

CORRECTED TRANSCRIPT

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Subcommittee on Governance

Inquiry into corporate governance in the Victorian public sector

Melbourne – 5 April 2004

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Witnesses

Mr T. Moran, Secretary;

Mr I. Killey, Acting Special Adviser; and

Mr M. Bini, Senior Adviser, Government Branch, Department of Premier and Cabinet.

The CHAIR — I declare open the subcommittee public hearing on corporate governance in the Victorian public sector. I welcome Mr Terry Moran, secretary of the Department of Premier and Cabinet, Mr Ian Killey, acting special adviser and Mr Marco Bini, senior adviser from the government branch.

All evidence taken by this subcommittee is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, any comments made outside the precincts of this hearing are not protected by parliamentary privilege. All evidence given today is being recorded. Witnesses will be provided with proof versions of the transcript shortly. I have to let you know that Mr Gordon Rich-Phillips has tendered an apology for this part of the hearing; he will join us for the second part of the hearing this morning when we hear from the Department of Treasury and Finance.

Mr Moran, we appreciate your making time available to attend this public hearing. As outlined in our correspondence, it has become an accepted practice of this committee that at the outset of an inquiry we seek a background briefing from the major department with responsibility for the matters under review, and at the conclusion of an inquiry, when we are at the stage of reaching some conclusions, we generally ask that the department meet with us again so we can clarify any final issues. This morning we would appreciate an overall briefing from you and the departmental officers with you on the corporate governance framework that applies to the Victorian public sector and an update on developments that have occurred since the whole-of-government submission was prepared in October 2002 and forwarded to this committee. We look forward to a presentation from you. We have overall 1 hour, so if we hear from you first, and then we will have some time for some questions at the end; we would appreciate that.

Mr MORAN — Thank you, Chair. It might conceivably be of more assistance to the committee if I keep my comments at the beginning quite brief so that you can then ask such questions as might be useful and we can see where that takes us. You have referred already, Chair, to the submission of October 2002 which sought to canvass a fairly traditional view of the way in which our system of government works in the state of Victoria. A number of basic principles, such as the separation of powers, how funding arrangements are handled and the Westminster tradition of public administration were canvassed briefly in the document. There was then an overview of the institutional structures in the executive branch, followed by mention of various acts of Parliament which provide the framework within which much governmental activity occurs and then some obvious conclusions.

The point I would most like to make here is that we operate on the basis that we are still within a Westminster system of government in Victoria, indeed in Australia generally; that a key feature of that is ministerial accountability to the Parliament; that officials are there to support ministers in that accountability and are themselves accountable to ministers rather than anybody else. I am sure we all share common ground on that. Nonetheless the Westminster system of government is not static — it is constantly moving — and in the literature on public administration you are of course aware that there are unending debates about how far we have deviated from the practices that are still identified most fully with the United Kingdom and its operations as opposed to some of the practices that are apparent within the United States federal system of government, and indeed within many, if not most, of the states also within the United States.

Clearly, starting really 30 years ago, we have seen changes to the basis of employment of senior officials. That is one of the things which has led some to say that we are heading more in the direction of Washington and its practices, but I think it is still fair to say that in this state and in most other jurisdictions in Australia, if not all, the assumption still is that our system of government works best with a professional civil service supporting the government of the day in as impartial a manner as possible, and that we have not really taken that big step towards the US system where perhaps 3000 senior officials in the US system of government are appointed by an incoming president in place of an equivalent number of people who leave if the administration changes.

Indeed it does not even take a change of president; it takes a new term, perhaps, to trigger the vacating of a lot of positions. We do not have that, and we do not have all that goes with it, which is a direct political role really for some 3000 people, direct accountability by those people to the Congress, and of course the involvement of the Senate in the actual approval of the appointment of many of those people appointed in that category.

Just because one sees from time to time in the literature this sort of speculation about whether we are heading in the direction of Washington or not, I think it is best to stress that, yes, we have made some steps in the direction of

making the public service at a senior level more directly accountable to ministers as the leaders of the executive, but we have not made steps that have really taken us fully down the path of the system that applies in the United States, which sits within quite different political traditions and governmental traditions to those which one sees in Australia. That having been said, it is interesting to note that the United Kingdom is itself now changing. The current government, with in some cases I think a measure of bipartisan support and sometimes not, is actually proposing changes to the UK civil service of the sort that we really debated in Australia 10 or 20 years ago.

An esteemed Australian, whose name I will not mention but who is something of a specialist in government and public administration, last year was invited to participate in a seminar in Germany about reform of public administration, and along the way called through the United Kingdom to see what the latest debates were there. He reported back, much to the surprise of some people in Australia, that in Germany he found that the country that was most often cited in the literature used in the context of that symposium in terms of public sector reform and good ideas of where to go was actually Australia, both at a national level and to an extent at a state level as well. From my contacts in the United Kingdom it is clear that many of the things that are now being debated in the UK as to the directions for public sector reform seem to be things that we debated long ago and accepted long ago but which at last they are getting around to attending to.

Mr FORWOOD — For example?

Mr MORAN — The nature of the senior executive group within the civil service; the extent to which you devolve a lot of activities away from a tight group in the centre; the means by which you hold people accountable; and, of course, the better known reforms which are already under way there, what we would call PPPs — public-private partnerships — but also freeing up many of the service delivery institutions within government to subject them to more competition and/or make them more accountable to their local communities.

I mention this because here is the Westminster system of government from which we drew the fundamentals of our system of government now starting to move, and the debate there is substantially around movement in the direction in which we have already shifted. The debates there, as they have been here over some decades, are still within the broad context of our Westminster system of government. So we are still talking there as we have here about, as I said before, a professional civil service, accountability to Parliament through ministers, and so on and so forth. That tends to suggest to me that our system of government is not only alive and well and serving the people of Australia and, in the case of the Victorian public service, serving the people of Victoria well by international standards but it also shows that we have been a bit ahead of the game in terms of reform to how government operates. Others have noticed that and are having their own debates about how they can move away from sometimes constipated and regulation-driven governmental arrangements, and in having those debates they seem to find insight in looking at what we have already been through in Australia. I think that is good news.

Having said all that, obviously as our system of government and their system of government is dynamic, it is alive, it is having new experiences all the time, if I can put it in those terms, we will always have debates about improvement. That is as it should be because if we are constantly looking at ways to improve we will end up with a system of government that in the light of contemporary circumstances is doing the best possible job in serving the people of the state and, more generally in other jurisdictions, the people of Australia.

I am an optimist when it comes to these issues. I think Australia has a good system of government. It has changed a lot in the last 100 years since Federation. Federation itself was a massive change in our system of government, but it has changed a lot over that time. You will always find things you would like to see improved — for example, New South Wales and Victoria have a good case on horizontal fiscal equalisation and the impact it has on New South Wales and Victoria, and I am sure over time that will have to be listened to. But we can have that system of debates, move our system forward and keep it not only fairly dynamic, but also able to well respond to contemporary circumstances.

The CHAIR — Thank you for that introduction. If I could take us back to the whole-of-government submission of October 2002 and the statement that the government is constantly monitoring the government framework as it applies to public bodies and will continue to develop policy and, where necessary, legislation to improve the accountability, the efficiency and operations of public bodies: Mr Moran, could you provide the committee with some of the governance-related changes the government has made to policy and legislation since late 2002?

Mr MORAN — In a sense the most significant proposals are yet to be publicly released. But it is known on the public record that the government asked the State Coordination and Management Council, which I chair and which comprises the secretaries of government departments, the public employment commissioner and the Chief Commissioner of Police, to do some work on accountability arrangements for so-called non-departmental public entities (NDPEs) and at the same time, as you will hear later no doubt, the Department of Treasury and Finance has done some work on aspects of accountability for a number of non-departmental public entities.

With the government's agreement, the State Coordination and Management Council proceeded to do its work by setting up a group of senior public servants combined with four prominent people from the private sector — people from outside government. Until her recent resignation, the Secretary of the Department of Primary Industry, Chloe Munro, was chair of this group. It had some other secretaries and deputy secretaries on it. In addition there were four people from outside: the former chair of Shell Australia — —

Mr FORWOOD — Peter Duncan?

Mr MORAN — Yes. Don Mercer, who would be known to many other people through a variety of roles and as chancellor of RMIT, but previously his involvement with the ANZ Bank; Elizabeth Alexander and Colin Carter, who has recently published a book internationally on governance particularly focused on the operation of boards. I did not go to the meetings, but the group was supported by the government branch within Department of Premier and Cabinet and some of my colleagues here have been involved in its work and have kept open the lines of communication with the DTF as its work has progressed on the financial issues.

This work has taken a little bit of time for a number of reasons, including, I suppose, the private sector people trying to grapple with the nature of government and how there are some differences between the private sector and what happens in government, but there is a report which is about to be considered by ministers — and obviously I cannot go too far into what that report suggests because it lays before ministers a number of proposals for further improvement. But it is a good document because it actually begins to wrestle with many of the issues thrown up by those thousands of non-departmental public entities — for instance, the nature of the relationship which they have with ministers, again in the context of the Westminster tradition of government, and it has a number of proposals for improvement more generally in how they operate. Treasury will speak for itself, but I think Treasury is looking at ways to make the most financially sensitive of the NDPEs a bit more transparent in their operations, and no doubt the details will be worked through but I think that is a sensible area for reform as well.

So that has been the principal body of work. The government had also given a commitment to look at the Public Sector Management and Employment Act and some substantial work has been done in that area as well, with an emphasis on preserving and protecting the merit principal in public service employment and looking at effective grievance arrangements for individual staff, because grievance arrangements are usually the means by which genuine problems that individuals — perhaps many individuals — have with how they are treated come to light. But we are also looking at some other issues that are currently more broadly in debate around Australia through the work of other jurisdictions. So for example, the commonwealth's public service commissioner has put quite a number of useful proposals for improvement into the public domain. There have been some recent changes in New Zealand which are very interesting and there have also been some developments in other state jurisdictions. So we are trying to take all of these on board in the context of framing some advice to government, but again that advice has not been put together finally and it is not with ministers, but the work is ongoing.

Ms CAMPBELL — Mr Moran, you made a comment in relation to the private sector coming to terms and grappling with the issues in the public service. What would you see as the consistent principles that the private and the public sectors should share on corporate governance?

Mr MORAN — There are quite a number, I should think, but just to give you one example, it is desirable that the members of boards and committees know precisely where they stand in terms of the rules and accountabilities vis-a-vis the people who manage the organisation that they are associated with plus the rest of government. If you look at the non-departmental public entities, in Victoria as elsewhere they are a product of history. So there is a very substantial legislative base — in fact it is huge — giving rise to all sorts of bodies serving different sorts of functions. They have all come up at a different time in the state's political history; some of them are very old; some of them are much newer and the assumptions at the time about how to put things together have guided how their powers have been expressed, how their roles and functions have been thought of; how it has been

suggested that they deal with ministers, and so on and so forth. We are not suggesting that all of that legislation be revisited and some sort of new template be installed over the top of it, but for many people who have not spent many years indeed in the belly of the beast, if I can put it in those terms, it can be very difficult for them to come to terms with why a minister's power in respect of one body is this, but in respect of another body it is quite different.

There is no overarching simplicity in the way that this has all been put together. I am not suggesting that anybody would want to go back and revisit all of that legislation in one big hit, but it may be that it is possible to distil some principles that could be taken as a source of guidance when new bodies are being considered in the future.

Ms CAMPBELL — And those principles would be?

Mr MORAN — That is the subject of the ongoing work that we are doing.

The CHAIR — So we will await the report with great interest.

Mr MORAN — Yes.

Mr FORWOOD — Terry, what was the brief that was given to Chloe Munro's group?

Mr MORAN — I am not sure whether I have the terms of reference here, but it came out of a discussion amongst the secretaries in particular, where some of the secretaries felt that under our system as we have it there was a measure of uncertainty about the level of their accountability to ministers in respect of what was happening with many of the non-departmental public entities. I would not want to name names or — —

Mr FORWOOD — No.

Mr MORAN — So the first trigger was that and frankly the second trigger was the upper house select committee that you will remember from a couple of years ago regarding a certain appointment where I felt that it showed a great deal of uncertainty on the part of nearly everybody involved about the notion of ministerial responsibility within our system of government as it applies to NDPEs. As I think that ministerial accountability to the Parliament for what happens in the executive is the cornerstone of our system of government, if there was some uncertainty it might be worth doing a bit of work to see what was going on. So those two things were triggers and basically this came about because the secretaries collectively took their concerns to the government and the government agreed that some work should be done.

Mr FORWOOD — In your opening remarks you talked about the Westminster tradition and the changes because we all agree it is a living entity in some senses. Are you now saying that this group is looking at those changes and how governance arrangements in the Westminster tradition needs to be changed in order to become up to date?

Mr MORAN — No, I think we are saying, 'Can we look at what is there and achieve a greater measure of transparency as to what is in place and suggest some means of achieving greater order into the future in these relationships'. So we are not proposing a redefinition of ministerial responsibility or anything like that; apart from anything else it would be impertinent to do so. But against a fairly well understood concept, the second and third orders of detail are a bit messy, I think that is what I am saying.

Mr FORWOOD — Right.

Mr MORAN — It is part of the political tradition in this state. You have bodies here that go back a long way and they were all set up for good purposes and with good intentions at the time. The work has revealed different types of non-departmental public entities and different arrangements are appropriate to those different types.

Mr FORWOOD — So those NDPEs have their own board of governance appointed by the government?

Mr MORAN — Yes.

Mr FORWOOD — And yet they are either closely or loosely allied to a particular departmental structure, so there is a permanent head — —

Mr MORAN — Well — —

Mr FORWOOD — There are a whole bunch in the health sector that would primarily relate through the health department, or TAFEs and universities through the education department.

Mr MORAN — They are actually aligned with ministers rather than departments through the administrative arrangements order.

Mr FORWOOD — Right.

Mr MORAN — So the administrative arrangements order allocates all acts as between all ministers, and it is then the ministers who technically have the responsibility for the administration of those acts, and Ian Killey will correct me if I am wrong — —

Mr FORWOOD — I am sure he will!

Mr MORAN — I not a lawyer and he is a better lawyer than I could ever aspire to be. It is the departments, and most particularly secretaries who assist ministers in the discharge of their responsibilities under the administrative arrangements order.

Mr FORWOOD — So we are in a situation where an NDPE reports to a minister and if the minister wants to get advice on that he or she goes to the department to see — —

Mr MORAN — That would be the normal practice but there may be some circumstances. For instance, if there is tension between the department and the NDPE, then the minister would have to consider how to arrange to deal with any matters brought forward directly to the minister by the NDPE.

Mr FORWOOD — More and more work is being now being done outside the old traditional departmental structure by NDPEs. Far more service delivery is done in those mechanisms. So is Chloe Munro's group, now headed by someone else, looking at mechanisms for understanding the governance arrangements that apply in the new way of service delivery, given the greater emphasis on NDPEs delivering what used to be traditional government?

The CHAIR — Well — —

Mr MORAN — I think this a useful point to pursue, Chair, because it says something about our political history as well. I am not sure that NDPEs are themselves doing that much more in service delivery than used to be the case. What has actually happened is that is a lot more service delivery has been outsourced or entities that were delivering services have been privatised.

So if you think in the welfare area — as Christine Campbell would know — there are some areas where things that might have been done by the predecessor to the Department of Human Services have been outsourced to one group or another. In fact this is quite common now around Australia and indeed is at the heart of some of the debates in Europe about the reform of public administration. I would be happy to agree that there have been some big successes here, but there have also been some examples where things have not been entirely successful in one jurisdiction or another throughout Australia. What I am saying is that a lot of stuff has moved out of the department but not necessarily to non-departmental public employment services.

The second point I would make is that the political history of Victoria in the last 100 years is very interesting on this point. Up until the period of the Bolte government beginning in the 1950s, as you would know better than I, Victoria was almost in a constant state of flux politically as governments came and went in usually a relatively short period of time. That had a lot to do with the shifting political coalitions forged in this building. In one sense one of the artefacts of that, was to develop a practice in Victoria whereby a lot of things done in other jurisdictions in Australia through departments were done through statutory entities of one sort or another for those entities to have considerable independence. Writers on Victorian politics 30 years ago drew attention to the fact that one of the features of the Victorian political tradition was this considerable engagement with the community in the governance of all sorts of service delivery points: the schools area is well-known example, and hospitals have had a long tradition of having boards that relate to the community — —

Mr FORWOOD — Board of works!

Mr MORAN — There are all sorts of stories which you must know about how they behaved towards government. So you had all these entities which had a measure of independence and that was — when you look back on it — for credible reasons to do with the state of government in the first half of the last century. But then the second half of the last century was actually characterised by much more stability: the long period of Liberal government first under Sir Henry Bolte and then under Sir Rupert Hamer, who sadly passed away last week, and for a short time under Mr Lindsay Thompson; then government under John Cain and Joan Kirner; and then the period of the Kennett government; and now the period of the Bracks government. What is noticeable is that the revolving door for governments that characterised the first half of the last century does not seem to be revolving with anything like the speed it once did. There is more stability and confidence at the level of ministers in terms of being in government and the ability to get things done. Our institutional frameworks are still to an extent back there in the first half of the last century — that is the point that I am making — and it comes to a point most decidedly around this issue of ministerial responsibility.

Mr MORAN — Could I just interrupt — did Jim wish to add — —

Mr FORWOOD — He would be brave!

Mr MORAN — Ian and I have had this debate once or twice, and he has not actually said I am profoundly wrong, but I think he has a few extra points.

Mr KILLEY — I would just say that I would go even further than the first half of last century — I think that it goes further.

Mr MORAN — Yes, into the 19th century

The CHAIR — Could you list for us the major responsibilities of the Department of Premier and Cabinet in relation to corporate governance frameworks and practices?

Mr MORAN — Firstly, the commissioner for public employment exists within the Premier's portfolio, but the commissioner has a range of statutory roles which are quite independent and the committee would know of those. That is an ongoing function performed within a group that relates to the department and which basically focuses on some aspects of public sector employment, and in the case of the public service beyond that issues to do with merit and so forth.

Secondly, within the Premier's department work is done on such things as, to use the arcane term, machinery of government and related to that the administrative arrangements order. So it is the Department of Premier and Cabinet which prepares the advice and the associated documents for the Premier to use in bringing about changes to what is really the structure of government within the existing legislative framework.

Thirdly, the department, at the Premier's request, will do work on various issues of governance and accountability. That is how the government branch within Department of Premier and Cabinet, in which Marco is a senior officer, has come to do the work on non-departmental public entities in support of that group which I mentioned before. It is also how Department of Premier and Cabinet has come to do work, again at the Premier's request, on the Public Sector Management and Employment Act and how it can be further improved. That work is best seen as policy project work which has a beginning and an end, the end being the proposals that go into the cabinet process, and of course if legislation is required after the proposals go to cabinet that work would be initiated through Department of Premier and Cabinet as well. In addition there are obviously some statutory bodies that are associated with the Department of Premier and Cabinet. In the arts area you have the various arts agencies, and there are a number of administrative offices established under the Public Sector Management and Employment Act — the Chief Parliamentary Counsel is one of those but there are a number of others which exist in association with the department — but the heads of those administrative offices have their own discrete powers under the Public Sector Management and Employment Act which establish them.

Finally, I suppose, it is part of my job to keep an eye on trends in public administration and things which might be drawn to the government's attention as the possible basis for some useful improvements, whether or not they require legislation, and that is an ongoing part of the department's role and my role in supporting the Premier in his

own right and the Premier as minister for public employment under the Public Sector Management and Employment Act. The work that Treasury does on the financial side would usually be seen as complementary to what Department of Premier and Cabinet does, and we strive to make sure that we make sure that keep in touch. I hope that the Treasury would say — I am sure you will ask them; they are here to hear me say it so we will see later on — that on the non-governmental public employment service issue there has been collective collaboration. I have had chats with Ian Little, the secretary of the Treasury, and other people in Treasury and Finance. I have had discussions with the people in Department of Premier and Cabinet who have been doing the work, and we should get a package going to government that whatever other merits it might have will be a package that is internally consistent.

Mr FORWOOD — Just a quick supplementary to that: does the department have a role if instances of governance weakness elsewhere in the public sector come to its attention?

Mr MORAN — This is a very, very interesting question. If there is a governance weakness in respect to finance, Treasury has that role and is equipped to perform it. If there is a governance weakness in the sense of the performance of boards or committees of management or management within entities, normally you would expect that the department supporting the minister who has the relevant act for that entity under the administrative arrangements order would support the minister in dealing with those issues. There are always such issues, frankly, and it is inevitable. There are thousands of NDPEs, and life is never going to be perfect all the time. That is just the way it is. There would sometimes be instances where I would become involved for reasons of linkages or difficulty in achieving a result, or because there is a tie-in with that machinery-of-government role that I mentioned before. But normally the expectation would be that the ministers with responsibility under the administrative arrangements order would deal with the great bulk of issues, supported by the departments that are engaged in that area of work.

Ms GREEN — I was interested in whether the DPC has an ongoing professional development program in this area for other departments. I know you have said that primarily that is an individual departmental responsibility, but I am referring to your machinery-of-government role in trying to skill up across the departments.

Mr MORAN — Are you thinking there of the members of boards and committees of management or the managers of the various entities?

Ms GREEN — More the actual departments in terms of how they would then provide the advice.

Mr MORAN — It is not something we have done anything about that I can recall. If ever a general change is made, there would normally be an associated piece of work to introduce that change to all those people who are affected to make sure they understand it. We are in fact in the midst of doing that in a totally unrelated area of change at the moment.

Ms GREEN — What did you call that again, in terms of the advice?

Mr MORAN — If there is an area of significant change, to bring about its implementation there is usually a need to make sure that everybody affected by that change is adequately informed, and that can take the form of professional development. Indeed, there is an instance where we are doing that right at the moment around another major change that is not of the sort we are talking about here.

The CHAIR — Mr Moran, notwithstanding your comments about views on what is happening in the Victorian public service that you have picked up from UK, is any research being undertaken into other corporate governance arrangements in public-sector agencies in other parts of Australia — in other jurisdictions and in the commonwealth — in order to better inform us in Victoria about other practices we might wish to look to and adopt?

Mr MORAN — In the case of the work on non-departmental public entities, we actually looked at what is happening in other jurisdictions.

Mr BINI — We looked at a number of jurisdictions.

Mr MORAN — Yes, because I can recall reading some information on that. By involving four very prominent private sector people in that work as well we got a distinctive private-sector perspective on these issues

and how they might be dealt with. To be frank, the reason why that was done — that is, involving those four private sector people — was that the Premier wanted to make sure that the whole exercise was not a sort of introspective piece of work by people schooled in our system of government who might be inclined to take some things for granted when they were looking at governance arrangements in this area. So involving some people who had to actually grapple with how government works, as these four private-sector people did, was in the Premier's view a useful way of ensuring that the views from secretaries and deputy secretaries were tested. Marco, that is probably what happened, is it not?

Mr BINI — Yes.

Mr FORWOOD — On page 18 of the government's submission you talk about appointments to boards, and obviously one of the major functions of the Department of Premier and Cabinet is to ensure that that happens efficiently, effectively and in a timely manner. Are you confident that the processes that DPC uses for appointments to boards are in keeping with good governance? I am particularly concerned about issues with timing.

Mr MORAN — In what sense?

Mr FORWOOD — Are you confident that people are appointed to boards on the expiry or before the expiry of other people's terms? Are you confident that we do not get situations where organisations find themselves without a quorum?

Mr MORAN — We run a system whereby every six months each department is supposed to advise us of upcoming vacancies, and the intention there is that it is possible to keep track of this very issue of timing. However, it is not a perfect system, because sometimes the returns from departments are late or whatever. I make these comments clearly against a background where the originators of nearly all appointments actually lie out there in departments or in the ministry.

Mr FORWOOD — That is right.

Mr MORAN — Therefore, we have been doing some work on approaching this problem differently. We are basically seeking to get a database up which would reflect all the positions on boards — who is in them, the terms of office and all that sort of thing — so that it would be possible to generate more frequently and more reliably reports on upcoming vacancies. Then if somebody does need a bit of encouragement to move on, they can indeed get it. We have a fair measure of support from departments for this development, and at the moment we have a contract out.

Mr BINI — We have some specifications.

Mr MORAN — Yes, we have had a contract out to specify in a technical sense what is required of the system, and we have the money to do it, so we will now proceed to try to get this in place.

Ms CAMPBELL — The committee is aware there have been a number of sector-specific reviews of governance arrangements in the last 18 months, a couple of examples being TAFEs and universities. My question goes to, firstly, what role the department plays as the central agency in the prioritisation of such reviews; and secondly, has the department highlighted any other sectors where such reviews should be conducted?

Mr MORAN — Most of those reviews are coming forward at the initiative of ministers and the departments they are working with. Our contribution in this area has been to try to stand back and look at the whole system through this piece of work on non-departmental public entities. We have involved people from departments in that work and, as I explained, people from the private sector as well, but I am not aware whether that work has actually flagged any particular priorities for areas within government that are a priority for further review. Treasury has a financial perspective, and it might have something to say about that when it is before you, but I personally have set my mind on the framework stuff at this stage rather than worrying about particular areas of government that, from our perspective, seem to be a high priority for review.

Mr FORWOOD — When do you think the report of that committee will be finished?

Mr MORAN — It is likely to go in to ministers fairly soon.

Mr FORWOOD — You said that before. I am more interested in when it is likely to come out from the ministers. It might be there for a helluva long time — jokes aside.

Mr MORAN — It is a priority issue, and do not forget that it is linked with the work that Treasury has been doing. At the moment the final set of documents is with departments for any final comment, and they are due in very soon; then there would have to be some discussions with Treasury about their final results and our final results; and then we would go to cabinet fairly soon.

Mr FORWOOD — Do you think it will be publicly released?

Mr MORAN — I could not say.

Mr FORWOOD — Privately released to this committee?

The CHAIR — Whatever happens, it is of great interest to this committee obviously.

Mr FORWOOD — The Chair will ask for it.

Mr MORAN — Rather than create an issue about that it might well be that in providing our advice to the Premier we could mention the committee's interest in some of these issues and then he would be in a position to consider what further information could be made available.

The CHAIR — That is very good, thank you.

Ms GREEN — Most of the recommendations arising from those sector-specific reviews of governance in universities, TAFEs and hospitals were adopted by government. Several recommendations were common across the three reviews and likely to have broad application across other sectors; for example, all three reviews supported enhancing the effectiveness of agency boards by ensuring the appropriate mix of skills and strategies, leadership training and performance reviews. In light of that, has DPC examined those sector-specific governance reviews and identified possible recommendations that could be applied generally across the Victorian public sector?

Mr MORAN — The issue of developing board members is a perennial issue — it always arises. I am not sure whether the committee would know but my first chief executive officer role began in 1987 in respect of what was then called the training system, which was TAFE and apprenticeships and so forth. Then you had TAFE college councils, which were fairly independent in their operation, plus the boards of industry training advisory bodies, which were also fairly independent in their operation and these boards were comprised of people drawn from industry. Always we got discussion of topics to do with the skill level of people on the boards and councils and how they might be improved. In fact, at the time what was then called the TAFE college councils association itself, with support from government, invested quite a lot of effort into developing the capacities of the members of TAFE college councils. I must say that I have lost track of where that has got to since I left my role in the state training system but I thought that it was good that the people representing council members were themselves concerned to do something about the development of the people who sat on councils, particularly new ones joining councils. I think that work was quite successful and useful.

However, it is very difficult to look across government and say everybody has to do some minimum development in respect of their roles because many of these non-departmental public entities are not necessarily hugely demanding from the government's point of view — it might be a local committee responsible for some public land or even conceivably a local school council that we are talking about here. There are some entities where with the size of their operations being substantial and the financial risks involved in their operations being significant from a government point of view, we probably need to just check that board members or committee members have available to them the information that they need. That might well flow from some of the things that Treasury has been looking at. We could look at it as well but I would be quite reluctant to argue before you that the many tens of thousands of people involved in these thousands of non-departmental entities generally should all have to get a thick book that they have to read and then be assessed on. I think we would find that if you have timing problems with filling vacancies, they would multiply significantly.

The CHAIR — If I could just go back to an earlier point about research into corporate governance in other jurisdictions and ask whether there are any particular developments that stand out that we would want to adopt as part of our practice.

Mr MORAN — Clearly the work of this group looking at non-departmental entities does indeed have a number of recommendations in it. It is premature for me to flag what those recommendations are but I think they make a useful contribution to improving things a little bit. However, please bear in mind that I am not coming from the point of view of saying that there is a really big problem out there in the world of non-departmental public entities. How they are going needs attention but it always needs attention and there are always things that can be improved. However, that is in the circumstances where, against Victoria's political tradition, we have quite a robust scene out there in non-departmental entities.

Having worked in other states I can truthfully say that I think the Victorian system, with its origins going back so far, is indeed much better than we can see in other states. I would not want to name names but our approach is more decentralised than perhaps two other significant states that one could draw attention to. There is more continuity in institutional terms than you see in at least one of those states; that is good for the state because it means you have institutions that know what they are doing, you have people involved who know what they are doing and they can get on with doing the job rather than every so often — in fact quite often — being faced with further statutory or organisational upheaval.

In that sense I am actually quite a conservative. I think that it is tempting to play around with organisations and structures but, as we all know, if you do that you do not necessarily get the changes you want anyway. It is tempting to play around but I think that those sort of changes ought only occur if there is a significant shift in policy or there is a serious issue of underperformance by a particular body. Otherwise it is best to always try to get the best group of people as clearly focused as possible on doing whatever job it is they are supposed to be doing and, according to whatever might be the accountability requirements of the time, letting them get on with the job. Victoria, if one takes the long-term view — going back decades — has actually done a better job of doing that while still constantly looking at how you can move forward and make improvements that I think, frankly, some other states have managed to do.

The CHAIR — You have one final question, Mr Forwood?

Mr FORWOOD — Yes, I do — of many I could ask. These days in corporate boards' governance arrangements, whatever they are, there is a huge focus on risk management. I wondered how the government ensures that there is an appropriate risk management framework across the myriad organisations that you need to have your fingers across. I am not just talking financial risk, there are all sorts of risks — occupational health and safety — and huge risks. I am after the framework.

Mr MORAN — The most critical risk is financial risk, and that is what you will be talking with my colleagues from Treasury about, no doubt. I think they have been giving a lot of attention to those issues over time. Secondly, quite frankly because of the origins of so many of these entities in history there are genuine difficulties for ministers and departments in managing relationships with many of these bodies because there is not one set of rules — it is not as if we are talking about the companies code or something like that, there are all these arrangements that sometimes go back decades, which can be very hard to handle if you are a minister or a senior public servant because there are just so many differences.

That might constitute a bit of a risk, I am not sure, but frankly it does not seem to be yielding a whole lot of problems that this committee or the Parliament or the executive needs to be acutely worried about as an absolutely top-order priority. The risk management issue is an issue on the finances, there are risks because of the nature of the system for people in departments and for ministers perhaps but otherwise the dynamic is different to that which is apparent in the private sector which has given us some of the well-publicised difficulties in recent times. That is because most people involved in nearly all government activities — not so in 100 per cent of cases — tend to have a different set of values as to why they are there. They are there to be as purposeful as they can to make a contribution to the community, therefore their motivations are different to those of most people who are placed in a position of being responsible for some of the larger companies in our economy.

The CHAIR — We will conclude at this point. Thank you, Mr Moran, Mr Kelly and Mr Bini for making time available to meet with the subcommittee. It has been a most interesting and useful session for the committee, particularly as we head forward to other hearings on this topic of corporate governance and public sector agencies. We are grateful to you for bringing us up to date in terms of what is happening across government at this time. After we have reviewed the transcript there may be some follow-up questions that we will forward on to you. As you know, the transcripts will become available for you to check in the next week or two, whenever they are finished. Again thank you very much.

Witnesses withdrew.

CORRECTED TRANSCRIPT

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Subcommittee on Governance

Inquiry into corporate governance in the Victorian public sector

Melbourne – 5 April 2004

Members

Ms C. M. Campbell
Mr B. Forwood
Ms D. L. Green

Mr G. K. Rich-Phillips
Ms G. D. Romanes

Chair: Ms G. D. Romanes

Staff

Executive Officer: Ms M. Cornwell

Witnesses

Mr W. Hodgson, Deputy Secretary, Commercial Division; and
Mr A. Hawkes, Director, Commercial and Financial Risk Management Group,
Department of Treasury and Finance.

The CHAIR — I welcome Mr Warren Hodgson, Deputy Secretary, commercial division; and Mr Alan Hawkes, Director, Commercial and Financial Risk Management group, Department of Treasury and Finance, to this public hearing of the subcommittee's inquiry into corporate governance in the Victorian public sector. All evidence taken by this subcommittee is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, any comments made outside the precincts of this hearing are not protected by parliamentary privilege. All evidence given today is being recorded and witnesses will be provided with proof versions of the transcript shortly.

Mr Hodgson and Mr Hawkes, we are pleased that you could attend this public hearing. As outlined in our correspondence, it has become the accepted practice of this committee that at the outset of an inquiry we receive a background briefing from the major departments with responsibility for the matters under review. Then at the conclusion when we are at the stage of reaching some conclusions with regard to our inquiry we generally ask the departments to meet with us again so we can clarify any final issues. This morning we would appreciate a briefing on the corporate governance framework that applies to government business enterprises in the Victorian public sector, so thank you again, and we look forward to your presentation.

Mr HAWKES — This morning I propose to focus specifically on those things that we call government business enterprises. The Department of Treasury and Finance, to assist the Treasurer, works through two key acts of Parliament — the State Owned Enterprises Act of 1992 and the Financial Management Act. I do not propose to deal very much at all with the Financial Management Act — my presentation to you makes a recommendation that you invite some other experts from the Department of Treasury and Finance for a description of financial compliance as it applies through the Financial Management Act — and that instead I focus on the governance aspects of business enterprises.

The benefits are that we deal with some of these things differently and it would be best to focus on the expertise amongst those specialists, so if you are happy with that I will proceed to talk specifically about our responsibilities under the State Owned Enterprises Act and the business enterprises that are covered by it. Your committee as it was constituted prior to the last election asked for a presentation about government business enterprises, and this is a follow-on from that specific request.

Mr FORWOOD — Did they get it?

Mr HAWKES — They did not get it, no. They disbanded before receiving it.

The CHAIR — Are you going to provide us with a written submission?

Mr HAWKES — I will table a written report, if that is all right, then cover it and invite questions at the end. The presentation will take probably about 10 minutes.

The Department of Treasury and Finance, which I will refer to as DTF for the purposes of convenience, represented this morning by Mr Warren Hodgson, who is Deputy Secretary, and me, Alan Hawkes, Director, Commercial Division, previously received a request from you for a presentation on a system used by DTF for governance of state-owned enterprises. We proposed that this would be an overview of the necessity for a governance regime, the structure of the regime used and the responsibilities for a group of 22 government business enterprises involving the Treasurer. To ensure we had a common understanding of what governance is in the public sector we referred to your issues paper and the opening paragraphs of the introduction to it. We are in great agreement with the description used therein — that is, corporate governance concerns the structures and processes for decision making, accountability, control and behaviour at the governing body and/or executive management level of an organisation.

Your issues paper then describes some differences between governance in the private sector and the public sector. We submit that governance principles for state-owned enterprises fall across both the public and the private sectors described in your paper's definitions, perhaps to the extent of being unique for the public sector. The corporatisation of government business activities from the 1990s to the present time has created the need for a control and accountability regime that mirrors the private sector to ensure such businesses remain commercially focused and yet fully accounts for the overriding responsibilities of ministers to the Parliament. This responsibility is clearly different from a shareholder of a private sector business. Because of the substantial size and risk spectrum

of the corporatised businesses, a unit was established within DTF to develop and administer a new governance framework for them.

The governance unit of the commercial division in DTF has oversight responsibility for the governance and monitoring processes for a number of state-owned enterprises where the Treasurer has a legislative responsibility to review the corporate plans or the business plans. I shall table a schedule of those businesses that we describe as government business enterprises. These usually make no claim on the state budget for funding, are required to operate in a commercial fashion and have a corporate structure pursuant to federal or state legislation.

The governance unit within the commercial division of DTF was formerly known as the business enterprises monitoring unit and does not have responsibility for the whole of government governance arrangements or the governance and monitoring arrangements for other GBEs or entities outside this fairly limited range of 22 businesses where the Treasurer has a legislative responsibility. Notwithstanding this, it is often acknowledged and recognised that the GBEs within this portfolio have an established and robust corporate governance regime that could be replicated in other areas of government.

To speak of that governance framework, corporate governance arrangements for government business enterprises are largely defined in the State Owned Enterprises Act of 1992 and other industry-specific legislation. The main features of these arrangements include: firstly, the setting of clear and non-conflicting objectives for the business which define the core business of the GBE and its objective in commercial terms; secondly, the appointment of independent skill-based commercial boards to lead, control and direct the business at arm's length from government; and thirdly, a performance reporting framework to increase accountability to the Treasurer and, where appropriate, a portfolio minister. For a description of the nature of the financial compliance framework that government businesses must follow, we recommend a separate presentation from representatives of our department who specialise in the application of the Financial Management Act of 1994.

Consistent with national competition policy principles GBEs are also subject to arrangements in relation to income tax equivalent payments, the financial accommodation levy payments and dividend payments. These arrangements are structured to reflect the financial discipline imposed on private sector businesses and are intended to both reinforce the commercial focus of GBEs and provide an appropriate basis for planning projections and assessing performance.

If I can talk briefly about board performance appraisals, the governance unit encourages the chairpersons of GBEs to undertake regular reviews by boards of their policies and performance, including assessment of individual directors and the skill base required in the business. These can be very useful to determine the most appropriate composition of the board and the development needs of individual directors.

Mr FORWOOD — What form does that encouragement take?

Mr HAWKES — The setting of some principles around the structure of board performance appraisals, a recommendation in relation to consultants that are specialists in this area — in other words, we create a panel of consultants who hold themselves out to be experts — and an encouragement to the chair on an annual basis to have a conversation with the Treasurer about the skills base of the board and any gaps that exist and whether those gaps could be filled by training of individual board members or by a few key changes to that board at the next appointments date.

The role of the board of a GBE includes the requirement to set the strategic direction for the business; monitor and assess the performance of the business; identify and manage significant risk areas; establish ethical standards; ensure compliance in legal and ethical matters, and report to the shareholder. The role of DTF is to monitor the performance of that role by the board from a shareholder perspective. In particular, the governance unit is involved in the review of corporate planning documents to ensure the strategic direction is appropriate for the next three years; performance monitoring on a quarterly basis of financial and non-financial standards set in the corporate plan; the negotiation of dividends on a half-yearly basis, and board appointments.

I will comment very briefly on each of these responsibilities — firstly, corporate planning documents. Under various legislative provisions GBEs are required to submit strategic planning documents to the Treasurer and in some cases noted in the tabled document to the portfolio minister as well. These are usually described in legislation

as corporate plans. The processes involved in the review of corporate planning documents are as follows: the establishment by the governance unit in the early stages of the annual planning process of the key issues for government to be addressed in corporate planning documents — in other words, we issue to the business enterprises a list of key issues that the government wants to focus on in the establishment of the corporate plan for the coming three years.

There is then a submission by government business enterprises of corporate planning documents to the Treasurer and portfolio minister, where appropriate, which include three key components: a statement of corporate intent, which provides an overview of the operations of a business, together with business targets relating to value creation, risk, efficiency and customer service; a corporate plan which defines the business environment, key business strategies, planning assumptions, financial and non-financial targets and a sensitivity analysis — sometimes called scenario planning; and the business plan which presents in greater detail an action plan for the first year of the plan period.

Our unit is then involved in a process of review which includes discussion at officer level between the governance unit and the business enterprise on any matters in the planning documents requiring clarification. This discussion may result in the revision of the documents at draft stage or the provision of additional information. Revision at draft stage would usually only occur if there was a misalignment between the key issues issued by the department and the proposals from the business enterprise. There is a preparation of a brief to the Treasurer and a draft letter from the Treasurer to the GBE board with comments on the planning documents. This letter may advise that the planning documents represent an appropriate basis by which the business should monitor its progress against the business plan, or request that the board give further consideration to various matters. To our mind it is a key that the Treasurer not approve corporate plans, rather that he accepts them. It is technically a fine point, but where there is a Corporations Law entity the Treasurer may be perceived to be a director of the organisation if he is approving the corporate plans of the board. He therefore accepts them. The formal response from the GBE board is then sought for the Treasurer where required.

I will give a very quick overview of our performance monitoring regime. Business enterprises are required to submit quarterly reports to the Treasurer and these include financial statements against forecasts, key financial and non-financial performance indicators, and a brief exceptions-based commentary. We use these reports to facilitate the early identification and management of emerging risks for the business.

I thought it might be useful to talk about distributions for the shareholder from the business enterprises. As with private sector businesses, at various times dividends are paid to the shareholder. These reflect a return to the shareholder to recompense for the cost of capital provided to the business enterprises. Following receipt of the half-year and full-year results the governance unit negotiates with GBE management and officers of the portfolio department as to an appropriate dividend amount to be paid to the consolidated fund.

Consideration is given to a number of factors including an appropriate dividend yield for an investor in such a business; the cash flows generated by the business in the prior accounting period; the views of the board and the relevant portfolio minister; the required credit standing of the business enterprise; the appropriate balance between borrowings and retained profits to finance growth; and the budgetary requirements of the state. Once agreement on the dividend amount has been reached, the governance unit advises the Treasurer and prepares the relevant documentation in the form of a dividend determination.

We are involved quite extensively in the board appointment process. Where the Treasurer has administrative responsibility for the legislative provisions relating to the appointment of board members, the governance unit uses the government's guidelines titled 'The guidelines for the appointment and remuneration of part-time non-executive directors of state government boards and members of statutory authorities'. This is a document issued by Mr Moran's department. The process that is spelt out there can include the preparation of a short list of potential candidates for discussion with the chairperson of the business enterprise, the preparation of a cabinet submission for these business enterprises and, where appropriate, executive council documentation or other documentation to be used to enable the company to appoint the directors. Here I emphasise that all appointments to the government business enterprise sector are cabinet appointments with recommendation going through to executive council in many cases. The Department of Premier and Cabinet guidelines are most useful and may be a worthy reference for this committee in considering how board members are selected in these major enterprises in this state.

We have a responsibility for the tabling of annual reports. Under the Financial Management Act 1994, the State Owned Enterprises Act 1992 or federal Corporations Law, GBEs are required to prepare formal annual reports according to the requirements of the relevant legislation. These annual reports are submitted for tabling in both houses of the Parliament. Where the Treasurer is the tabling minister, the governance unit is required to review each annual report and to provide a brief to the Treasurer so that he can discharge his responsibilities properly in the house.

We have a document which is called the 'Corporate monitoring and governance guide'. As the committee has acknowledged in its issues paper, the governance group of DTF has issued a governance guide for GBEs. This has proven to be a simple and useful document to advise GBEs of the framework in which the department is going to operate. It was not, however, designed to be an operating manual more broadly in the public sector beyond the GBE sector.

We thought it might be useful to the committee if our department was invited to attend another meeting to speak specifically about the role of the budget and financial reporting division of DTF rather than the commercial division. This unit could inform you of the nature of the financial compliance framework that government businesses must follow in the application of the Financial Management Act 1994. This refers to the financial standards to be applied by state-owned enterprises to ensure a common approach is applied to compliance and the crossover between compliance of business enterprises and the public sector more generally through the financial reporting framework.

I am happy to answer any questions committee members may have on this framework we have developed to handle the larger organisations with the more significant financial risks of the state.

The CHAIR — Thank you. It is helpful for the committee to have that submission and that background information. We thank you also for the recommendations you have made as to further evidence we might hear as part of the work of this subcommittee and for other references that you have made. I will start with a question that draws together perhaps the earlier information that we heard from Mr Moran relating to the State Coordination and Management Council and its work in looking at corporate governance of NDPEs and ask how the corporate governance unit of DTF works with that committee? Presumably you have representation on it and you have much to share with the council in doing its work. Can you give the subcommittee some insight into the relationship between the two departments and its work on that council?

Mr HAWKES — Within the constraints that Mr Moran quite reasonably described, which include the fact that only some material has gone forward even to the Treasurer at this stage and has certainly not been discussed by ministers more broadly, I am happy to describe our thoughts at departmental level on what we think is appropriate for the Department of Premier and Cabinet to give some consideration to.

We currently have a framework for state-owned enterprises which we would claim is robust and comprehensive. The question is whether the framework should be extended more broadly into other enterprises in this state that might not specifically fit within the framework of the State-Owned Enterprises Act 1992, but may undertake some business activities which create financial risk for the state and which might only emerge through the Financial Management Act reporting framework after the event. Under the State-Owned Enterprises Act a considerable amount of our work is dealing with things in advance so that we understand what the business enterprises are planning to do, and then through a quarterly performance monitoring regime pick up on progress against that plan in an early way. We thought it was appropriate for the Department of Premier and Cabinet to give consideration to other enterprises that might need some assistance with understanding financial risk that they are about to embark on, or perhaps as early as getting involved in some of the structuring of these enterprises, if they are new enterprises being established. Sometimes that is an enterprise being established by a minister or perhaps a subsidiary of an existing enterprise.

We have put some suggestions to the Department of Premier and Cabinet in relation to framework, possibly around new legislation that says that different entities can be dealt with in different ways; you do not need to apply a deep and robust framework to an agency that is simply not financially risky to the state. So it is a scheduling in some way for a break-up of entities into groups as to the extent of financial risk they present to the state, and we leave it to the Department of Premier and Cabinet to deal with that suggestion as it sees fit.

The CHAIR — Thank you very much.

Mr FORWOOD — I would like to congratulate you on your submission and I look forward to getting my head around the deep and robust system that you have put in place. You are dealing with 22 really significant organisations and it would seem to me that one of the crucial things you need to do is ensure that you get your board appointments right, and I have two questions in relation to that. Firstly, are people of talent available sufficient for you to have confidence that these organisations are being represented at board level by people capable of fulfilling your desire for a deep and robust government system, and secondly, have you run into problems with timing of appointments?

Mr HAWKES — Firstly, as to the pool of talent, it is not a single pool; there are multiple pools. As we look at the structure of a board it could be that we are looking for some deep experience at board level in other places, perhaps in the private sector or perhaps in the government sector. It could be that we are looking for a particular blend of technical skills because of the industry groups that a business is in, such as the water industry or the financial sector where we have business enterprises. It could be that we are looking for a particular blend of youth and experience on the board or a blend based upon gender. In our view it is perfectly reasonable that we focus on gender balance on boards that reflects the community structure. So we then look at a variety of pools. The pool is fairly deep in terms of people who are experienced in corporate governance and who have had board experience in other places in terms of some technical groups such as those with a chartered accounting background, a legal background, perhaps some of the more common engineering disciplines — water engineering or civil engineering. It is perhaps not so deep in some areas like our ports corporation where we would like to have a marine engineer or a specialist in port matters, and we then look to the Department of Premier and Cabinet's guidelines, perhaps use search consultants or maybe advertise the position and draw upon the registers kept by some departments who specialise in those industries such as the Department of Sustainability and Environment or the Department of Infrastructure. We remain very cautious about using some of those sources because of the requirements of the Privacy Act and the fact that people's personal details have been given to those departments in some privacy. So we are conscious of that fact. So it depends on what we are looking for at the time to get that balance of skills, experience and gender on a particular board.

In terms of timing, we too maintain a system of early alert. It tells us six months in advance and we then have a timetable for each position which enables us to have conversations with the chair of the business and with the particular minister — in this case the Treasurer — and that enables us to head into those pools in a timely way and still meet cabinet's deadlines on getting papers to it at an appropriate time. We infrequently find ourselves up against a deadline, and in the last six years I cannot remember a case where we have not had a quorum on a board.

Ms CAMPBELL — I refer to this committee's strong interest in annual reports. You might know from our budget outcomes reports that we comment upon annual reports throughout the public service. As part of our inquiry into annual reporting in the Victorian public sector under the Financial Management Act we have recommended that the Financial Management Act be amended to allow the tabling of annual reports when Parliament is not sitting, and the Department of Treasury and Finance accepted the committee's recommendations. Could you give us some indication of where that has progressed since DTF's response?

Mr HAWKES — I cannot because I am not the specialist in the Financial Management Act nor its progress; it is a completely different division of Treasury that handles that. I think I will either take the question on notice or it could be referred back if you are going to meet with somebody from the budget and financial reporting area.

Ms CAMPBELL — But the GBEs under your preserve put their annual reports to Parliament.

Mr HAWKES — Yes, they do.

Ms CAMPBELL — And has there been any discussion about that at your level?

Mr HAWKES — At the present time we are required to table the annual report pursuant to the State-Owned Enterprises Act and that specifies tabling by 31 October or the next sitting day thereafter if 31 October is not a sitting day, and we hold to that date. Until we are told by the Budget and Financial Reporting Division of Treasury to do something different we will stick with that responsibility, but I suspect that there will be

a crossover here between the State-Owned Enterprises Act and the Financial Management Act which we will have to address internally.

Mr RICH-PHILLIPS — What role does the commercial division have with compliance monitoring of that set of GBEs under the Treasurer's influence, if you like. If you have an obscure, relatively minor GBE, what sort of process does the commercial branch follow to ensure that the framework you have outlined here is adhered to, particularly if it is a small GBE with possibly limited corporate governance experience on its board? Is it something that DTF is actively involved in and the Treasurer or the Minister for Finance takes responsibility for? Can you outline that please?

Mr HAWKES — Yes, I can. There are two aspects to compliance monitoring from our perspective. One is the formal quarterly reporting framework, which covers both financial and non-financial indicators. Non-financial indicators are typically service delivery indicators, whereby we insist that key performance indicators are developed for each business, depending upon its industry. They may have to do with timeliness of service delivery or quantity of service delivery. It really is a deep process, and it changes across the industry groups that we have. In terms of financial reporting, the indicators are a fairly standard suite used in both the private sector and the public sector. We have rolled out a more generic indicator of performance, which is a shareholder-value calculation. That is an economic value calculation based upon the weighted average cost of capital. I will not go into that too much more here, but that is a common indicator across the group.

The second element of our compliance framework is one that insists upon continuous disclosure. Continuous disclosure is an element brought from the private sector as well, which is used most frequently by the Australian Stock Exchange. It says that if the board is aware of anything that will have a material effect on the financial or non-financial performance of the business, the shareholder is entitled to know far earlier than at a regular reporting date. The continuous disclosure framework is well recognised by every business enterprise, I can assure you, and we would have regular discussions with the management of these enterprises about risks on a continuous basis as they are developing.

Mr RICH-PHILLIPS — In cases where those principles are not adhered to — and continuous disclosure is probably a good example — whose responsibility is it for follow-up? Is that something the department is actively engaged in, or does it lay down this framework and then assume that enterprises will adhere to those requirements? Is there an active monitoring process undertaken by the department?

Mr HAWKES — We believe compliance is a board matter. Ultimately it is a board matter until the board has proven itself of being incapable of handling the situation, in which case we would step in. After our conversations at executive level, we would, if necessary, escalate it to board level and ask for its follow-up of the particular issue. Again based on my experience, we have not had a matter that has not been dealt with comprehensively by a board if the board has been alerted at our level, and I also cannot think of a serious example where the Treasurer has had to get involved in the discussion with a board about such a matter.

Mr RICH-PHILLIPS — What I am particularly interested in is that alerting process. Assuming that a board or an enterprise has failed to comply with something, what process will lead to your alerting it to that? How do you monitor compliance?

Mr HAWKES — It is monitored on a quarterly basis or on a continuous disclosure basis, depending on the nature of the issue, with potential elevation to Treasurer level if it is serious and if there is continuing non-compliance.

Mr RICH-PHILLIPS — Obviously — —

The CHAIR — Sorry, Mr Rich-Phillips, you have had three follow-on questions, and Mr Forwood is indicating he has a follow-on question as well.

Mr FORWOOD — Mine is very brief.

Mr RICH-PHILLIPS — That is fine.

Mr FORWOOD — The only thing I wanted to ask was, do you monitor compliance of GBEs with the corporate planning documents? You went through how you do the negotiations and end up with the Treasurer, so there is some sort of — I will not use the word agreement — acknowledgment of the direction you want an organisation to go in; do you then monitor that direction?

Mr HAWKES — Indeed. It is monitored both through the financial projections that are included in the corporate plan and through the strategic projects coming out of strategic issues that a business will undertake. There is monitoring of their capital expenditure plans each quarter — for example; there is monitoring of their cash flows to ensure they are generating the cash they said they would; and there is monitoring of their borrowing levels through the same framework. So it is very much a continuous process. I know I keep using those words, but it really is a regular process of checking the elements of a business's operations, both financially and non-financially.

Ms GREEN — You referred before to the corporate monitoring and governance guide; would you describe this as a best-practice model for GP governance?

Mr HAWKES — It was at the time it was created. It was a document that was created during 1997, and it is now scheduled for update. The only reason we had paused for an update of that is what might come out of the Department of Premier and Cabinet's work at the present time on governance and non-departmental public entities as to whether it needs to be expanded a little more. But it is scheduled now for an update to make sure it is best practice. It has proven to be quite a durable document, though. Corporate governance has grown in those years, but we would say it is the role of the board to interpret the current philosophies on corporate governance and apply them to their business, rather than to turn to a corporate guide, which we would not ever describe as an operations manual.

Ms GREEN — What features of the guide would you say have been incorporated into Victoria's governance arrangements? You were saying it probably is a best-practice model, so what particular features do you think have been incorporated?

Mr HAWKES — I am not sure I am competent to answer across the Victorian governance framework. I think I am competent to answer questions in relation to the GBEs.

Ms GREEN — In the GBEs, yes.

Mr HAWKES — Your question then is?

Ms GREEN — What features of that have been incorporated overall? If you are calling it a best-practice model, which things would you want to highlight as being the most important?

Mr HAWKES — Firstly, there is the structure for board appointments and the identification of the key roles and responsibilities of board members when they are placed on these boards; secondly, a corporate planning framework that lets the shareholder know in advance what these business enterprises plan to do three years ahead; and thirdly, a financial reporting framework for these businesses that will enable the shareholder to understand whether they are doing what they said they were going to do through the corporate plan process. Questions of structure of a corporation come through legislation and not through this guide. So whether it is a state-owned enterprise that turns out to be a state body, a state-owned corporation or a state business corporation is a question for legislation and for the minister and cabinet; it is not a question for this manual, but it is a key element of governance processes. That is what is not in it at the present time.

The CHAIR — The Department of Treasury and Finance has developed risk-related exemption criteria under which agencies can apply for exemptions from corporate governance requirements. What has been the department's experience in the number of agencies seeking such exemptions?

Mr HAWKES — I do not believe we have ever given an exemption to any of the business enterprises I have spoken of today. Again I cannot talk more widely than that.

Mr FORWOOD — I just want to touch on the issue of risk management again, particularly in organisations like these which are exposed to significant risks of a wide variety, not just commercial or financial. I wondered what process you have in place to ensure that the risk management framework internally in the GBEs for

each one is robust enough for you. As an adjunct to that, do you get copies of the agendas and board minutes of the GBEs?

Mr HAWKES — We believe that risk management is a key responsibility of the board of directors and we would counsel incoming board members on that very important responsibility. This is because they are responsible and they have potentially quite some liability if they get it wrong — —

Mr FORWOOD — Individual liability.

Mr HAWKES — Individual liability if they get it wrong. We would not attempt to tell them what we think the risks are in a particular business enterprise because business risk varies so much across each enterprise and we think the board is best placed to inquire of those risks and decide that they are being properly managed.

We do not seek nor receive board agendas or board minutes except where the legislation prescribes it. Working a little from memory, I believe Treasury Corporation of Victoria is required to supply its minutes to us but not board papers — not discussion papers, just board minutes. I would need to check my memory on the Rural Finance Corporation. They are rather specialist activities, they are financial institutions. The Treasury Corporation of Victoria is probably the closest financial institution to the Department of Treasury and Finance because it is our borrowing arm. There was perceived by Parliament to be a need for the minutes to come across so they can become departmental papers.

Mr FORWOOD — Y2K turned out to be a damp squib, but I guess you instructed each of the GBEs at that time that they were to treat Y2K as a serious business risk. I presume with terrorism and the port, again would you not see it as your role to ensure that the port corporation is liaising with the Australian Federal Police or whoever it is to fix it up and make sure we do not get those sorts of things? Are you saying that you do not go that far or you do?

Mr HAWKES — First of all, Y2K — —

Ms CAMPBELL — In terms of a point of order, Chair, I am not quite sure what Mr Hawkes is going to answer and I do not imagine it would be anything that would be a security risk, but this is going on transcript and I just wanted to highlight that.

Mr FORWOOD — Sure.

Ms CAMPBELL — I am happy for you to follow it up.

Mr HAWKES — I will take note of that. Y2K is an interesting case in relation to business enterprises. The Department of Treasury and Finance created a unit that focused on Y2K in the belief that it was a very important issue. It offered its services to the business enterprises rather than have each of them develop their own expertise or hire their own consultants and contractors. Every business enterprise that I can recall utilised the services of that unit and then personalised it to the industry. They did have their own specialists in-house, but they could contain the expenditure so there was limited doubling up, if any at all. That was an interesting model that we are alert to going forward.

The other issue you raised is the point where a portfolio minister would be the point of contact for the board. In most of our business enterprises there are two ministers involved — there is the Treasurer and there is a portfolio minister. I would have thought the portfolio minister for the port would have an interest in port risk issues. The Treasurer would have a concern as to the impact on the government as a shareholder perhaps but would leave the portfolio matters to the portfolio minister and we would therefore not get involved in those portfolio issues.

Ms CAMPBELL — The Auditor-General's report on public sector agencies referred to corporate governance being enhanced by an effective and independent audit committee. He encouraged greater attention to be given by a number of boards or accountable officers of public sector agencies to ensuring that audit committees are established and operate in accordance with better practice. Do you have any comment to make in relation to activities over the past year on the structure of audit committees in your particular area of responsibility? Is there anything in particular that you would like to draw to our attention that we should really focused some of our attention on?

Mr HAWKES — I am happy to. We would suggest to every board that an audit committee is a key feature of corporate governance in the business enterprise sector. In some small institutions it may be the whole board that deals with this as a separate subject at its regular meeting. However, as we move into the larger organisations — perhaps the largest 10 or 12 organisations out of the 20 plus — we would say that there is a real need for a board audit committee. We would suggest that the board should incorporate in an audit committee members who have audit or accounting experience from their past or current work environment. We would say that the chief executive is not a member of an audit committee, but the chief executive should be prepared to attend audit committee meetings and should be prepared to answer questions, as should the chief financial officer. We would say that where a board is five to eight members we would expect two to three people to be on the audit committee to reflect the importance of the issues coming up in front of it. We have some general guidelines on this and we gain good support for those when we talk with the boards. We now have board audit committees in all of the major business enterprises.

The CHAIR — We are just about out of time; is there another burning question?

Mr RICH-PHILLIPS — I would like to ask one.

The CHAIR — Perhaps we will make yours the final question.

Mr RICH-PHILLIPS — I was wondering if you could expand on the dividend policy. You mentioned six factors which are taken into consideration when dividends are being negotiated between the board and government. Can you tell us more about that negotiation process, given that some of these factors are external to the operations of the GBE, particularly the budgetary requirements of the state? Given your earlier comment about the planning process whereby the Treasurer accepts rather than approves so there is not seen to be a director relationship there I was wondering how that sits with the requirement to consider the budgetary requirement of the state which is an external factor to the operation of the GBE. Are those six factors something that the boards are required to consider in the negotiation or is it the case that some of them are considered from the government point of view and others exclusively from the GBE point of view? Can you expand a bit on that process?

Mr HAWKES — In fact the latter case you put is what applies. Each party brings to the discussion their own perspective on these features. Let me address the budget question: the government has put a significant amount of capital into these businesses and we would argue in DTF that that capital has a cost just as any shareholder in a private sector business would claim that the money they are putting in has a cost, and it should have a dividend yield applied to it. It is purposely put at the end of our list of dot points in our paper. It is not the overriding criteria here. In our view it is important for the state to earn a return commensurate with the amount of capital involved in the business and commensurate with the degree of risk taken in that investment; so we look at each business according to the risk which comes through the calculation of the weighted average cost of capital, and we look at the generation of profits that these businesses are required to earn through the State Owned Enterprises Act, which says they must act commercially.

The other dot points are usually things that the board brings to the table. They would talk about their plans for the use of funds in the businesses and whether those funds are to be borrowed funds or whether they are to be generated from business activity and hence profits are retained in the business rather than being distributed to the shareholder, so we take account of the need for funds for growth in a business going forward. We take account of things like the credit-worthiness of businesses, because even though they do not borrow from the public, they borrow from the Treasury Corporation of Victoria. We would not want to see business enterprises that are not credit-worthy in their own right because it could impact on the financial risk of the state as assessed by ratings agencies, so we are trying to balance credit-worthiness across these institutions as well. I am happy to talk about any of the other dot points if that helps.

Mr RICH-PHILLIPS — Could you just contrast the difference between the first dot point, which refers to the dividend yield return on capital and the last one, which is separately listed as the budgetary requirements of the state — is there a distinction between those two? In your first answer I thought you were talking about the investor.

Mr HAWKES — Yes, the appropriate dividend yield for an investor is a calculation of what is a required yield, and it would come up with a percentage return on capital employed.

Mr RICH-PHILLIPS — Does it take account of weighted average cost of capital risk, et cetera?

Mr HAWKES — That is right, it does. So the first dot point is a calculation of what is an appropriate yield to a shareholder from a business enterprise. The last dot point, the budgetary requirements of the state — as I say, it is put last purposely because it is not a key point — are such that we require a return on funds invested, and that tends to be a calculation more of the government's cost of capital. But it is a matter of history that these businesses have been able to generate funds for the benefit of consolidated revenue that are available to be used more widely across the public sector, so there is no ignoring the budgetary requirements of the state here.

Mr FORWOOD — I must have been wrong last year when I claimed that the reason you took the extra dividends from the water authority was to get a \$100 million surplus!

Mr HAWKES — Would you like me to respond to that?

Ms CAMPBELL — You are often wrong, Mr Forwood. We are just used to it, Mr Hawkes!

The CHAIR — I do not think you need to respond to that! That completes the hearing. Thank you, Mr Hawkes and Mr Hodgson, for spending time with us this morning. We thank you for the written submission that you have provided to the subcommittee and for being prepared to answer our questions. We are very grateful for that. After we have reviewed the transcript there may well be some follow-up questions — not to the one of Mr Forwood, of course — and they will go forward to you for a response if they arise. Thank you very much again.

Mr HAWKES — Thank you.

Committee adjourned.