743 7200

Facsimile (02) 9743 7124