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Dear Ms Solomon

NSW boards and committees: Consultation paper

Governance Institute of Australia (Governance Institute) is the only independent professional association with a sole focus on whole-of-organisation governance. Our education, support and networking opportunities for directors, company secretaries, governance professionals and risk managers are unrivalled.

Our members have primary responsibility to develop and implement governance frameworks in public listed, unlisted and private companies, as well as not-for-profit organisations (NFPs) and the public sector. Governance frameworks encompass formal and rigorous processes that independently verify and safeguard the stewardship of public sector resources. Ensuring the preservation of the integrity of these resources is vital in maintaining community confidence in government.

We welcome the opportunity to provide feedback on the Consultation paper and thank the Department for allowing us to lodge a late submission after the deadline for responses has passed.

Governance Institute commends the Department in its efforts to improve the way NSW Government entities operate and how they interact with the community and businesses by clarifying and improving public reporting to ensure their purpose and function is easily understood by the community and business. It is Governance Institute's view that these efforts should be undertaken more regularly to ensure that there is greater congruence of the entity's activities with state government priorities. Boards should report annually to the relevant Minister on how well their activities have been directed at these priorities.

Governance Institute notes that the administrative changes proposed by the NSW Government are not intended to impact the function of the entity but will result in the entity reporting directly to its corresponding government agency or department. We also note that where reform involves the discontinuation of some entities, frontline services will not affected nor jobs lost within the public service.

We consider that, as with the private sector, it is important for public sector entities to be fit for purpose, with clarity as to how they are to be subject to direction and control, as well as the responsibilities and duties of those with influence over decision-making and their reporting responsibilities. We note that a particular governance issue in the public sector is that the introduction of various types of public sector entities in different Acts results in inconsistencies in the definition of a public sector entity. As a result, there is the potential for the following issues to arise:

- a lack of clarity about the role and powers of public sector governing bodies/boards, which has implications for the understanding by directors/members (and indeed other stakeholders, including 'owners') of their accountability, responsibilities and obligations
- a myriad of legal structures, which has implications for the types of governance frameworks that are implemented for each entity
- uncertainty about differing funding and reporting obligations for different types of public sector entities, and
- increases in associated costs for entities that may be required to seek advice about their reporting, audit and other accountability requirements
- duplication of functionality.

We also note that introduction of various types of public sector entities results in a lack of clarity among public sector bodies as to their roles and powers. It is good governance, therefore, for the shareholding or relevant ministers or head of the agency responsible for creating a governing or advisory body or board to detail the accountabilities, responsibilities and obligations of the directors of the board or governing or advisory body, as well as those of other stakeholders, including the shareholding or relevant ministers, where applicable.

In the first instance, it is good governance to establish whether the public sector board is a governing or advisory body. An advisory board provides expert advice to the shareholding or relevant ministers and/or the senior executives. A governing board is empowered to set the strategic direction and oversee the management and performance of the organisation.

Governance Institute supports the Governments' proposed reforms, which we believe are likely to bring some clarity to these issues across a range of NSW Government entities.

Governance Institute has developed guidance on the issues to be considered in the formation of public sector boards and entities in *Good Governance Guide: Issues to consider in the formation of public sector boards* and *Good Governance Guide: Issues to consider in the formation of public sector entities*. These Guides are attached to this submission for your reference.

Yours sincerely

Judith Fox FGIA
National Director, Policy & Advocacy

Good Governance Guide

Issues to consider in the formation of public sector boards

Public sector governance

In order to keep pace with longer-term objectives, government change and community needs, governments consider the establishment of boards (advisory or decision making) within departments or consider the creation of other public sector entities (for example, statutory bodies) which in turn have boards established to run them. Ultimately, members of these boards take on a 'directorship' role similar to that in a company.

The introduction of various types of public sector entities across Commonwealth, state, local government and territory public sectors has resulted in a lack of clarity among public sector bodies as to their roles and powers: see Good Governance Guide: *Issues to consider in the formation of public sector entities*. It is **good governance**, therefore, for the shareholding or relevant ministers or head of the agency responsible for creating a governing or advisory body or board to detail the accountabilities, responsibilities and obligations of the directors of the board or governing or advisory body, as well as those of other stakeholders, including the shareholding or relevant ministers, where applicable.

While governing or advisory bodies or boards may be established pursuant to statute or other mechanisms, it is **good governance** for the shareholding or relevant ministers or head of the agency responsible for creating the board to outline the business case and detail the value proposition which sets out the criteria for creating the governing or advisory body or board in the first place.

The business case for establishing a board should highlight the value of directorship in the public sector, which might include the oversight of and advice and guidance in relation to the:
- robustness of strategies to improve performance and contribute to community well-being
- capability and culture of the organisation/management to implement the strategies and deliver services effectively, efficiently, ethically, and legally
- business risks, their mitigation and effectiveness of controls, and
- integrity of financial statements and compliance.

Choosing the right form of board

In the first instance, it is **good governance** to establish whether the board is a governing or advisory body. An advisory board provides expert advice to the shareholding or relevant ministers and/or the senior executives. A governing board is empowered to set the strategic direction and oversee the management and performance of the organisation.

Clarity as to which form of board is the most fit for purpose is central to outlining the business case and detailing the value proposition. A one-size-fits-all approach is not appropriate to such determinations, as the formation of a board will need to reflect:
- why the board was established in the first place
- its legislative requirements
- any other relevant circumstances, such as whether the statutory appointment of an individual to fulfil the role, for example, a commissioner, may be appropriate. However, it should be noted that normally an individual does not constitute a board, unless otherwise prescribed by legislation, for example, a government-appointed administrator of a local government council.

Having regard to the above, the form of the board may include any of the following:
- a statutory board which has been constituted by an act of state or federal parliament
- a board of a company (given that a company in this context would be an entity controlled by another public sector entity) which has been established by the constitution of the company
- a board of a commercialised government entity (such as a government-owned corporation, [GOC],

government business enterprise [GBE], state-owned corporation [SOC] or government trading enterprise [GTE]), which has been set up by either an act of parliament or the constitution of the corporation
- an internal decision-making board of management or executive team which has been formed by the charter or terms of reference approved by the director general or departmental secretary (see Good Governance Guide: *Achieving governance in organisations without boards*)
- an internal non-decision making executive team or advisory board constituted by either charter or terms of reference approved by the director general or departmental secretary, or an act of parliament (see Good Governance Guide: *Achieving governance in organisations without boards*)
- a board of a joint venture which is created through the terms of contract between individual entities.

A local government council which has been created by state legislation also acts as 'board' in a practical sense. Joint local governments usually are run by a board of representatives of the component local governments. While a local government council is elected by local voters, aspects of this Good Governance Guide are also relevant, for example, where a local government has established an internal board of management or executive management group or has established a controlled entity, for example, a company with a board over whose decision making the local government has significant influence.

Understanding the role and responsibilities of the shareholding or relevant Ministers and the board

The terms of reference or charter or pertinent legislation should clearly establish the roles and responsibilities of board members and clarify the authority of the board and its accountability to the shareholding or relevant ministers, where applicable.

It is **good governance** for the public sector entity to document:
- the identities and roles of the key stakeholders (for example, minister, chairman, directors, chief executive (or equivalent) etc)
- the powers vested in each stakeholder and the basis on which such powers rest (for example, do the powers arise from legislation?)
- the reporting responsibilities of each stakeholder and the identity of the stakeholder to whom those reporting obligations are owed (for example, does the chief executive report to the board or to the relevant minister directly?)
- whether the relationships between stakeholders are formally based in a performance agreement, and the nature of the performance agreement
- the frequency of review of any performance agreement
- the function of the board (advisory or governing)
- the extent of the board's decision-making powers, including powers of delegation
- clarity of roles as between the board and the shareholding or relevant ministers as to who
  - sets the strategic direction of the business
  - appoints the chairman of the board and its members
  - appoints the chief executive or managing director
  - determines the remuneration of the board and CEO
- recruitment and selection of the board members.

It is **good governance** to adopt a wide view of the operation of boards in general by considering the following:
- In general, boards should be established with a long term view, unless they have been established for a particular short-term project.
- The longer-term view should take account of:
  - longer-term value drivers of the agency
  - feedback from its stakeholders, including the community
  - members of the board actively overseeing and understanding the board strategy and regularly monitoring, along with management, the implementation and effectiveness of strategic plans
  - risk management, including strategic risks and the relationship of those with the board strategy and key objectives.

It is **good governance** to also consider:
- implementing a protection mechanism for board decision-making for directors on public sector boards which is akin to the business judgment rule under s180 of the *Corporations Act 2001*, or otherwise clarifying whether this type of protection is available or desirable, for example, this protection is not required

for an advisory board that does not engage in business decision-making
- designing a plan for ongoing review of the board's functions and ensuring that its functions are aligned to the longer-term view of the government
- ensuring that there are arrangements in place for the dispensation of assets and liabilities of the agency upon dissolution
- how the life cycle operating costs of the board will be assessed
- the most appropriate audit arrangements for the board, and
- seeking approval for remuneration requirements, in line with Commonwealth and state guidelines.

Consideration should also be given to the appropriate size of the board. Good governance practice indicates that the larger the board, the greater the difficulty in achieving consensus when making decisions. Notwithstanding this, diversity of opinion is essential to the proper functioning of a board. In the private sector, the majority of companies permit a maximum of up to ten directors on the board.

The board's requirements and relationship with the shareholding or relevant ministers should also be regularly reviewed to ensure that there is no misalignment with government priorities.

Oversight responsibilities of the board

It is **good governance** for the terms of reference or charter to link the board's function to the government's key policy and service delivery priorities. It is also a matter of **good governance** to decide if the structures and processes which are integral to the strategic oversight of the board are to be contained in the terms of reference or charter or in supporting documentation that can be amended by the board without reference to the shareholding or relevant ministers.

As a matter of **good governance**, the board should be independent of management or political influence and resilient to changes in the machinery of government. It is also important that any directors appointed to the board by a sponsoring body have clarity that they must act in the best interests of the organisation rather than the constituency they represent.

It is **good governance** for professionalism to be promoted among public sector boards. Such an approach should include the board's responsibility to:
- implement an induction program for all new directors and provide for access to continuing education to update and enhance directors' skills and knowledge, recognising any legislative requirements in relation to skills sets
  which may relate to specific sectors within which the board operates
- implement a plan for evaluating and identifying the relevant competencies, skills, experience and expertise required by the board in order to discharge its responsibilities
- develop a governance framework based on the relevant legislation, regulations and standards applicable to the organisation
- appropriately integrate with board committees and detail the board committees' responsibilities
- design the relevant delegations policy required to support the board structure
- implement a process for the regular review of board performance — it may be an internal or externally-facilitated review process
- ensure a risk management policy is developed for the oversight and management of risk and require management to design and implement the risk management framework and internal control system, including reporting to the board on whether risks are being appropriately managed
- ensure a policy for managing conflicts of interest and related party transactions is developed (consideration can be given to whether this policy needs to include reference to political affiliations), which includes a process for managing perceived, actual and potential conflicts of interest
- provide input to and final approval of management's development of the strategic plan and performance objectives
- ensure it can provide strategic guidance to the public sector entity and effective oversight of management.

See also: various Good Governance Guides in the section on *Board structure*.

Role of the chair

The role of the chair is to encourage independence and diversity of thought in the boardroom and establish a collegiate culture that is not captive to group think. While the board is charged with acting in the best interests of the organisation, the chair's role in the public sector can face different challenges than in the private sector. The chair must take into account the government's policy objectives, the role of the shareholding or relevant ministers and the board's contribution to government outcomes. Ideally, the chair needs to be politically astute to ensure that the agency can effectively interact with the government.

The chair must also promote team dynamics and work with the board to set the overall tone for the organisation, including establishing an agreed set of values for the culture of the organisation and setting expectations in terms of behaviour.

Selection and appointment process of directors

While the selection and appointment of directors/ members on public sector boards is usually the responsibility of the shareholding or relevant ministers — or, in the case of an internal board, the head of a public sector entity — it is **good governance** for a public sector board to evaluate the range of skills, experience and expertise it requires to discharge its responsibilities. Such an evaluation enables identification of the particular skills that will best increase board effectiveness and provides an opportunity for the board to offer advice to the shareholding or relevant ministers in relation to board renewal and succession planning (see Good Governance Guide:t *Matters to consider in the selection and nomination of directors*).

In order to enable an efficient mechanism for advice on the selection and appointment of directors (other than for an internal board of management), it is **good governance** for a public sector board to establish a nominations committee (or similar mechanism). Such a committee can make recommendations about the necessary and desirable competencies of the directors. It is important that the board's charter clarify whether the board is able to recommend its own appointments, or whether suggestions for board appointments should be provided to the shareholding or relevant Ministers for consideration (see Good Governance Guide: *Nomination Committee*).

An independent nominations panel advising the government on the selection and appointment of directors is an alternative model that can be considered. An external provider may also be used in the identification and selection process.

Evaluating the performance of the board

It is **good governance** for the board to put in place a policy and mechanism for annual evaluations of the board.

Assessment of the board's performance should be undertaken in relation to the value proposition set out in the business case and value proposition for establishing the board.

It is **good governance** for an externally-facilitated evaluation to take place every two to three years with an annual internal evaluation in the intervening period. It is also **good governance** for a regular review of the implementation of the recommendations arising from the evaluation to be undertaken.

Secretariat support

Appropriate administrative and secretariat support for the board is integral to ensuring that the operation of the board remains efficient and effective. It is **good governance** for the shareholding or relevant Ministers or agency appointing the board to clarify who will be responsible for providing secretariat support to the board.

Good Governance Guide

Issues to consider in the formation of public sector entities

Public sector governance

The Commonwealth, state and territory public sectors are comprised of multiple types of organisational forms, including entities. They are generally established by an Act of Parliament (for example, Public Service Act), or are deemed by legislation to be a public sector entity because they are controlled by another public sector entity or are established by a specific constituting Act, for example, a public sector entity might be a government-owned corporation constituted under a State Government Owned Corporations Act.

The introduction of various types of public sector entities in different Acts and across different jurisdictions has resulted in inconsistencies in the definition of a public sector entity.

As a result, there is the potential for the following issues to arise:

- a lack of clarity about the role and powers of public sector governing bodies/boards, which has implications for the understanding by directors/members (and indeed other stakeholders, including 'owners') of their accountability, responsibilities and obligations
- a myriad of legal structures, which has implications for the types of governance frameworks that are implemented for each entity
- uncertainty about differing funding and reporting obligations for different types of public sector entities, and
- increases in associated costs for entities that may be required to seek advice about their reporting, audit and other accountability requirements.

It is **good governance** for governments and their ministers and any panels advising them to utilise a limited menu of pre-defined categories of organisational forms from which to choose when creating a public sector entity to ensure that clarity is achieved as to the governance framework that is being established, including the accountability and responsibilities of the governing body/board. Each category should, within applicable regulatory constraints, outline the governance framework applicable to any entity created under a particular category; the framework would provide guidance for the governance documentation created for the relevant entity.

The private sector has clarity as to the role of the governing body, the responsibilities and duties of those who have influence over decision making and the reporting responsibilities of the entity to members and other relevant parties.

In the public sector, it is equally important that the entity must be fit for purpose, with clarity as to how it is to be subject to direction and control, the responsibilities and duties of those with influence over decision making and the reporting responsibilities of the entity.

It is **good governance** for a public sector entity to be any of the following principal categories:

- a department, or
- a statutory body (Including universities), or
- a commercialised government-owned entity (including government and state-owned corporations, government business enterprises and government and government trading enterprises), or
- a local government.

Other types of peripheral public sector entities, including controlled entities, advisory bodies, executive agencies and public service offices, should be carefully considered to ensure that their proposed contribution or alignment to government priorities can be readily assessed and their proposed role cannot be performed by or within an existing department, statutory body, government-owned corporation/enterprise or local government. Rigorous performance assessment processes should be in place to evaluate the need for the continued operation of each individual body. Clear guidance should be given as to the governance, reporting and disclosure requirements of each entity.

Entities which are controlled by government departments, statutory bodies, commercialised government entities, or local governments also pose issues surrounding clarity of role, accountability and responsibilities to the parent organisation, reporting, and cessation of the entity due to interpretation of what the term 'control' means. Some definitions include:

- the controlling entity has influence over the body that runs the entity, that is, the governing body. This influence can be overt, such as when the entity has the ability to appoint half or more of the directors, thereby dominating decision making, or less overt, or
- the controlling entity has the ability to determine operational outcomes even if it has no control over the governing body, or
- an investor has the ability to use its power over the investee to affect the amount of the investor's returns.

It is **good governance** to establish, across the states and Commonwealth, a uniform basis for determining whether or not an entity is 'controlled' by another public sector entity.

In general, peripheral public sector entities add unnecessary complexity to the public sector landscape and may result in further confusion with respect to the accountability, decision making responsibilities, reporting obligations, and risk and transparency requirements which the entity is obliged to observe.

It is **good governance** for the constituting legislation to define the terms of reference for public sector entities established under that legislation so as to clearly state the basis for financial accountability and public administration in order to avoid confusion, uncertainty and the legal costs associated with clarifying this basis.

It is also **good governance** for an entity and those establishing it to understand the context of the entity, including regulation, policy and all relevant rules and directives of public administration to ensure that an integrated governance framework is in place. An integrated governance framework may need to consider the potential for collaboration and interaction with other public sector agencies.