

The Auditor-General  
Audit Report No.15 2000–2001  
Performance Audit

**Agencies' Performance Monitoring of  
Commonwealth Government  
Business Enterprises**

Australian National Audit Office

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Canberra ACT  
9 November 2000

Dear Madam President  
Dear Mr Speaker

The Australian National Audit Office has undertaken an across-agency performance audit in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Agencies' Performance Monitoring of Commonwealth Government Business Enterprises*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—  
<http://www.anao.gov.au>.

Yours sincerely



P. J. Barrett  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

## AUDITING FOR AUSTRALIA

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# Abbreviations/Glossary

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ACA	Australian Communications Authority
AGS	Australian Government Solicitor
ANAO	Australian National Audit Office
ARTC	Australian Rail Track Corporation Limited
ATG	Australian Technology Group Limited
Australia Post	Australian Postal Corporation
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
ComLand	ComLand Limited
CSAU	Commonwealth Shareholder Advisory Unit
CSOs	Community Service Obligations
DOCITA	Department of Communications, Information Technology and the Arts
Defence	Department of Defence
DISR	Department of Industry, Science and Technology
DOFA	Department of Finance and Administration
DHA	Defence Housing Authority
DHAC	Department of Health and Aged Care
DTRS	Department of Transport and Regional Services
EAL	Essendon Airport Limited
EN	Employment National
GBE	Government Business Enterprise
GTEs	Government Trading Enterprises
HSA	Health Services Australia Limited
JCPAA	Joint Committee of Public Accounts and Audit
Medibank Private	Medibank Private Limited
NPAT	Net Profit After Tax
OASITO	Office of Asset Sales and IT Outsourcing
ROIC	Return On Invested Capital

SACL	Sydney Airports Corporation Limited
SCI	Statement of Corporate Intent
SHT	Snowy Hydro Trading Pty Ltd
SHL	Snowy Hydro Limited
SMHEA	Snowy Mountains Hydro-electric Authority
SOE	State-Owned Enterprise
Telstra	Telstra Corporation Limited
Telstra Act	<i>Telstra Corporation Act 1991</i>
WACC	Weighted Average Cost of Capital





# **Summary and Recommendations**



# Summary

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## Background

1. Government Business Enterprises (GBEs) constitute significant Commonwealth Government investments and operate in key parts of the Australian economy. The GBEs operate in a diverse range of business activities ranging from telecommunications to health insurance and transport infrastructure. In 1998–99, Commonwealth GBEs generated revenues of nearly \$25 billion; controlled assets of some \$40 billion; and provided to the Commonwealth dividends of nearly \$3 billion.

2. A GBE is a Commonwealth authority or company that is prescribed under the regulations to the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The decision whether or not to prescribe Commonwealth authorities or companies as GBEs rests with Ministers. As at 30 June 2000 there were 13 Commonwealth GBEs.<sup>1</sup> Given the magnitude of the public investment which GBEs represent and their economic importance, successive Governments and the Parliament have had a continuing interest in the governance, performance and accountability of these entities. Accordingly, monitoring by agencies of Commonwealth GBEs is seen as important area for performance audit coverage.

3. In May 1999, the Parliament's Joint Committee of Public Accounts and Audit (JCPAA) commenced an inquiry into corporate governance and accountability arrangements for Commonwealth GBEs. The Committee's report on its inquiry was tabled in Parliament in February 2000. The Committee made seven recommendations relating to the current GBE governance framework. The Government provided the JCPAA in June 2000 with its response to four of the Committee's recommendations and advised that, as the remaining recommendations involve cross portfolio impacts and/or significant changes to the Governance Arrangements, these will be addressed in a separate Government response.<sup>2</sup> In its report, the Committee noted its support for the ANAO's proposal to conduct this audit.

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<sup>1</sup> Australian Postal Corporation (Australia Post), Telstra Corporation Limited (Telstra), Defence Housing Authority (DHA), Employment National (EN), Australian Rail Track Corporation Limited (ARTC), Australian Technology Group Limited (ATG), Health Services Australia Limited (HSA), Medibank Private Limited (Medibank Private), Snowy Mountains Hydro-electric Authority (SMHEA), Essendon Airport Limited (EAL), Sydney Airports Corporation Limited (SACL), ComLand Limited (ComLand) and the Australian Government Solicitor (AGS).

<sup>2</sup> The Government's response provided by the Minister for Finance and Administration outlined the actions it will take in response to Recommendations 1, 4, 5 and 7 of the JCPAA's Report No.372, *Corporate Governance and Accountability Arrangements for Commonwealth Government Business Enterprises*.

## Audit Approach

4. ANAO previously considered monitoring by Commonwealth agencies of GBEs in Audit Report No. 2 1997 that had regard to the March 1997 report of the *Review of GBE Governance Arrangements* and the commencement on 1 July 1997 of new Governance Arrangements for GBEs. This audit examines the monitoring by the Department of Finance and Administration (DOFA) and relevant portfolio departments<sup>3</sup> of portfolio GBEs since 1 July 1997 against the requirements of the new Governance Arrangements and relevant legislation.

5. The objectives of the audit were to examine:

- the effectiveness of agencies' implementation of the current GBEs' governance framework;
- the extent to which agencies and GBEs comply with the Governance Arrangements and legislative requirements; and
- whether the GBE monitoring system provides an effective level of accountability to Ministers and to the Parliament.

## Audit Conclusions

### Governance framework

6. The most recent reforms of the GBE accountability framework involved the introduction from 1 July 1997 of the current Governance Arrangements for GBEs and the commencement on 1 January 1998 of the CAC Act, part of the legislative package replacing the *Audit Act 1901*. The CAC Act, for the first time, sets out in legislation an accountability and reporting regime for all Commonwealth authorities and companies, including GBEs. The current GBE Governance Arrangements reflect the requirements of the CAC Act and expand upon them.

7. The current GBE governance framework represents a marked improvement over the system applying until June 1997. The revised Governance Arrangements issued by the Government in June 1997:

- introduced a model where the Commonwealth's ownership interest was to be represented by two 'Shareholder Ministers', the portfolio Minister and the Minister for Finance and Administration;

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<sup>3</sup> Departments other than DOFA that have responsibility for the GBEs included in the scope of the audit are the: Department of Transport and Regional Services (DTRS) in relation to ARTC; Department of Health and Aged Care (DHAC) in relation to Medibank Private and HSA; the Department of Defence (Defence) in relation to DHA; Department of Communications, Information Technology and the Arts (DOCITA) in relation to Australia Post and Telstra; and Department of Industry, Science and Technology (DISR) in relation to ATG and SMHEA.

- included an increased emphasis on financial performance covering issues such as capital structure, dividend policy, risk management, financial targets and GBE borrowings;
- clarified the application of the governance arrangements to GBEs involved in a sale or restructuring process; and
- introduced a requirement for GBEs to table annually in the Parliament a Statement of Corporate Intent.

8. The March 1997 report on the *Review of GBE Governance Arrangements* recommended that a GBE Unit should be established within the then Department of Finance, which would be responsible for providing commercially focussed advice on GBEs to Shareholder Ministers. Acting on this recommendation, DOFA established the Commonwealth Shareholder Advisory Unit (CSAU) which has centralised responsibility for the Department's role in GBE oversight and concentrated staff with the range of financial and analytical skills required to undertake this role.

9. Under the Governance Arrangements, the focus in the portfolio departments is generally on operational and industry policy issues while DOFA generally takes the lead on financial governance issues. The final outcomes on issues relating to dual Shareholder Minister GBEs are negotiated between the Ministers and the agencies. Accordingly, there is little apparent duplication of effort by the portfolio departments and DOFA.

10. Audit Report No. 2 1997–98 identified that a significant portion of GBE oversight under the 1993 GBE arrangements was undertaken in the various portfolio departments by a small number of staff with varying skills and experience. In this circumstance, there was the potential for a relatively large loss of corporate memory and expertise if these staff left the departments without at least some system for capturing that experience and knowledge. The centralisation of responsibility for the bulk of the work on financial issues relating to the GBEs within DOFA's CSAU has contributed structurally to redressing this weakness.

### **Compliance with the Governance Arrangements**

11. A principal objective for each GBE is that it adds to shareholder value and, in order to achieve this, it is required to: operate efficiently; price efficiently; and earn at least a commercial rate of return. Accordingly, to allow the Government to monitor GBEs' performance against these requirements, a number of obligations have been placed on GBEs under the GBE accountability framework. Compliance with these obligations is an important aspect of agencies' performance monitoring of GBEs.

### *Corporate plans*

12. At least once a year, all Commonwealth GBEs, are required to prepare and provide to Shareholder Ministers a corporate plan that covers a period of at least three years and also covers any subsidiaries of the GBE. With the exception of Essendon Airport Limited (EAL), GBEs have submitted corporate plans each year in accordance with the requirements of CAC Act and the GBE Governance Arrangements. EAL was advised by DOFA in April 1999 that it need not provide a corporate plan for 1999–00 to the Shareholder Minister due to the uncertainty surrounding the company’s ownership. The requirement for wholly Commonwealth owned GBEs to provide a corporate plan at least once a year to the responsible Minister is set out in the CAC Act. Moreover, that Act does not include any discretion to excuse a GBE from compliance with this requirement.

13. The best practice timetable for submission of GBE corporate plans provides that GBEs should submit their corporate plan to Shareholder Ministers for comment by 31 May each year with Shareholder Ministers responding by 15 July and final corporate plans submitted to Shareholder Ministers by 31 July. All of Australia Post and Telstra’s corporate plans have been submitted by July each year with the exception of Telstra’s 1997 corporate plan, which Ministers agreed should be submitted in September 1997 in light of the first tranche sale of Telstra shares. In respect of the remaining GBEs, where revisions have been required by Ministers, final corporate plans have generally been submitted well after the 31 July date specified in the best practice timetable.

### *Capital structure*

14. The GBE Governance Arrangements provide that each GBE should have a target optimal capital structure<sup>4</sup> that is agreed annually between the directors and the Shareholder Ministers in the consultation process for developing the corporate plan. DOFA advised ANAO that it has in place a comprehensive framework for the analysis of GBEs’ capital structures. DOFA noted that a number of reviews have been commissioned either by GBEs or DOFA with a view to determining an entity’s capital structure. DOFA considers issues such as the quality of assets, the stability of earnings and risk factors when determining,

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<sup>4</sup> Defined in the GBE Governance Arrangements as the combination of financial liabilities and equity used to fund the assets of the GBE.

monitoring and reviewing capital structures. DOFA further advised that, where warranted, the analysis of GBEs' corporate plans also includes consideration of the appropriateness of current capital structures, the entity's progress towards achieving its target capital structure and/or factors that may warrant the capital structure being reviewed.

### *Financial targets*

15. Each GBE is to work towards a financial target<sup>5</sup> and dividend policy, agreed in advance with Shareholder Ministers. The financial target is to be set on the basis that each GBE be required to earn commercial returns at least sufficient to justify the long-term retention of assets in the business, and to pay commercial dividends from those returns.

16. A principal financial target has not been calculated and agreed with Shareholder Ministers for any of the current Commonwealth GBEs. DOFA advised ANAO that, while a single principal financial target may not have been separately agreed between the Shareholder Ministers and the individual GBES, financial targets are agreed as part of the corporate plan process. The CSAU has developed a suite of financial and non-financial performance measures tailored to each individual GBE for use in assessing their performance. This approach is based on DOFA's view that GBEs are inherently different from each other based on characteristics stemming from the services/products provided and the maturity and characteristics of the industry they operate in, including competitive pressures facing the GBE.

17. The ANAO considers the application of a cost of capital (as required by the current GBE Governance Arrangements) would greatly assist in identification of an appropriate allowance for the risk of Commonwealth investment by comparison with comparable risk returns applying in the private sector. It would also provide a common performance measure as a complement to the GBE specific measures, to inform decision relating to the retention of the business, commitment to new investment and dividend returns.

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<sup>5</sup> The Governance Arrangements provide that for GBEs that are classified as trading GBEs, the target is to be a specified weighted average cost of capital (WACC). For GBEs that are classified as financial GBEs, the target is to be a specified return on equity. All current Commonwealth GBEs, with the exception of Medibank Private, are trading enterprises.

## *Risk management*

18. Audit Report No.2 1997–98 recommended that the 1997 GBE Governance Arrangements be amended to require GBEs to specify in their corporate plans and progress reports their material risks and strategies for treating these risks. The GBE Governance Arrangements have not been revised since their introduction in July 1997 and so this requirement has not been included in the Governance Arrangements. DOFA advised that it anticipated there will be scope to explicitly incorporate the requirement set in the 1997–98 audit report recommendation in any revision to the Governance Arrangements arising from the Government’s consideration of the recommendations of the JCPAA’s December 1999 Report 372 on GBE Corporate Governance.

19. There is a specific requirement included in the GBE Governance Arrangements that GBEs include in their corporate plans and progress reports a statement that the Board has appropriate risk management policies and practices in place and that adequate systems and expertise are being applied to achieve compliance with those policies. Only half of the GBEs considered in the audit fully conformed with this requirement. However, risk management is addressed by all of the GBEs in their corporate plans and progress reports although Ministers have advised some GBEs of the need to improve this area in future corporate plans.

20. The GBE Governance Arrangements provide that, as a general rule, the Government will not provide formal guarantees of GBE liabilities. Following the significantly poorer than expected outcome for EN from the Job Network 2 tender, the company has been operating under a letter of comfort. The Government has also provided a guarantee to support bank finance to ComLand that is capped at \$60 million. Ongoing Commonwealth indemnities have been provided to the members of the Boards of EN and ComLand.

## **Accountability**

21. Prior to the introduction of the current GBE Governance Arrangements in July 1997, it was the practice of the then Department of Finance<sup>6</sup>, following the publication of GBE annual reports, to prepare a submission to Cabinet containing an assessment of past and expected future financial performance of GBEs. The March 1997 report on the *Review of GBE Governance Arrangements* noted the practice and argued that it should be continued. DOFA advised ANAO that this practice has been

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<sup>6</sup> The Department of Finance and Administration came into being on 9 October 1997 following the amalgamation of the previous Departments of Finance and Administrative Services.



discontinued under the current GBE accountability framework. ANAO considers that providing briefings on a regular basis to Cabinet could improve accountability and transparency to Government on the operations of GBEs.

**22.** The requirement for wholly-owned Commonwealth GBEs to provide Statements of Corporate Intent, which are tabled in the Parliament, presents an opportunity for increased transparency and accountability regarding these very significant Commonwealth investments. However, the benefits of such openness can be reduced if Statements of Corporate Intent are not tabled in a timely manner in accordance with the requirements of the GBE Governance Arrangements. Only in the case of Medibank Private has the GBE Governance Arrangements' deadline of tabling Statements of Corporate Intent by the fifteenth sitting day after the commencement of the new financial year been effectively met in both 1998 and 1999. Australia Post also met the 1998 deadline and Australia Post and SACL were next closest to achieving the 1999 deadline, missing it by 22 and 23 sitting days respectively or some 11 weeks.

**23.** ANAO considers that transparency and accountability to Parliament could be further enhanced by the introduction of a requirement for GBEs to include in their annual reports specific reporting against the broad expectations on key financial and non-financial performance included in the previous year's Statement of Corporate Intent.

## Improvement opportunities

**24.** ANAO made three recommendations aimed at improving agencies' implementation of the current GBE governance framework and seeking further improvements to the framework. ANAO identified room for improvement in the areas of consistent application of legislative requirements, development and monitoring of performance against financial targets and reporting to Parliament via the Statement of Corporate Intent process.

## Agency responses

**25.** Under section 19 of the *Auditor-General Act 1997*, the proposed audit report was issued to relevant Commonwealth agencies for comment in late September 2000. DOFA provided a formal whole-of-government response to the section 19 proposed report on 20 October 2000 which also covered the following portfolio departments: Defence, DOCITA, DHAC, DISR and DTRS.

26. DOFA's whole of government response advised that agencies agreed with Recommendations Nos. 2 and 3 but that agencies disagreed with Recommendation No. 1. The DOFA whole of government response noted that a review of all agencies' monitoring practices was not considered to be supported by the evidence and therefore not warranted. In the case of EAL, the DOFA whole of government response advised that the issue of non-compliance was remedied immediately when the issue was brought to DOFA's attention.

27. ANAO notes that an essential element of the effectiveness of any corporate governance structure is comprehensive compliance with the legislative framework underpinning it. Accordingly, ANAO considers, particularly in the context of the constantly changing environment in which GBEs operate or are established, that it would be prudent for all agencies having GBE governance responsibilities to periodically review their procedures to ensure they are able to monitor effectively GBEs' compliance with all relevant requirements.

# Recommendations

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Set out below are the ANAO's recommendations and agencies' abbreviated responses. More detailed responses and any ANAO comments are shown in the body of the report.

**Recommendation No.1**  
**Para. 3.20** ANAO *recommends* that agencies review the adequacy of their procedures to ensure they are able to monitor effectively GBEs' compliance with legislative requirements such as the mandatory requirement under the *Commonwealth Authorities and Companies Act 1997* that GBEs annually provide to Ministers a corporate plan.

*Disagree:* DOFA whole-of-government response.

**Recommendation No.2**  
**Para. 3.52** ANAO *recommends* that DOFA consider recommending amendments to the GBE Governance Arrangements whereby:

- (a) GBEs, which are classified as trading enterprises and have material assets, are required to establish a target weighted average cost of capital that takes account of the particular risk characteristics of the environment in which the GBE operates; and
- (b) appropriate financial targets are set for GBEs for which a weighted average cost of capital target is inappropriate.

With these amendments, the GBE Governance Arrangements would then be more closely aligned with current operational practice.

*Agree:* DOFA whole-of-government response.

**Recommendation No.3**  
**Para. 4.21** ANAO *recommends* that DOFA, in order to enhance accountability to Parliament for the significant Commonwealth investments and roles performed by GBEs, consider recommending an amendment to the GBE Governance Arrangements requiring GBEs to include in their annual reports specific reporting against the broad expectations about key financial and non-financial performance included in the previous year's Statement of Corporate Intent.

*Agree:* DOFA whole-of-government response.

# **Audit Findings and Conclusions**



# 1. Introduction

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## Background

**1.1** Government Business Enterprises (GBEs) constitute significant Commonwealth Government investments and operate in key parts of the Australian economy. The GBEs operate in a diverse range of business activities<sup>7</sup> ranging from telecommunications to health insurance and transport infrastructure. In 1998–99, Commonwealth GBEs generated revenues of nearly \$25 billion; controlled assets of some \$40 billion; and provided to the Commonwealth dividends of nearly \$3 billion. Figure 1.1 outlines the financial position of the 11 current GBEs which were operating as of 30 June 1999.<sup>8</sup>

**1.2** A GBE is a Commonwealth authority or company that is prescribed under the regulations to the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The explanatory memorandum to the CAC Act notes that, in general, GBEs should satisfy three criteria: they are commercial, trade outside the public sector, and are not primarily regulatory bodies. There are Commonwealth entities that may meet these criteria which are not currently GBEs, including entities such as the Export Finance and Insurance Commission which have previously been classified as GBEs although they are not currently prescribed under the CAC Act. The decision whether or not to prescribe Commonwealth authorities or companies as GBEs rests with the Government.

**1.3** As at 30 June 2000 there were 13 Commonwealth GBEs: Australian Postal Corporation (Australia Post), Telstra Corporation Limited (Telstra), Defence Housing Authority (DHA), Employment National (EN), Australian Rail Track Corporation Limited (ARTC), Australian Technology Group Limited (ATG), Health Services Australia Limited (HSA), Medibank Private Limited (Medibank Private), Snowy Mountains Hydro-electric Authority (SMHEA), Essendon Airport Limited (EAL), Sydney Airports Corporation Limited (SACL), ComLand Limited (ComLand) and the Australian Government Solicitor (AGS).

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<sup>7</sup> Commonwealth GBEs currently operate in industries including aviation infrastructure, rail transport infrastructure, telecommunications, housing, health insurance, health services, legal services, employment services and electricity generation.

<sup>8</sup> Two current Commonwealth GBEs, ComLand Ltd and Australian Government Solicitor have been established as GBEs since 1 July 1999.

**Figure 1.1**

**GBEs' Financial Position as at 30 June 1999**

GBE	Total Assets \$ m	Shareholders Equity <sup>A</sup> \$ m	Net Profit After Tax \$ m	Dividends \$ m
Telstra Corporation	27 682.00	10 294.00 <sup>B</sup>	3486.00	4246.10 <sup>C</sup>
Snowy Mountains	3240.51	2286.89	(78.78)	Nil
Hydro-electric Authority Sydney Airports Corporation	2927.54	1901.15	48.40	29.04
Australia Post	2853.50	969.50	247.80	148.70
Defence Housing Authority	1981.69	1802.14	36.64	21.98
Medibank Private	710.54	352.51	57.27 <sup>D</sup>	Nil
Australian Rail Track Corporation	152.54	102.91	13.16	2.00
Employment National <sup>E</sup>	134.60	32.09	44.48	8.00
Australian Technology Group	30.89	29.76 <sup>B</sup>	2.45	Nil
Health Services Australia	23.78	14.77	1.96	1.30
Essendon Airport	16.42	15.06	0.16	0.096

**Notes:**

<sup>A</sup> This is the book value of shareholder's equity as reported in the entities' financial statements. This does not reflect the market value.

<sup>B</sup> Neither Telstra nor ATG are 100 per cent owned by the Commonwealth. The Commonwealth currently has a 50.1 per cent interest in Telstra and owns 99.9 per cent of the shares in ATG.

<sup>C</sup> The Commonwealth's share of Telstra's dividends in 1998–99 was \$2.83 billion.

<sup>D</sup> Medibank Private is a not-for-profit entity. It pays all relevant taxes and charges including sales tax, fringe benefits taxes and payroll tax but as a not-for-profit health fund is exempt from income tax. Accordingly, the figure included in the table is Medibank Private's Net Operating Surplus.

<sup>E</sup> As a result of the outcome of the Job Network 2 tender in December 1999, EN's financial position has substantially changed since 30 June 1999.

Source: Agency Annual Reports/Financial Statements 1998–99.

**1.4** The GBEs vary significantly in size, maturity, profitability and structure. For example, the partially Commonwealth owned Telstra<sup>9</sup> and the fully owned Australia Post are both large mature businesses with substantial asset bases. Telstra is one of the largest companies in Australia and as at 30 June 1999 it employed more than 52 000 people, had total assets of \$27.68 billion, generated revenue in 1998–99 of more than \$18 billion<sup>10</sup> and paid dividends out of 1998/99 profits of some \$4.25 billion, of which the Commonwealth's share was \$2.83 billion.<sup>11</sup> The market capitalisation of the Commonwealth's 50.1 per cent holding in

<sup>9</sup> The Commonwealth now owns 50.1 per cent of the shares in Telstra having sold 49.9 per cent of the shares in Telstra by public offer in two tranches, in 1997 and 1999 respectively.

<sup>10</sup> *Telstra Corporation Limited and controlled entities Annual Report 1999*, p. 3.

<sup>11</sup> During 1998-99 the Commonwealth's shareholding in Telstra was 66.7 per cent.



Telstra was valued at some \$39 billion as of 27 October 2000. Australia Post, currently a statutory authority<sup>12</sup>, is also a large employer with some 35 000 staff employed by the Corporation as at 30 June 1999. In 1998–99, Australia Post had total assets of \$2.85 billion, generated revenues of nearly \$3.5 billion and in 1999 paid the Commonwealth dividends totalling \$148.7 million.<sup>13</sup>

**1.5** By contrast, HSA and EAL are much smaller companies that were only established as GBEs in June 1997 and July 1998 respectively. HSA employed, as at 30 June 1999, some 400 permanent and part time staff in providing a range of work-related health services to clients in both the public and private sectors. In 1998–99, the company's total assets were \$24 million, it generated revenues of \$38.2 million and paid the Commonwealth dividends totalling \$1.3 million.

**1.6** Not all of the current Commonwealth GBEs are structured to generate a profit from which dividends may be paid to the Commonwealth. Medibank Private operates the Medibank Private health fund on a not-for-profit basis under the *National Health Act 1953* and so makes no dividend payments to the Commonwealth. SMHEA owns and operates the Snowy Mountains Scheme under the *Snowy Mountains Hydro-electric Power Act 1949* and attached 1957 Agreement as a cooperative venture under a Net Cost of Production methodology, rather than as a traditional for profit government business enterprise.<sup>14</sup> Accordingly, SMHEA currently generates electricity in return for a guaranteed recovery of costs, including debt servicing. It does not make profits or pay dividends.<sup>15</sup> Additionally, while SMHEA holds day to day responsibility for the operation and maintenance of the Scheme involving as at 30 June 1999 net assets of some \$2.3 billion, ultimate control is with the Snowy Mountains Council, which has responsibility for directing the operational output and maintenance of the Scheme.<sup>16</sup>

<sup>12</sup> The *Postal Services Legislation Amendment Bill 2000*, introduced into the Parliament on 6 April 2000, is aimed at implementing a number of decisions made by the Government in response to the review of the *Australian Postal Corporation Act 1989* completed in 1998 and conducted by the National Competition Council. In addition to winding back further Australia Post's monopoly, the bill proposes to convert Australia Post from a statutory corporation established under the *Australian Postal Corporation Act 1989* to a public company under the Corporations Law.

<sup>13</sup> Australia Post Annual Report 1998-99.

<sup>14</sup> Although SMHEA is regarded as a wholly owned Commonwealth GBE, the Commonwealth is only entitled to 13 per cent of the Authority's output.

<sup>15</sup> The Commonwealth, NSW and Victorian Governments have been pursuing the corporatisation of the SMHEA since 1993 with the aim of converting it to a Corporations Law company (Snowy Hydro Limited) with the Governments as sole shareholders. The Commonwealth will hold 13 per cent of the company, with NSW holding 58 per cent and Victoria 29 per cent.

<sup>16</sup> The Council comprises representatives of the Commonwealth, NSW and Victorian Governments, and SMHEA. Decisions taken by SMHEA in relation to electricity and water management can therefore be overturned by the Council.

1.7 Given the magnitude of the public investment that GBEs represent, the importance of the services they provide, and their economic importance, successive Governments and the Parliament have had a continuing interest in the governance, performance and accountability of these entities. Accordingly, monitoring by agencies of Commonwealth GBEs is seen as an important area for performance audit coverage.

## Previous ANAO coverage

1.8 ANAO previously considered monitoring by Commonwealth agencies of GBEs in Audit Report No. 2 1997–98 *Government Business Enterprise Monitoring Practices—Selected Agencies*. This report examined monitoring by the relevant portfolio departments under the 1993 GBE oversight and governance framework of four of the then 14 Commonwealth GBEs.<sup>17</sup> The agencies selected were the Department of Defence (Defence) with regard to its monitoring of ADI Limited; the then Department of Communications and the Arts with respect to Australia Post; the then Department of Transport and Regional Development with respect to the Australian National Railways Commission (Australian National); and the Department of the Treasury with respect to the Housing Loans Insurance Corporation (HLIC). Of the four GBEs examined in the 1997–98 audit report, only Australia Post remains a GBE in Commonwealth ownership.<sup>18</sup>

1.9 The audit report contrasted the 1993 and 1997 GBE oversight and governance arrangements and the report's three recommendations were framed taking into account the provisions of the 1997 GBE Governance Arrangements. Figure 1.2 sets out the 1997–98 audit report's recommendations and the responses of the relevant agencies. These recommendations have been followed up in the context of this audit.

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<sup>17</sup> As at July 1997 the list of Commonwealth GBEs was: Australian Postal Corporation; Telstra Corporation Limited; Defence Housing Authority; ADI Limited; Public Employment Placement Enterprise (subsequently became Employment National); Health Services Australia Limited; Australian Industry Development Corporation; Export Finance and Insurance Corporation; Australian Technology Group Limited; Snowy Mountains Hydro-electric Authority; Australian National Railways Commission; ANL Limited; Housing Loans Insurance Corporation; and the Federal Airports Corporation.

<sup>18</sup> The sale of Australia National's intrastate freight and interstate passenger rail businesses to three separate parties with total gross proceeds of \$95.4 million was completed in November 1997. The sales are reported on in Audit Report No. 28 1998-99, *Sale of SA Rail, Tasrail and Pax Rail*. HLIC and ADI Limited have also each been sold by trade sale. The sale of HLIC to GE Capital Services Australia for \$7.85 million was completed in December 1997 and the sale of ADI Limited to Transfield Thomson—CSF Investments Pty Limited for \$346.78 million was concluded on 30 November 1999.

Figure 1.2

## Audit Report No. 2 1997–98 recommendations

ANAO Recommendations	Agency Responses
<p><b>Recommendation No.1 Para 2.53</b> ANAO recommends that portfolio departments periodically commission an independent assessment of the corporate plans of GBEs within their portfolio to provide objective assurance to Ministers and the Parliament on an important element of the governance framework.</p>	<p><b>Agreed:</b> The Department of Defence and the then Departments of Communications and the Arts and Transport and Regional Development. <b>Agreed with qualification:</b> The Department of the Treasury and the then Department of Finance.</p>
<p><b>Recommendation No.2 Para 3.37</b> ANAO recommends that departments ensure that GBEs within their portfolios comply with the requirements of the 1997 Governance Arrangements, including the preparation and submission of corporate plans, when they are being sold or restructured unless and until otherwise agreed by Shareholder Ministers.</p>	<p><b>Agreed:</b> The Department of Defence and the then Departments of Finance and Communications and the Arts. <b>Agreed with qualification:</b> The Department of the Treasury and the then Department of Transport and Regional Development.</p>
<p><b>Recommendation No.3 Para 4.18</b> ANAO recommends that the 1997 Governance Arrangements be amended to require GBEs to specify in their corporate plans and progress reports their material risks and strategies for treating these risks.</p>	<p><b>Agreed:</b> The Department of Defence and the then Department of Communications and the Arts and Transport and Regional Development. <b>Agreed with qualification:</b> The Department of the Treasury and the then Department of Finance.</p>

Source: Audit Report No.2 1997–98, *Government Business Enterprise Monitoring Practices—Selected Agencies*.

## JCPAA inquiry

**1.10** In May 1999, the Parliament’s Joint Committee of Public Accounts and Audit (JCPAA) commenced an inquiry into corporate governance and accountability arrangements for Commonwealth GBEs. The Committee’s report on its inquiry, *Report 372, Corporate Governance and Accountability Arrangements for Commonwealth Government Business Enterprises*, was tabled in Parliament in February 2000. In its report the Committee considered:

- the governance framework;
- the shareholder Minister oversight model;
- issues relating to GBE Boards; and
- reporting and accountability mechanisms.

**1.11** The Committee made seven recommendations relating to the current GBE governance framework. The Government provided the JCPAA, in June 2000, with its response to four of the Committee's recommendations and advised that, as the remaining three recommendations involve cross portfolio impacts and/or significant changes to the Governance Arrangements, these will be addressed in a separate Government response.<sup>19</sup> In its report, the Committee noted its support for the ANAO's proposal to conduct this audit.<sup>20</sup>

## **Audit approach**

**1.12** Audit Report No.2 1997–98 had regard to the March 1997 report of the *Review of GBE Governance Arrangements* and the commencement on 1 July 1997 of new Governance Arrangements for GBEs which incorporated improvements recommended by the 1997 Review. This audit examines the monitoring by the Department of Finance and Administration (DOFA) and relevant portfolio departments of portfolio GBEs since 1 July 1997 against the requirements of the new Governance Arrangements and relevant legislation. Two current Commonwealth GBEs, ComLand Limited and the Australian Government Solicitor, were excluded from the general scope of the audit because they were established on or after 1 July 1999 and, accordingly, no time series record of monitoring by agencies was available.

**1.13** The objectives of the audit were to examine:

- the effectiveness of agencies' implementation of the current GBE governance framework (including the Governance Arrangements introduced in July 1997; the CAC Act; the Corporations Law; and other relevant legislation such as enabling legislation for some of the GBEs);
- the extent to which agencies and GBEs comply with the Governance Arrangements and legislative requirements; and
- whether the GBE monitoring system provides an effective level of accountability to Ministers and to the Parliament.

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<sup>19</sup> The Government's response provided by the Minister for Finance and Administration outlined the actions it will take in response to Recommendations 1, 4, 5 and 7 of the JCPAA's Report No. 372, *Corporate Governance and Accountability Arrangements for Commonwealth Government Business Enterprises*

<sup>20</sup> *Report 372, Corporate Governance and Accountability Arrangements for Commonwealth Government Business Enterprises*, JCPAA December 1999, p. 51.

**1.14** Under the current GBE Governance Arrangements portfolio departments (whose Ministers have joint shareholder responsibility with the Minister for Finance and Administration for particular GBEs) and DOFA each have a role in the implementation of the GBE governance framework. Departments other than DOFA, which have responsibility for the GBEs included in the scope of the audit, are the:

- Department of Transport and Regional Services (DTRS) in relation to ARTC;
- Department of Health and Aged Care (DHAC) in relation to Medibank Private and HSA;
- Department of Defence (Defence) in relation to DHA;
- Department of Communications, Information Technology and the Arts (DOCITA) in relation to Australia Post and Telstra; and the
- Department of Industry, Science and Technology (DISR) in relation to ATG and SMHEA.

**1.15** The approach taken in the audit was to initially seek from the relevant portfolio departments responses to a request for data about their implementation of the GBE governance framework in relation to GBEs for which their Ministers have joint shareholder responsibility. DOFA was requested to provide the same data in relation to the three GBEs included in the audit for which the Minister for Finance and Administration has sole shareholder responsibility and also additional information in relation to all of the GBEs, given the Department's central role in the current GBE governance framework. Relevant files held by the portfolio departments and DOFA were also reviewed with fieldwork carried out over the period February to August 2000. The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of \$230 500.

## 2. GBE Accountability Framework

### Background

2.1 The most recent reforms of the GBE accountability framework involved the introduction from 1 July 1997 of the current Governance Arrangements for GBEs and the commencement on 1 January 1998 of the CAC Act, part of the legislative package replacing the *Audit Act 1901*. The CAC Act, for the first time, sets out in legislation an accountability and reporting regime for all Commonwealth authorities and companies, including GBEs.

**Figure 2.1**

**Status of current Commonwealth GBEs**

GBE	Statutory Authority	Corporations Law Company	Wholly-owned by the Commonwealth
AGS	✓		✓
Australia Post	✓		✓
ARTC		✓	✓
ATG		✓	
ComLand		✓	✓
DHA	✓		✓
EAL		✓	✓
EN		✓	✓
HSA		✓	✓
Medibank Private		✓	✓
SACL		✓	✓
SMHEA	✓		✓
Telstra		✓	

2.2 Of the 13 current Commonwealth GBEs, four are statutory authorities<sup>21</sup> and nine are Corporations Law companies (see Figure 2.1). In addition to any legislative accountability requirements imposed on statutory authority GBEs through their enabling or other legislation, the

<sup>21</sup> Australia Post; SMHEA; DHA; and AGS.

CAC Act imposes a range of accountability requirements on GBEs.<sup>22</sup> Company GBEs are also subject to the CAC Act and, in addition, must meet accountability requirements under the Corporations Law and any other legislation applying to their industry or the GBE itself.<sup>23</sup>

**2.3** Community service obligations (CSOs) are important considerations in relation to Australia Post and Telstra. No other current GBEs have CSOs, although DISR notes that, in the past, SMHEA has voluntarily entered into a wide range of CSOs but that these are not core business and will not be undertaken after corporatisation is achieved. A CSO arises when the Government/Parliament specifically requires a Commonwealth organisation to carry out specified activities or processes relating to outputs or inputs which the GBE would not elect to do on a commercial basis, or which it would only do commercially at higher prices.

**2.4** Section 27 of the *Australian Postal Corporation Act 1989* sets out the Corporation's CSO. Australia Post is required in its Corporate Plan to include a statement of the strategies and policies that it will follow to carry out its CSO. In addition, the Corporation is required to include in its Annual Report:

- an outline of the strategies and policies that Australia Post is following to carry out its CSO;

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<sup>22</sup> Under the CAC Act, statutory and wholly-owned Commonwealth company GBEs are, among other things, required to:

- notify the responsible Minister in writing of the particulars of significant events;
- keep the responsible Minister informed of the operations of the company and its subsidiaries and give the responsible Minister and the Finance Minister such reports, documents and information in relation those operations as the Ministers require within any time limits set by the Minister concerned;
- prepare a corporate plan at least once a year and give it to the responsible Minister. The plan must cover a period of at least 3 years and include the details of a range of matters set out in section 43 of the Act and any other matters required by the responsible Minister;
- keep the responsible Minister informed about significant changes to the GBE's corporate plan; and matters that arise that might significantly affect the achievement of the objectives of the plan;
- if required by Finance Minister by notice in the *Gazette*, give the responsible Minister an interim report or reports for periods prescribed by the notice; and
- comply with any general policies of the Commonwealth Government that the responsible Minister has notified the company in writing apply to it.

As a partly owned company GBE, Telstra is not subject to the sections of the CAC Act (that is sections 38, 40, 41, 42 and 43) which impose these obligations on Commonwealth company GBEs. However, equivalent obligations to those contained in sections 38, 40, 41 and 42 of the CAC Act have been placed on Telstra, while it remains in majority Commonwealth ownership, through sections 8AD, 8AE, 8AF and 8AG of the *Telstra Corporation Act 1991*.

<sup>23</sup> As a result of Telstra's evolution from a Commonwealth statutory authority to a partially privatised listed public company, Telstra remains subject to its own legislation, the *Telstra Corporation Act 1991*.

- an assessment of the appropriateness and adequacy of the strategies and policies Australia Post is following to carry out its CSO; and
- a statement about compliance during the year with prescribed performance standards.

2.5 Australia Post reports in its Annual Report the cost of providing its section 27 CSO, calculated according to the avoidable cost methodology. DOCITA advised ANAO that, because the scope of Australia Post's CSO (that is the requirement that Australia Post ensure that it makes a letter service 'reasonably accessible' to all Australians) is not precise, the Department does not measure whether Australia Post has met its CSO each year. The Department notes that Australia Post's Annual Report contains a commitment by Australia Post to meet its CSO obligations. The cost of Australia Post's CSO in both 1996–97 and 1997–98 was reported as \$67 million and in 1998–99 as \$70 million.

2.6 Telstra's CSOs are specified in Telstra's licence and the *Telecommunications (Consumer Protection and Service Standards) Act 1999*. Under section 105 of the *Telecommunications Act 1997*, the Australian Communications Authority (ACA) is required to monitor and report to the Minister for Communications, Information Technology and the Arts on significant matters relating to the performance of carriers and carriage service providers. DOCITA advise that Telstra has met its CSOs each year and that Telstra receives some contribution from its competitors for most of its CSOs. The only CSO that is costed is the provision of reasonable access on an equitable basis to a standard telephone service, payphones and any prescribed carriage services. In 1998–99, this CSO was costed by the ACA at \$548.087 million but was capped by the Government at \$253.32 million for the purposes of contributions from other carriers.

## GBE Governance Arrangements

2.7 The current Governance Arrangements reflect the requirements of the CAC Act and expand upon them. These arrangements are the culmination of a reform process that commenced with the issuing in 1987, by the then Minister for Finance, of a statement on *Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises*. Under the 1987 guidelines, responsibility for GBE accountability and performance rested with each GBE board and the relevant portfolio Minister, although some consultation with other Ministers was also required.



**2.8** In May 1993, the policy statement was replaced with *Accountability and Ministerial Oversight Arrangements for GBEs* issued jointly by the then Minister for Finance and the then responsible portfolio Ministers. These arrangements, which applied from 1 July 1993, formed the centre-piece of the GBE accountability framework until 1 July 1997, when the current GBE framework was introduced. The 1993 oversight arrangements sought to clarify the previous policy statement, emphasised the importance of government properly exercising its shareholder role and increased the role of the then Minister for Finance.

**2.9** The Government issued revised governance arrangements for GBEs in June 1997, following consideration of the 27 recommendations made by the 1997 Review of GBE Governance Arrangements report. The revised arrangements:

- introduced a model where the Commonwealth's ownership interest was to be represented by two 'Shareholder Ministers', the portfolio Minister and the Minister for Finance and Administration. Previously the portfolio Minister had sole responsibility for GBEs within the portfolio but had been required to consult the Minister for Finance and Administration on major matters and risk management;
- included an increased emphasis on financial performance;
- clarified the application of the governance arrangements to GBEs involved in a sale or restructuring process; and
- introduced a requirement for GBEs to table annually in the Parliament a Statement of Corporate Intent.

**2.10** The GBE Governance Arrangements apply to GBEs that are wholly owned by the Commonwealth and, indirectly to subsidiaries of wholly owned GBEs through the governance arrangements that the wholly owned GBE has with its subsidiaries. The Governance Arrangements provide that, for partly owned GBEs, the extent to which the Governance Arrangements apply will be identified in legislation applying specifically to the GBE, and or the GBE's memorandum and articles of association and/or shareholder's agreement.

**2.11** Two current GBEs are partly owned by the Commonwealth, Telstra and ATG. ATG is 99.9 per cent Commonwealth owned and a Shareholders Agreement exists between minority shareholders and the Commonwealth. In general the Governance Arrangements apply to ATG but where inconsistencies exist the Shareholders Agreement takes priority.

**2.12** The Governance Arrangements do not apply to Telstra given that the Commonwealth's shareholding is only 50.1 per cent. Division 3 of Part 2 of the *Telstra Corporation Act 1991*<sup>24</sup> sets out Telstra's reporting obligations to the Government. These requirements mirror the obligations placed on wholly owned company GBEs through sections 38, 40, 41 and 42 of the CAC Act. Telstra is not subject to the additional requirements placed on wholly owned GBEs set out in the Governance Arrangements such as the requirement to provide an annual Statement of Corporate Intent to be tabled in the Parliament or the requirement to annually agree a principal financial target with Shareholder Ministers.

### **Non-financial targets**

**2.13** The Governance Arrangements state that Shareholder Ministers may set non-financial targets for particular GBEs, on a case by case basis. In addition, the Government may impose service quality standards on GBEs providing goods and services in a monopolistic market or for CSO goods and services.

**2.14** This aspect of the GBE governance framework is not applicable to Telstra. DOFA advised that, noting the nature of ATG's operations (which is investing in early stages of commercialising Australian technology) there have been no specific non-financial targets agreed by Shareholder Ministers for ATG. DOFA advised that SMHEA's corporate plan as endorsed by Shareholder Ministers includes operational measures against which actual performance is reported and monitored.

**2.15** Defence and DOFA advised ANAO that, in relation to DHA, non-financial performance targets have been agreed as part of the acceptance of corporate plans. For Medibank Private, Shareholder Ministers have endorsed a range of measures in the context of the corporate plan. These include membership, market share, customer satisfaction, staff satisfaction, hospital market share, ancillary market share and unprompted brand awareness. HSA's 1999–2002 corporate plan includes a range of non-financial targets but these have not been specifically approved by Shareholder Ministers.

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<sup>24</sup> Under the *Telstra Corporation Act 1991*:

- section 8AD—the Minister may direct Telstra to provide specified financial statements in respect of periods specified by the Minister;
- section 8AE—Telstra and its subsidiaries are required to give the Minister immediate notice of certain significant events;
- section 8AF—the Telstra Board must keep the Minister informed of the operations of Telstra and its subsidiaries, and must give the Minister and the Minister for Finance such reports, documentation and information about those operations as either Minister requires; and
- section 8AG—Telstra must provide the Minister with a Corporate Plan at least once a year covering both Telstra and its subsidiaries, and must keep the Minister informed about changes to the Plan or matters that may affect its achievement.

**2.16** DTRS advised that performance outcomes for ARTC were included in the 1998–99 Statement of Corporate Intent approved by Shareholder Ministers, most of which have a two year timeframe for achievement. EN has reported to the Shareholder Minister against key performance indicators (KPIs) for the company’s performance under its Job Network contracts with the Department of Employment, Workplace Relations and Small Business.

**2.17** While no non-financial targets are currently in place for SACL, DOFA and SACL are working to develop appropriate non-financial measures. SACL also regularly monitors service quality standards internally and reports its findings to DOFA. Apart from service quality standards applying to certain GBEs, no other non-financial targets have been imposed.

**2.18** The Government has imposed service quality standards through legislation on Australia Post, SACL, EAL and Telstra. In 1998, the Government introduced new performance standards for Australia Post. These relate to delivery standards and availability of postal outlets.<sup>25</sup> SACL and EAL as airport operators, are subject to quality standards imposed by regulation via the airport leasing agreements and the *Airports Act 1996*. As industry regulator, DTRS is responsible for monitoring compliance with these standards. Quality standards are also imposed on the telecommunications industry, including Telstra, through the customer service guarantee (CSG). The ACA monitors compliance with the CSG and issues quarterly reports on the level of compliance by each carrier.

**2.19** Medibank Private and HSA have each voluntarily developed service charters but these are not specifically endorsed by Shareholder Ministers. Defence and DHA have agreed service quality standards that have been reviewed in the context of developing their recently signed Service Agreement. The Service Agreement also includes non-financial performance measures.

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<sup>25</sup> Specifically Australia Post is required to:

- provide daily delivery services to 98 per cent of all delivery points and twice weekly services to 99.7 per cent of all delivery points;
- to deliver 94 per cent of all reserved letters within the time specified in Post’s schedule of delivery times;
- to maintain 10 000 street posting boxes in addition to providing lodgement facilities at each of its retail outlets; and
- maintain at least 4000 postal outlets of which at least 50 per cent of the total number or a minimum of 2500 (whichever is the greater) must be located in rural or remote areas.

## Shareholder Ministers

**2.20** The Governance Arrangements state that the Commonwealth's relationship to its GBEs is similar to the relationship between a holding company and its subsidiaries. The features of this relationship include a strong interest in the performance and financial returns of the GBE; reporting and accountability arrangements that facilitate active oversight by the shareholder; and action by the shareholder in relation to the strategic direction of its GBEs where it prefers a different direction from the one proposed.

**2.21** The Governance Arrangements provide that it is Government policy that the appointment of departmental officers to GBE Boards will only be considered in exceptional circumstances, having regard to their ability to represent the interests of the Government, their possession of the relevant business skills, and to any potential conflicts of interest that might arise. ANAO notes that there is an increased risk of a potential and/or actual conflict of interest when the departmental officers also provide policy advice in relation to the GBE.

**2.22** As at 30 June 2000, public servants were serving on the Boards of three GBEs, DHA, ComLand and EN. In the case of the DHA Board, this occurs as a function of the *Defence Housing Authority Act 1987* (DHA Act) which provides that four members of the Defence Force and one public servant holding designated appointments are members.<sup>26</sup> Defence advised ANAO in September 2000 that there has been a recent review of the DHA Act, which has recommended the removal or reduction of departmental officers serving on the DHA Board. Defence advised that the Department supports this approach in principle and is reviewing the draft recommendations of the review. DOFA advised ANAO that, as ComLand was a startup company, public servants were initially appointed to allow timely establishment of the business and all but one have since been replaced with private sector appointees, with the remaining public servant director having significant and relevant property management experience. DOFA further advised that public servants with significant change management experience have been appointed to EN's board to lead the company's transition to Job Network 2.

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<sup>26</sup> Section 12 of the DHA Act sets out the constitution of the Authority. The Defence Force appointments currently designated by the Governor-General under this section as members of the Authority are: the Chiefs of Navy, Army and Air Force and the Head of the Personnel Executive. The designated public servant position is that of First Assistant Secretary Resources and Financial Programs.

**2.23** A key structural innovation in the current GBE governance framework is the move to an ownership and accountability model where the Commonwealth's ownership interest is represented by two 'Shareholder Ministers', the portfolio Minister and the Minister for Finance and Administration. The guiding principles of the Governance Arrangements are that the Shareholder Ministers are responsible for the exercise of strategic control of the GBEs, consistent with their accountability to the Parliament and the public, and for setting clear objectives for GBEs. Directors of GBEs are responsible for developing business strategies, handling the management policies, and ensuring that:

- the GBE's activities are conducted so as to minimise any divergence of interests between the GBE and the shareholders;
- GBEs are managed in the best interests of the shareholders; and
- GBEs and their officers maintain the highest standards of integrity, accountability and responsibility.

**2.24** Sections 28 and 43 of the CAC Act provide, that the responsible Minister<sup>27</sup> may notify the directors of a Commonwealth authority or a wholly-owned Commonwealth company respectively in writing of the general policies of the Commonwealth that are to apply to the authority or company. In addition, the Constitutions of EN and ComLand provide the Shareholder Minister with a power of direction. While these companies are wholly-owned by the Commonwealth, it is the duty of the directors of the companies to comply with any direction given by the Minister in respect of the business, affairs or property of the company. The Shareholder Minister has issued two directions to EN and one to ComLand.

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<sup>27</sup> 'Responsible Minister' is a defined term under the CAC Act. In most cases it is the relevant portfolio Minister who is the responsible Minister. However, the Minister for Finance and Administration has been prescribed under the CAC regulations as the responsible Minister for Employment National, Sydney Airports Corporation Limited and Essendon Airport Limited, notwithstanding that these GBEs fall within other portfolios' area of responsibilities, because he is the sole Shareholder Minister for these companies

**2.25** Although the Governance Arrangements contemplate that there will be two Shareholder Ministers, four of the 13 current Commonwealth GBEs have only one Minister with shareholder responsibility, the Minister for Finance and Administration. In the case of ComLand, this is a consequence of the location of the GBE within the Finance and Administration Portfolio. However, the Government has also appointed the Minister for Finance and Administration as the sole Shareholder Minister for three other GBEs that fall within other portfolios, EN<sup>28</sup>, SACL and EAL.<sup>29</sup>

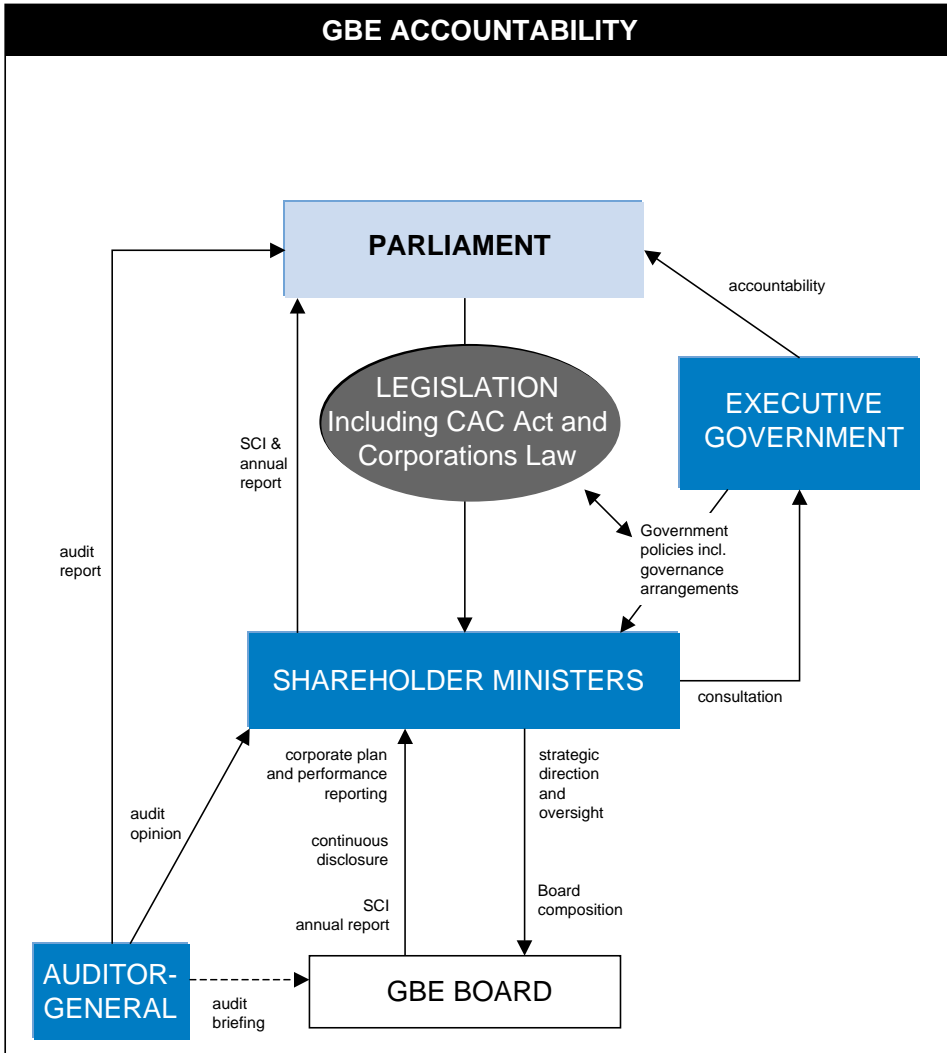
**2.26** Figure 2.2 illustrates the components of the current GBE accountability framework as discussed as above.

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<sup>28</sup> EN was established on 4 August 1997, for the purpose of competing as a provider in the new 'Job Network' employment services market. Selected staff from the former Commonwealth Employment Services (CES) were employed by the company, which commenced operations in May 1998. Initially, a joint shareholder ownership model was applied to the company. In April 1999, the Minister for Finance and Administration became the sole Shareholder Minister for EN, as it was considered this was more appropriate in light of the Minister for Employment, Small Business and Work Place Relations' role as purchaser of employment services under the Job Network contracts.

<sup>29</sup> The Commonwealth sold the leases for the former FAC airports in two phases completed in mid 1997 and 1998 respectively. SACL and EAL were formed as Corporation Law companies to take over ownership of the leases on the remaining FAC airports and each commenced operations in July 1998. In light of the substantial regulatory role of the Minister for Transport and Regional Services in relation to airports, the Government decided that a single shareholder model, with the Minister for Finance and Administration as sole shareholder, was the most appropriate ownership structure for these companies.

**Figure 2.2**  
**GBE Accountability Framework**



Source: DOFA Submission to JCPAA Inquiry and ANAO analysis

2.27 **Finding:** In June 1997, the Government issued revised governance arrangements for GBEs, which:

- introduced a model where the Commonwealth's ownership interest was to be represented by two 'Shareholder Ministers', the portfolio Minister and the Minister for Finance and Administration;
- included an increased emphasis on financial performance;
- clarified the application of the governance arrangements to GBEs involved in a sale or restructuring process; and
- introduced a requirement for GBEs to table annually in the Parliament a Statement of Corporate Intent.

2.28 Although the Governance Arrangements contemplate that there will be two Shareholder Ministers, for four of the 13 current Commonwealth GBEs (ComLand, EN, SACL and EAL) only one Minister has shareholder responsibility, the Minister for Finance and Administration.

2.29 The GBE Governance Arrangements apply to GBEs that are wholly owned by the Commonwealth. The Governance Arrangements provide that, for partly owned GBEs, the extent to which the Governance Arrangements will apply will be identified in legislation applying specifically to the GBE, and or the GBE's memorandum and articles of association and/or shareholder's agreement. Two current GBEs are partly owned by the Commonwealth, Telstra and ATG. Division 3 of Part 2 of the *Telstra Corporation Act 1991* sets out Telstra's reporting obligations to the Government. Telstra is not subject to the additional requirements placed on wholly owned GBEs set out in the Governance Arrangements. ATG is 99.9 per cent Commonwealth owned and a Shareholders Agreement exists between minority shareholders and the Commonwealth. In general, the Governance Arrangements apply to ATG but where inconsistencies exist the Shareholders Agreement takes priority.

2.30 The Governance Arrangements provide that it is Government policy that the appointment of departmental officers to GBE Boards will only be considered in exceptional circumstances. As at 30 June 2000, public servants were serving on the Boards of three GBEs, DHA, ComLand and EN.



## Agency monitoring

**2.31** Portfolio departments have varying levels of experience with oversight of GBEs. Staffing arrangements for undertaking this role within portfolio departments is dependent on a number of factors including the nature of the GBE's functions, size and role in the policy framework. In the portfolio departments, the total number of staff having involvement in oversight of a particular GBE ranges from one to five officers and this is often on a part-time basis. Generally, among the officers working on GBE oversight in the portfolio departments, particularly at the more senior levels, there is effective operational knowledge management.

**2.32** For example, DOCITA has a long background in monitoring two large GBEs, Telstra and Australia Post, with that monitoring currently undertaken within the Enterprise and Radiocommunications Branch by officers who are also responsible for postal and enterprise policy. Including the Branch Manager, who has more than five years' experience in the area, up to five officers are involved on a part-time basis in monitoring each of Telstra and Australia Post and their skills include qualifications in economics, accounting and information science.

**2.33** There are also two GBEs in the DISR portfolio, SMHEA and ATG. Monitoring of the two GBEs occurs in two different areas of DISR. SMHEA is monitored by the Electricity Reform Branch in conjunction with the reform of the Snowy Mountains Hydro-electric Scheme and the corporatisation of SMHEA. One key officer, who has undertaken the role for more than six years with occasional assistance, is responsible for monitoring of SMHEA. ATG is monitored by two officers on a part-time basis in the Science and Technology Policy Branch with the more senior of these having been involved for some 18 months.

**2.34** Responsibility for monitoring DHA is split across two areas of Defence with one dedicated officer with financial and accounting skills involved within the Directorate of Budget Analysis-B and two other officers involved on a part-time basis in the Directorate of Housing. Within DTRS, monitoring of ARTC is undertaken by the Rail Policy Section in the Rail Industry Branch. The Rail Policy Section oversaw the establishment of ARTC in February 1998 and now undertakes the GBE oversight role. With a staff of five people, the Section includes officers with a range of relevant skills including economics and law. While the longest serving officers in the Section have been involved since the establishment of ARTC, there has been a significant turnover of staff.

**2.35** Monitoring of the two GBEs in the DHAC portfolio, Medibank Private and HSA, is centralised within the Portfolio Business Unit in the Corporate Development Branch. Prior to the establishment of HSA in July 1997, DHAC had not had responsibility for monitoring of any GBEs. This role is now undertaken by the Portfolio Business Unit in the context of its broader corporate governance role within the Department.<sup>30</sup> The staff currently involved in monitoring the Department's GBEs have a range of relevant skills including business, accountancy, corporate governance, economics and law. Senior staff undertaking monitoring of the GBEs have generally been involved for more than two years.

**2.36** The focus in the portfolio departments is on operational and industry policy issues with DOFA more active on financial governance issues. Accordingly, there is little apparent duplication of effort by the portfolio departments and DOFA. In respect of GBEs with dual Shareholder Ministers, there are not usually formal protocols in place apportioning shareholder tasks between DOFA and the portfolio departments. The exceptions to this are in relation to Australia Post and Telstra where there are protocols in place between DOFA and DOCITA formally documenting how the shareholder responsibilities will be managed and divided between the two portfolios. The protocols provide that DOFA takes the lead on financial matters in advising Ministers and drafting related correspondence while DOCITA takes the lead on operational matters. Arrangements for consultation between the Departments and Ministers and for signing of correspondence by Ministers are also set out in the protocols.

**2.37** In respect of the remaining dual Shareholder Minister GBEs, issues are usually jointly managed between the Shareholder Ministers, with DOFA more involved on financial issues, particularly in relation to corporate plans, progress reports and capital structure, and on general GBE governance arrangements matters. ANAO was advised that, while DOFA generally focuses on financial issues and portfolio departments generally focus on operational and industry policy issues, DOFA needs to seek agreement from portfolio departments in preparing shareholder responses to GBEs on financial issues, as both Shareholder Ministers need to agree on responses. The final outcomes on issues relating to dual Shareholder Minister GBEs are negotiated between the Ministers and the agencies.

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<sup>30</sup> In addition to its GBE monitoring role, the Portfolio Business Unit is also responsible for corporate governance matters relating to 16 CAC and FMA entities within the portfolio; advice to other areas in the Department on appropriate corporate governance structures for new undertakings; and coordination of board appointments. Among the CAC bodies for which the Portfolio Business Unit has responsibilities is Australian Hearing Services, which although not designated as a GBE, is monitored by both DOFA and DHAC in much the same way as a GBE.

## Commonwealth Shareholder Advisory Unit

**2.38** Until July 1997, the GBE monitoring process within the then Department of Finance was divided into a policy and coordination function on one level, and the monitoring of specific GBEs by the relevant supply areas of the Department at another. The March 1997 report on the *Review of GBE Governance Arrangements* recommended that a GBE Unit should be established within the then Department of Finance that would be responsible for providing commercially focussed advice on GBEs to Shareholder Ministers.<sup>31</sup> Acting on this recommendation, DOFA established the GBE Oversight Unit with responsibility for all of the Department's GBE monitoring functions centralised within this unit from 1 July 1997. The Unit was subsequently renamed the Commonwealth Shareholder Advisory Unit (CSAU). DOFA advised ANAO that the CSAU, as part of responsibility for management of the Commonwealth's shareholder interest in GBEs, undertakes assessment of capital structures and monitors changes in financial standing.

**2.39** Initially employing 10 staff, the CSAU has grown over the last few years to have a total of 19 staff plus a full time in-house consultant with approximately 1.5 staff allocated to work on issues associated with non-GBE public trade and financial enterprises for which the CSAU has been given some oversight responsibilities.<sup>32</sup> DOFA advised that, in 1999–2000, the total cost of the CSAU's GBE oversight role was approximately \$3 million.

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<sup>31</sup> *Review of GBE Governance Arrangements*, Richard Humphry AO, March 1997, Recommendation No. 8. The report commented that *establishing such a group would have the added advantage of consolidating, in one portfolio, the scarce resources such as economic, financial and industry understanding, that have the capacity of protecting the Commonwealth's interest as shareholder.*

<sup>32</sup> Although not a GBE, oversight of Australian Hearing Services (a statutory authority responsible for the provision of hearing services and products to pensioners, veteran and designated beneficiaries under a community service obligation, including children and indigenous Australians) by DHAC and the CSAU mirrors the GBE Governance Arrangements with the Minister for Finance and Administration being consulted on significant issues. Other entities for which the CSAU has some oversight responsibilities are: Aboriginal Hostels Limited; Airservices Australia; Albury-Wodonga Development Corporation; Australian Film Finance Corporation; Australian Industry Development Corporation; Australian National Railways Commission; Coal Mining Industry (Long Service Leave) Corporation; Export Finance and Insurance Corporation; Film Australia Limited; Maritime Industry Finance Corporation; Stevedoring industry Finance Committee and the Reserve Bank of Australia.

**2.40** Audit Report No.2 1997–98 identified that a significant portion of GBE oversight under the 1993 GBE arrangements was undertaken in the various portfolio departments by a small number of staff with varying skills and experience.<sup>33</sup> In this circumstance, there was the potential for a relatively large loss of corporate memory and expertise if these staff left the departments without at least some system for capturing that experience and knowledge. The centralisation of responsibility for the bulk of the work on financial issues relating to the GBEs within the CSAU has contributed structurally to redressing this weakness. However, since 30 June 1997, there have been four Branch Managers of the CSAU. Of the 19 officers currently employed within the CSAU, only three have been with the unit for three years, but 11 have worked there for one year or less. DOFA advised ANAO, that noting the growth in the number of staff employed in the CSAU in the last few years (from 10 to 19), the turnover of staff has been no greater than the APS average.

**2.41** DOFA has sought to concentrate, within the CSAU, staff having financial and analytical skills.<sup>34</sup> The CSAU provides comprehensive briefing to the Minister for Finance and Administration in relation to GBEs. The Minister is provided with advice and analysis regarding each GBE's proposed corporate plan and their progress reports against their corporate plans. The Minister also receives advice in relation to board meetings and board appointments and briefings regarding any special activities conducted such as capital structure reviews.

**2.42** The unit produces a consolidated report to the Minister providing a status report on each of the GBEs. The format and structure of this report has developed over time with the current report including summary information and a two page update on each GBE providing analysis of financial performance and performance against key performance indicators as well as setting out the current issues relating to the GBE. In 1997 and 1998, this report was provided to the Minister annually. In 1999, two six monthly reports were provided in March and September and, in addition, monthly updates were generally provided. In 2000, the CSAU has moved to providing the consolidated report to the Minister on a quarterly basis as well as continuing to provide monthly updates.

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<sup>33</sup> Audit Report No.2 1997-98, *Government Business Enterprise Monitoring Practices—Selected Agencies*, p. 23.

<sup>34</sup> Staff currently employed within the CSAU include those with tertiary qualifications in financial administration, accountancy, economics, banking and finance, commerce and law.

**2.43 Finding:** The March 1997 report on the *Review of GBE Governance Arrangements* recommended that a GBE Unit should be established within the then Department of Finance which would be responsible for providing commercially focussed advice on GBEs to Shareholder Ministers. Acting on this recommendation, DOFA established a unit with responsibility for all of the Department's GBE monitoring functions centralised within this unit from July 1997. DOFA advised that, in 1999–2000 according to DOFA's records, the total cost of the Commonwealth Shareholder Advisory Unit's (CSAU's) GBE oversight role was approximately \$3 million.

**2.44** The establishment within DOFA of the CSAU has centralised responsibility for the Department's role in GBE oversight and concentrated staff with the range of financial and analytical skills required to undertake this role. Audit Report No.2 1997–98 identified that a significant portion of GBE oversight under the 1993 GBE arrangements was undertaken in the various portfolio departments by a small number of staff with varying skills and experience. In this circumstance, there was the potential for a relatively large loss of corporate memory and expertise if these staff left the departments without at least some system for capturing that experience and knowledge. The centralisation of responsibility for the bulk of the work on financial issues relating to the GBEs within DOFA has contributed structurally to redressing this weakness.

## 3. Financial Governance

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### Background

**3.1** Guidelines in relation to financial governance form a major part of the GBE Governance Arrangements. The financial governance section of the GBE Governance Arrangements covers issues including capital structure, dividend policy, risk management, financial targets for GBEs and GBE borrowings.

**3.2** A principal objective for each GBE is that it adds to shareholder value and, in order to achieve this, it is required to: operate efficiently; price efficiently; and earn at least a commercial rate of return. Accordingly, to allow the Government to monitor GBEs' performance against these requirements, a number of reporting obligations have been placed on GBEs under the GBE accountability framework. Under the current GBE accountability framework, all GBE reporting obligations are to the Shareholder Ministers.

### Managing risks

**3.3** The GBE Governance Arrangements provide that Directors are responsible for managing risk and so should therefore establish processes and practices within the GBE to manage all risks associated with the GBE's operations. Directors have a responsibility to keep Shareholder Ministers informed of risk management strategies by outlining them in corporate plans, progress reports and other reports when necessary. The Arrangements provide that, unless otherwise qualified because of circumstances applying to a particular GBE, corporate plans and progress reports should contain a statement from the Board that the Board has appropriate risk management policies and practices in place and that adequate systems and expertise are being applied to achieve compliance with those policies. GBEs, in normal circumstances, should only use derivative financial instruments for the purpose of hedging exposures. In addition, GBEs are advised that Shareholder Ministers may require the Board of a GBE to provide a risk management plan, the contents of which to be agreed on a case-by-case basis.<sup>35</sup>

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<sup>35</sup> Although not subject to the GBE Governance Arrangements, DOFA noted that Telstra's Annual Reports provide both quantitative and qualitative disclosures about risks to the business in addition to appropriate contingency plans and risk management policies.

**3.4** Australia Post's, ATG's, Medibank Private's, SACL's and ARTC's corporate plans and progress reports contain a statement from the Board about risk management policies and practices and progress in implementing them. As at 30 June 2000, EAL did not have a current corporate plan. While HSA's, SMHEA's, DHA's and EN's corporate plans have addressed risk management strategies, a specific Board statement has not been included in their plans.

**3.5** HSA is the only GBE from which Shareholder Ministers have sought details of a specific risk management plan. Although Shareholder Ministers have not requested a formal risk management plan from Medibank Private, Ministers did request the company to identify and address specific risk factors as part of future corporate plans. Both DHA and ARTC have also been advised by Shareholder Ministers of the need to improve future corporate plans in terms of how risk management is addressed. Shareholder Ministers have also endorsed the negotiation of a service level agreement between Defence and DHA to clearly articulate risk sharing between the parties. The Service Agreement, which was signed in August 2000, aims to put DHA's operations on a more commercial footing.

**3.6** Recommendation No.3 of Audit Report No.2 1997-98 recommended that the 1997 GBE Governance Arrangements be amended to require GBEs to specify in their corporate plans and progress reports their material risks and strategies for treating these risks. The GBE Governance Arrangements have not been revised since their introduction in July 1997. DOFA advised ANAO that, as a result, this requirement has not been formally incorporated into the Governance Arrangements. DOFA noted that, in practice, risk identification and its management is something that the CSAU has focussed on and DOFA considers that corporate plans have improved to include more of this information. DOFA advised that it anticipated there will be scope to explicitly incorporate the requirement set in the 1997-98 audit report recommendation into any revision to the Governance Arrangements arising from the Government's consideration of the recommendations of the JCPAA's December 1999 Report 372 on GBE Corporate Governance.<sup>36</sup>

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<sup>36</sup> DOFA responded to the JCPAA on 18 May 2000 in relation to four of the Committee's seven recommendations relating to administrative matters and has advised the Committee that the other three recommendations relate to policy matters and involve cross portfolio impacts and/or significant changes to the Governance Arrangements and will be addressed in a separate Government response.

3.7 The GBE Governance Arrangements provide that ongoing oversight of GBE borrowings is also an integral part of the corporate plan and progress reporting processes laid out in the Arrangements. The GBE Governance Arrangements state that the Government will consider supporting a borrowing proposal beyond the first forward year for GBEs that have a proven track record of good performance and accountability, and which provide appropriate justification (including expected rate of return) in corporate plans to support proposed capital expenditure programs. The Arrangements also state that GBEs will usually borrow from financial markets and that borrowing from the Commonwealth Budget requires the specific approval of the Finance Minister. The Minister for Finance and Administration has not been requested to consider such a borrowing request from any of the 11 GBEs included in the general scope of the audit.

3.8 The GBE Governance Arrangements provide that, as a general rule, the Government will not provide formal guarantees of GBE liabilities and that, accordingly, Directors should take this policy into account when making decisions which affect a GBE's operations and performance. The Arrangements state that guarantees provided in the past continue to apply to existing borrowings until they mature, in order to protect the interests of investors.<sup>37</sup> SMHEA has made no borrowing proposals since the introduction of the current GBE Governance Arrangements but previous borrowings of the Authority are guaranteed by the Commonwealth pursuant to section 28A of the *Snowy Mountains Hydro-electric Power Act 1949*.<sup>38</sup>

3.9 Following the significantly poorer than expected outcome for EN from the Job Network 2 tender, the company has been operating under a letter of comfort originally provided by the Minister for Finance and Administration on 23 December 1999 with a revised letter of comfort provided in February 2000. Finance Circular 1997/06, *Potential Liabilities*

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<sup>37</sup> Two guarantees previously provided to Telstra continued in force after the commencement of the current GBE governance framework. Prior to 1989 most of Telstra's borrowings were guaranteed by the Commonwealth. The last remaining guaranteed loan of \$42.25 million was repaid on 15 November 1999. In addition, following Telstra agreeing to make additional employer contributions to the Telstra Superannuation Scheme, on 27 June 1995, the Commonwealth guaranteed to cover any outstanding employer contributions in the event that Telstra becomes insolvent. The net present value of the contingent liability in respect of the guaranteed stream of payments for the Telstra Superannuation Scheme as at 30 June 1999 was \$1 billion.

<sup>38</sup> SMHEA borrowings are secured by the issue of inscribed stock. Section 28A of the *Snowy Mountains Hydro-electric Power Act 1949* provides for such borrowings to be guaranteed by the Commonwealth. There are currently five tranches of inscribed stock with an aggregate face value of \$181.467 million subject to explicit Commonwealth guarantees given under section 28A, with maturity dates ranging from 15 March 2004 to 12 July 2008.



and Losses, provides guidelines to agencies on the issuing of indemnities, guarantees and letters of comfort. The guidelines define a letter of comfort as a form of reassurance that may be used to facilitate an action or transaction that might not otherwise occur but state that, unlike indemnities or guarantees, letters of comfort are not intended to give rise to legal obligations.

**3.10** Ongoing Commonwealth indemnities have been provided to the members of the Boards of EN and ComLand. An indemnity is a legally binding promise whereby one party undertakes to accept the risk of loss or damage another may suffer.<sup>39</sup> The indemnities provided to the Boards of EN and ComLand do not have financial caps and this is not uncommon for such indemnities issued by the Commonwealth.<sup>40</sup> The Government has also provided a guarantee to support bank finance to ComLand, which is capped at \$60 million.

**3.11 Finding:** There is a specific requirement included in the GBE Governance Arrangements that GBEs include in their corporate plans and progress reports a statement that the Board has appropriate risk management policies and practices in place and that adequate systems and expertise are being applied to achieve compliance with those policies. Only half of the GBEs considered in the audit fully complied with this requirement. However, risk management is addressed by all of the GBEs in their corporate plans and progress reports although Ministers have advised some GBEs of the need to improve this area in future corporate plans.

**3.12** Audit Report No.2 1997–98 recommended that the 1997 GBE Governance Arrangements be amended to require GBEs to specify in their corporate plans and progress reports their material risks and strategies for treating these risks. The GBE Governance Arrangements have not been revised since their introduction in July 1997 and so this requirement has not been included in the Governance Arrangements. DOFA advised that it anticipated there will be scope to explicitly incorporate the requirement set in the 1997–98 audit report recommendation in any revision to the Governance Arrangements arising from the Government’s consideration of the recommendations of the JCPAA’s December 1999 Report 372 on GBE Corporate Governance.

<sup>39</sup> Finance Circular 1997/06, p. 1.

<sup>40</sup> Audit Report No. 47 1997-98, *Management of Commonwealth Guarantees, Indemnities and Letters of Comfort*, reported that although Finance Circular 1997/06 adequately addressed, among other things, the desirability of including, where possible a financial limit in indemnities there had not been high levels of compliance by agencies with the guidelines. p. 37.

**3.13** The GBE Governance Arrangements state that the Government will consider supporting a borrowing proposal beyond the first forward year for GBEs that have a proven track record of good performance and accountability, and which provide appropriate justification in corporate plans to support proposed capital expenditure programs. The Minister for Finance and Administration has not been requested to consider such a borrowing request from any of the 11 GBEs included in the general scope of the audit.

**3.14** The GBE Governance Arrangements provide that, as a general rule, the Government will not provide formal guarantees of GBE liabilities. Following the significantly poorer than expected outcome for EN from the Job Network 2 tender, the company has been operating under a letter of comfort. The Government has also provided a guarantee to support bank finance to ComLand, which is capped at \$60 million. Ongoing Commonwealth indemnities have been provided to the members of the Boards of EN and ComLand.

## Corporate Plans

**3.15** At least once a year, all wholly owned Commonwealth GBEs, are required under the CAC Act to prepare and provide to Shareholder Ministers a corporate plan that covers a period of at least three years and also covers any subsidiaries of the GBE.<sup>41</sup>

**3.16** Telstra's statutory reporting obligations are set out in Division 3 of Part 2 of the *Telstra Corporation Act 1991*. Division 3 of the Act requires Telstra to provide a corporate plan annually and the company has done so. Ministers have not sought any changes to any of the corporate plans provided by Telstra since July 1997.

**3.17** The current GBE Governance Arrangements provide that they apply in full to a wholly owned GBE during a sale or restructuring process until the Shareholder Ministers decide on variations to facilitate the sale/restructuring process. Audit Report No. 2 1997–98, recommended that departments ensure that GBEs within their portfolios comply with the requirements of the 1997 Governance Arrangements, including the preparation and submission of corporate plans, when they are being sold or restructured unless and until otherwise agreed by Shareholder

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<sup>41</sup> Section 17 for Commonwealth authority GBEs and section 42 for Commonwealth company GBEs.

Ministers.<sup>42</sup> However, the CAC Act, which commenced on 1 January 1998 after Report No. 2 1997–98 was tabled, also includes a requirement that GBEs prepare and provide annually to the responsible Minister a corporate plan but does not include any discretion to excuse GBEs undergoing sale or restructuring processes from this obligation.

**3.18** In April 1999, DOFA advised EAL that it had confirmed that the company need not provide a corporate plan for 1999–00 to the Shareholder Minister by 31 May 1999 due to uncertainty surrounding the company’s future ownership. No further corporate plans had been submitted by the company as of 30 June 2000.

**3.19 Finding:** With the exception of EAL, GBEs have submitted corporate plans each year in accordance with the CAC Act and the GBE Governance Arrangements. EAL was advised by DOFA in April 1999 that it need not provide a corporate plan for 1999–00 to the Shareholder Minister due to the uncertainty surrounding the company’s ownership. The requirement for wholly Commonwealth owned GBEs to provide a corporate plan at least once a year to the responsible Minister is set out in the CAC Act. Moreover, that Act does not include any discretion to excuse a GBE from compliance with this requirement.

## Recommendation No.1

**3.20** ANAO *recommends* that agencies review the adequacy of their procedures to ensure they are able to monitor effectively GBEs’ compliance with legislative requirements such as the mandatory requirement under the *Commonwealth Authorities and Companies Act 1997* that GBEs annually provide to Ministers a corporate plan.

### 3.21 Agencies’ responses:

- **DOFA whole of government response to the recommendation:** **Disagree.** The recommendation is based on the finding that all GBEs except Essendon Airport Limited (EAL) have submitted corporate plans each year in accordance with the requirements under the CAC Act and the Governance Arrangements. Noting that the audit covered 11 GBEs, non-compliance by one GBE in one year does not represent systematic non-compliance by Departments with the requirements of

<sup>42</sup> The 1993 GBE Oversight and Accountability Arrangements which applied until 1 July 1993 did not explicitly provide discretion not to apply the oversight framework in full to GBEs undergoing sale or restructure. Audit Report No.2 1997–98 identified that, notwithstanding that the 1993 arrangements also required GBEs to prepare and submit annually a corporate plan to Ministers, the former Housing Loans Insurance Corporation had not complied with this requirement.

the CAC Act and Governance Arrangements. On this basis we consider that a review of all agencies' monitoring procedures is not supported by the evidence and therefore not warranted. In the case of EAL, the issue of non-compliance was remedied immediately when the issue was brought to DOFA's attention.

**3.22 ANAO comment:** An essential element of the effectiveness of any corporate governance structure is comprehensive compliance with the legislative framework underpinning it. ANAO considers, particularly in the context of the constantly changing environment in which GBEs operate or are established, that it would be prudent for all agencies having GBE governance responsibilities to periodically review their procedures to ensure they are able to monitor effectively GBEs' compliance with all relevant requirements.

### Timing and assessment

**3.23** The GBE Governance Arrangements provide that the response by the Shareholder Ministers to a GBE's corporate plan will include (if necessary) proposed changes to the corporate plan to better reflect the Government's policies and objectives for the business; and be within 45 days of receipt of the plan. The best practice timetable for submission of GBE corporate plans<sup>43</sup> provides that GBEs should submit their corporate plan to Shareholder Ministers for comment by 31 May each year with Shareholder Ministers responding by 15 July and final corporate plans submitted to Shareholder Ministers by 31 July.

**3.24** Telstra and Australia Post are only required to provide final corporate plans<sup>44</sup>, however, discussions do occur with agencies on the Corporations' corporate plans. All of Australia Post's and Telstra's corporate plans have been submitted by July each year with the exception of Telstra's 1997 corporate plan, which Ministers agreed should be submitted in September 1997 in light of the first tranche sale of Telstra shares. In respect of the remaining GBEs, where revisions have been required by Ministers, final corporate plans have generally been submitted well after the 31 July date specified in the best practice timetable. The best practice

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<sup>43</sup> The *Best Practice Timetable for GBE Reports and Dividends* Attachment B to the GBE Governance Arrangements

<sup>44</sup> Although Australia Post is a wholly owned Commonwealth GBE it does not provide draft copies of its corporate plan to Shareholder Ministers. Section 40 of the *Australian Postal Corporation Act 1989*, provides that, after receipt of a corporate plan provided by Australia Post pursuant to section 17 of the CAC Act, the portfolio Minister has a period of 60 days in which he can direct the Board to vary the statement included in the plan of the strategies and policies that Australia Post adopts to carry out its community service obligations and/or the financial target under the plan. The Minister has not sought changes to any of the corporate plans submitted by Australia Post since 1 July 1997.

timetable is intended as a guide only and the GBE Governance Arrangements note that variations to the timing of the submission of corporate plans and final corporate plans may be agreed between the Shareholder Ministers and the directors of GBEs, on a case by case basis.

**3.25** The corporate plan submitted by each GBE is assessed by the CSAU and the relevant portfolio department. The CSAU has a significant role in relation to the assessment of corporate plans given that they are a key financial tool but undertakes this role in consultation with the relevant portfolio department. The CSAU briefs the Minister for Finance and Administration on each draft corporate plan providing advice as to the key issues raised and any improvements that the Shareholder Ministers may wish to seek in providing their comments to the GBE. DOFA advised ANAO that it seeks early involvement in the annual corporate planning process in each GBE in order to ensure that GBES are aware of the Shareholder Ministers' requirements and to facilitate the preparation of quality corporate plans which comply with the requirements of the CAC Act and the GBE Governance Arrangements.<sup>45</sup>

**3.26 Finding:** The best practice timetable for submission of GBE corporate plans provides that GBEs should submit their corporate plan to Shareholder Ministers for comment by 31 May each year with Shareholder Ministers responding by 15 July and final corporate plans submitted to Shareholder Ministers by 31 July. All of Australia Post and Telstra's corporate plans have been submitted by July each year with the exception of Telstra's 1997 corporate plan, which Ministers agreed should be submitted in September 1997 in light of the first tranche sale of Telstra shares. In respect of the remaining GBEs, where revisions have been required by Ministers, final corporate plans have generally been submitted well after the 31 July date specified in the best practice timetable.

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<sup>45</sup> Audit Report No. 2, 1997–98 recommended that portfolio departments periodically commission an independent assessment of corporate plans of GBEs within their portfolio to provide objective assurance to Ministers and the Parliament on this important element of the governance framework. There are four GBEs for which the Minister for Finance and Administration is the sole shareholder (SACL, EAL, EN and ComLand). DOFA advised that both EN and ComLand were relatively new organisations and it had not arranged independent assessment of either of EN's first two corporate plans or ComLand's recently submitted first corporate plan. DOFA noted that EAL had been given an exemption by the Minister to submit a corporate plan until its future was resolved. In respect of SACL, DOFA advised that a strategy paper prepared by consultants was used by the CSAU to assess the strategic content of SACL's 1999–2000 corporate plan.

## Capital structure

3.27 The GBE Governance Arrangements provide that each GBE should have a target optimal capital structure<sup>46</sup> that is agreed annually between the directors and the Shareholder Ministers in the consultation process for developing the corporate plan. The GBE Governance Arrangements define an optimal capital structure as one that, in light of economic, industry and firm specific factors, would provide for an investment grade credit rating, whilst at the same time imposing a discipline on the GBE to optimise efficiency.<sup>47</sup> The Governance Arrangements also provide that the capital structure of a GBE is to be reviewed where the application of dividend policy has not lead to, or is unlikely to lead to, an optimal capital structure within a reasonable period of time.

3.28 Capital structure considerations have important implications for the Commonwealth in terms of a myriad of factors relating to future profitability, maintenance of competitive position in services and prices, dividend payments and default risk. DOFA advised ANAO that it has in place a comprehensive framework for the analysis of GBE's capital structures. DOFA noted that a number of reviews have been commissioned either by GBEs or DOFA with a view to determining an entity's capital structure. DOFA considers issues such as the quality of assets, the stability of earnings and risk factors when determining, monitoring and reviewing capital structures. DOFA further advised that, where warranted, the analysis of GBEs' corporate plans also includes consideration of the appropriateness of current capital structures, the entity's progress towards achieving its target capital structure and/or factors that may warrant the capital structure being reviewed.

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<sup>46</sup> Defined in the GBE Governance Arrangements as the combination of financial liabilities and equity used to fund the assets of the GBE.

<sup>47</sup> The GBE Governance Arrangements also provide that:

- a GBE's level of estimated dividends (and forecast payout ratio) is to be agreed annually between the directors and the Shareholder Ministers in the consultation process for developing the corporate plan;
- the level of estimated dividends should have regard to the maintenance of, or progress toward, the GBE's optimal capital structure;
- the agreed dividend payout ratio should take account of the Government's preference for dividends over capital gains (a payout ratio of greater than 60 per cent of profits after tax and abnormals is considered to reflect that preference), but the payout for each year and for each GBE should relate primarily to the above considerations; and
- where the application of dividend policy has not lead to, or is unlikely to lead to an optimal capital structure within a reasonable period of time, the capital structure of the GBE is to be reviewed.

**3.29** Telstra is not subject to the GBE Governance Arrangements and the agreement with Shareholder Ministers of a target optimal capital structure is not provided for in the Telstra Act. Accordingly, DOFA advised ANAO that Telstra's capital structure is a matter for the Board of Telstra. Special dividends were made to shareholders prior to the first and second tranche sales of Telstra shares as a means of adjusting the company's capital structure.

**3.30** Agencies advise that target optimal capital structures have been agreed for Australia Post and ARTC. Australia Post's capital structure has been agreed with Shareholder Ministers in the course of the corporate planning process and the Corporation's capital structure was independently reviewed in 1999. A target optimal structure for ARTC was agreed following its establishment in 1998 and this covered the mechanism to achieve the target over a number of years. This capital structure was agreed following independent studies to value the assets and business and to report on credit ratings and target capital structures. DOFA advised that ARTC's estimated dividends have had regard to achieving an optimal capital structure and liquidity.

**3.31** Although a target optimal capital structure has not been agreed for Medibank Private, DOFA noted that, while there has been no formal review of the company's capital structure, in approving the financial forecasts in Medibank Private's corporate plans, Shareholder Ministers have implicitly approved the proposed capital structure for the relevant corporate plan period.

**3.32** DISR noted that the elements of the GBE Governance Arrangements relating to capital structure and dividend policy are not relevant to SMHEA as it is not a profit based agency. It is intended that the proposed corporatisation of SMHEA will address these issues.

**3.33** SACL's target optimal capital structure was also not agreed during the corporate planning process but was originally established on commencement of trading based on a review undertaken by consultants. DOFA advised ANAO that the structure achieved as a result of the January 1999 refinancing of the company's debt is the current agreed capital structure, and will continue to be so in the medium term. DOFA and DHAC also advised ANAO that a capital structure review was initiated by HSA in 1999, using the services of a major accounting firm. Shareholder Ministers are currently considering the outcome of this review.

**3.34** In July 1998, Shareholder Ministers agreed that EN should remain debt free during its establishment phase following two reviews by consultants. In February 1999, EN's working capital requirements were examined by the company and reviewed by Shareholder departments. Subsequently, in April 1999, the company undertook a share buy-back, repaying \$40 million in capital to the Commonwealth. DOFA noted that, while not a capital structure review in the strictest sense, EN's financial position was reviewed by a major accounting firm in November 1999, following the announcement of the Job Network 2 tender results. The review indicated a need for additional Commonwealth equity in the future, in light of the unexpected adverse outcome for EN from the Job Network 2 tender. In the 2000–2001 Budget, the Government announced that it would be injecting capital of \$56 million into EN over the next three years.

**3.35** DOFA advised ANAO that a target optimal capital structure for EAL has not been agreed with the Shareholder Minister because of the uncertain future of the company. In December 1998, the Minister agreed to allow leases on the airport with maximum terms of two years.

**3.36** A target optimal capital structure for DHA has also not been agreed with Shareholder Ministers. The capital structure of DHA was last reviewed and adjusted in 1992. DOFA noted that with the recent finalisation of the Service Agreement with Defence, work was expected to occur on reviewing DHA's capital structure

**3.37 Finding:** The GBE Governance Arrangements provide that each GBE should have a target optimal capital structure<sup>48</sup> that is agreed annually between the directors and the Shareholder Ministers in the consultation process for developing the corporate plan. DOFA advised ANAO that it has in place a comprehensive framework for the analysis of GBEs' capital structures. DOFA noted that a number of reviews have been commissioned either by GBEs or DOFA with a view to determining an entity's capital structure. DOFA considers issues such as the quality of assets, the stability of earnings and risk factors when determining, monitoring and reviewing capital structures. DOFA further advised that, where warranted, the analysis of GBEs' corporate plans also includes consideration of the appropriateness of current capital structures, the entity's progress towards achieving its target capital structure and/or factors that may warrant the capital structure being reviewed.

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<sup>48</sup> Defined in the GBE Governance Arrangements as the combination of financial liabilities and equity used to fund the assets of the GBE.



## Financial targets

**3.38** The 1997 review report noted that GBEs should aim, on average, to generate returns equal to their cost of capital. The current GBE Governance Arrangements state that the requirement is to earn at least a commercial rate of return, which means recovering the full cost of the resources employed by the GBE, including the cost of capital. Each GBE is to work towards a financial target and dividend policy, agreed in advance with Shareholder Ministers, with the financial target to be set on the basis that each GBE should be required to earn commercial returns at least sufficient to justify the long-term retention of assets in the business, and to pay commercial dividends from those returns. All GBEs are required to add to shareholder value in their operations with a view to at least meeting a financial target agreed by the Shareholder Ministers.

**3.39** The Governance Arrangements provide that for GBEs that are classified as trading GBEs, this target is the weighted average cost of capital (WACC). This target requires the GBE to earn returns sufficient to cover the cost of debt and the required return on equity. WACC is used to estimate the required rate of return on total assets, taking into account the different required rates of return attached to the different components of the company's capital structure.<sup>49</sup> For GBEs that are classified as financial GBEs, the target is return on equity, that is the risk free rate plus the proportion of market risk premium appropriate to the GBE. Any other financial targets that might be set for particular GBEs, on a case-by-case basis, should be consistent with the objective of increasing shareholder value.

**3.40** In terms of measuring GBEs' performance against agreed financial targets, the Governance Arrangements state that Shareholder Ministers will agree with each GBE the methodology they will use as their measure for performance against the WACC, or return on equity as appropriate. The measure being based on shareholder value added and the change in shareholder value added year-on-year. The Governance Arrangements note that the basic methodology for this is outlined in the Steering Committee on National Performance Monitoring of Government Trading Enterprises' July 1996 publication *An Economic Framework for Assessing the Financial Performance of Government Trading Enterprises*.<sup>50</sup>

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<sup>49</sup> The cost of debt is the expected rate at which the GBE is able to borrow. The required return on equity is the risk free rate plus the proportion of market risk premium appropriate to the GBE.

<sup>50</sup> The Arrangements state that financial targets should not be adjusted for any unfunded components of CSOs. Rather any adjustments considered necessary should be made, notionally to the organisation's actual revenues.

**3.41** The GBE Governance Arrangements state that, as a minimum, in providing for a GBE to expand its capital base through retained earnings capital expenditure plans must meet a hurdle rate of return that is consistent with the GBE's principal financial target.

**3.42** All current Commonwealth GBEs, with the exception of Medibank Private, are classified as trading enterprises.<sup>51</sup> Notwithstanding the requirements of the GBE Governance Arrangements, a principal financial target has not been calculated and agreed with Shareholder Ministers for any of the current Commonwealth GBEs. In addition, WACC targets are not currently used for any GBE as a financial target although DOFA advised that WACC is used as minimum benchmark of Australia Post's performance and a WACC target is implicit in the shareholder acceptance of SACL's aeronautical pricing proposal.

**3.43** DOFA advised ANAO that, while a single principal financial target may not have been separately agreed between the Shareholder Ministers and the individual GBES, financial targets are agreed as part of the corporate plan process. The CSAU has developed a suite of financial and non-financial performance measures tailored to each individual GBE for use in assessing their performance. This approach is based on DOFA's view that GBEs are inherently different from each other based on characteristics stemming from the services/products provided and the maturity and characteristics of the industry they operate in, including competitive pressures facing the GBE.

**3.44** The ANAO considers the application of a cost of capital (as required by the current GBE Governance Arrangements) would assist in identification of an appropriate allowance for the risk of Commonwealth investment by comparison with comparable risk returns applying in the private sector. It would also provide a common performance measure as a complement to the GBE specific measures, to inform decision relating to the retention of the business, commitment to new investment and dividend returns.

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<sup>51</sup> DISR advised ANAO that SMHEA does not neatly fit within the classification of either a trading or a financial GBE. SMHEA is required to generate electricity for electricity entitlement holders on a cost recovery basis, that is it is engaged in a business and produces outputs, but it does not trade those outputs. It is precluded from operating in a commercial manner by its enabling legislation, the *Snowy Mountains Hydro-electric Power Act 1959*, which provides that SMHEA will operate under a cost-recovery rather than a profit based regime. DOFA advised that, while the non-commercial nature of SMHEA's supply arrangements means that SMHEA itself does not 'trade' its product, on the basis that it is not a financial GBE, it is DOFA's understanding that the Australian Bureau of Statistics classification system requires it to be treated as a trading GBE.

3.45 DOFA advised ANAO that, in its experience, using WACC as a benchmark minimum rate of return is not appropriate for services businesses, which many of the current Commonwealth GBEs are. This is because these types of businesses generally have low asset bases and they do not leverage off their capital to earn a return. ANAO concurs that for service GBEs, such as AGS and HSA, WACC would not be appropriate given the absence of material assets.

3.46 Although Shareholder Ministers have not agreed principal financial targets with individual GBEs, the GBEs do include a range of financial targets in their corporate plans and report performance against these. In regard to DHA, DOFA advised ANAO that financial projections are agreed as part of the corporate plan process, although no specific financial target has been agreed by the Shareholder Ministers as DHA is still undertaking processes to place it on a more commercial basis. The *Defence Housing Authority Act 1987* indicates that DHA needs to earn a reasonable return on assets but does not outline a specific measurement methodology.

3.47 DHAC advised ANAO that Medibank Private's corporate plan includes a range of financial targets against which it reports performance. DOFA reports that, while no formal financial target has been agreed by Shareholder Ministers for Medibank Private, the Ministers have endorsed the financial targets contained in the company's corporate plan. Similarly for HSA, DHAC reports that the company reports performance against a range of financial projections included in its corporate plan.

3.48 DOFA advised ANAO that, for illustrative purposes in advice to Ministers on ARTC's performance, the company's return on invested capital (ROIC) has been compared to WACC. In respect to Australia Post, notwithstanding that formal financial targets have not been agreed with Shareholder Ministers, DOFA notes that a rate of return has been in the corporate plan financial projections accepted by Shareholder Ministers each year. The methodology Shareholder Ministers have agreed to use in measuring performance against this rate of return is ROIC. However, in respect of EN, DOFA advised that following the April 1999 capital repayment of \$40 million, ROIC is no longer a meaningful measure of EN's financial performance.

**3.49 Finding:** Each GBE is to work towards a financial target and dividend policy, agreed in advance with Shareholder Ministers. The financial target is to be set on the basis that each GBE be required to earn commercial returns at least sufficient to justify the long-term retention of assets in the business, and to pay commercial dividends from those

returns. The Governance Arrangements provide that for GBEs that are classified as trading GBEs, the target is the WACC. This target requires the GBE to earn returns sufficient to cover the cost of debt and the required return on equity. For GBEs that are classified as financial GBEs, the target is return on equity, that is the risk free rate plus the proportion of market risk premium appropriate to the GBE. All current Commonwealth GBEs, with the exception of Medibank Private, are classified as trading enterprises.

**3.50** A principal financial target has not been calculated and agreed with Shareholder Ministers for any of the current Commonwealth GBEs. DOFA advised ANAO that, while a single principal financial target may not have been separately agreed between the Shareholder Ministers and the individual GBEs, financial targets are agreed as part of the corporate plan process. The CSAU has developed a suite of financial and non-financial performance measures tailored to each individual GBE for use in assessing their performance. This approach is based on DOFA's view that GBEs are inherently different from each other based on characteristics stemming from the services/products provided and the maturity and characteristics of the industry they operate in, including competitive pressures facing the GBE.

**3.51** The ANAO considers the application of a cost of capital (as required by the current GBE Governance Arrangements) would assist in identification of an appropriate allowance for the risk of Commonwealth investment by comparison with comparable risk returns applying in the private sector. It would also provide a common performance measure as a complement to the GBE specific measures, to inform decision relating to the retention of the business, commitment to new investment and dividend returns.

## Recommendation No.2

**3.52** ANAO *recommends* that DOFA consider recommending amendments to the GBE Governance Arrangements whereby:

- (a) GBEs, which are classified as trading enterprises and have material assets, are required to establish a target weighted average cost of capital that takes account of the particular risk characteristics of the environment in which the GBE operates; and
- (b) appropriate financial targets are set for GBEs for which a target weighted average cost of capital is inappropriate.

With these amendments, the GBE Governance Arrangements would then be more closely aligned with current operational practice.

**3.53 Agencies' responses:**

- **DOFA whole-of-government response: Agree.**

## 4. Accountability

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### Reporting to shareholders

**4.1** Under sections 16 and 41 of the CAC Act, the directors of Commonwealth authorities and wholly owned Commonwealth companies are required to keep the responsible Minister informed of the operations of the authority/company and its subsidiaries and give both the responsible Minister and the Minister for Finance and Administration such reports, documents and information in relation to those operations as the Ministers require within the time limits set by the Minister concerned.<sup>52</sup> Section 8AF of the Telstra Act mirrors the requirements in sections 16 and 41 of the CAC Act.

**4.2** The GBE Governance Arrangements state that GBEs are to provide confidential periodic reports to the Shareholder Ministers reporting progress against, and any changes to, their corporate plans. The progress reports are required to include financial statements in a format approved by the Minister for Finance and Administration. Shareholder Ministers have agreed that ARTC, EAL, DHA and SMHEA are to provide six-monthly progress reports. ATG, Medibank Private, HSA, Australia Post and SACL provide quarterly progress reports.

**4.3** Shareholder Ministers decided when EN was established that it was appropriate to require the company to provide monthly progress reports given the immaturity of the market in which it operates. In December 1999, following the announcement of the outcome of the Job Network 2 tender and in light of the resulting substantial reduction in Employment National's share of this business, the Shareholder Minister advised the company that he required weekly progress reports. The

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<sup>52</sup> The CAC Act provides a further mechanism for the Finance Minister to obtain information during the financial year from Commonwealth authorities and wholly owned Commonwealth companies, including GBEs. Under sections 13 and 38 respectively, the Finance Minister may, by notice in the *Gazette*, require particular authorities and wholly owned companies to give to the responsible Minister an interim report for the first six months of the financial year or an interim report for each of the first 3 months, 6 months and 9 months of the financial year. The Act prescribes what an interim report is to include; that the directors must give the interim report to the responsible Minister within 2 months after the end of the period to which the report relates (although an extension of time may be granted in special circumstances); and that the responsible Minister must table the interim report in each House of the Parliament as soon as practicable. The Finance Minister has not *Gazetted* a requirement for any GBE to provide an interim report under the CAC Act provisions as compliance of the GBEs with the progress reporting and other reporting requirements of the GBE Governance Arrangements has been considered sufficient to provide the necessary information to Government.

company continued to provide weekly progress reports until May 2000 when the Minister agreed that the company could resume monthly reporting.

**4.4** Although Telstra is not subject to the Governance Arrangements, the company is required under section 8AF of the Telstra Act to keep the Shareholder Ministers informed. It has been agreed between the company and the Shareholder Ministers that periodic written reports be replaced by regular meetings between the shareholder departments (representing their Ministers) and Telstra management.

### **Continuous reporting**

**4.5** The GBE Governance Arrangements provide that directors of wholly owned GBEs should follow a continuous disclosure principle, which is similar to the continuous disclosure requirements of the Australian Stock Exchange (ASX) listing rules. That is, once a GBE becomes aware of any information that may have a material effect on its value, that information must be immediately provided to the Shareholder Ministers. In addition, where a wholly owned GBE or any of its subsidiaries, proposes to participate, change or dispose of an interest in a company, significant business, significant partnership, trust, unincorporated joint venture or similar arrangement, the GBE Governance Arrangements provide that the directors should immediately give the Shareholder Ministers the written particulars of the proposal.<sup>53</sup> The directors of wholly owned GBEs are also required to keep the Shareholder Ministers informed of the operations of the GBE and its subsidiaries, and to give the Ministers such information in relation to those operations as the Shareholder Ministers require, within the time limits set by the Ministers.

**4.6** Prior to the introduction of the current GBE Governance Arrangements in July 1997, it was the practice of the then Department of Finance<sup>54</sup>, following the publication of GBE annual reports, to prepare a submission to Cabinet containing an assessment of past and expected future financial performance of GBEs. DOFA advised ANAO that this practice has been discontinued under the current GBE accountability framework, noting that the information contained in these submissions tended to be somewhat dated by the time that the analysis was completed and agreed with portfolio departments.

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<sup>53</sup> The requirement for GBEs to keep Ministers informed of significant events such as these is also set out in section 15 of the CAC Act for Commonwealth Authorities, section 40 of the CAC Act for Commonwealth companies and section 8AE of the Telstra Act. Telstra as a listed company is also subject to the Australian Stock Exchange (ASX) listing rules and provides copies of its notifications to the ASX in satisfaction of its obligations under this requirement of the Telstra Act.

<sup>54</sup> The Department of Finance came into being on 9 October 1997 following the amalgamation of the previous Departments of Finance and Administrative Services.

4.7 There is no reference to such a practice in the current GBE Governance Arrangements. However, the March 1997 report on the *Review of GBE Governance Arrangements* noted the practice and argued that it should be continued, with the additional requirement that the Shareholder Ministers write to the chair of each GBE on any issues identified in the Cabinet Submission. The report suggested that the Minister for Finance should have carriage of the annual report to Cabinet but that, consistent with the dual shareholder model, the portfolio Minister should also have ownership of the assessment of the performance of their individual GBE(s).<sup>55</sup>

4.8 Under the current GBE accountability framework, mechanisms exist to keep Shareholder Ministers informed about the status of GBEs for which they have particular responsibility. However, there is no regular briefing of the Government overall. The CSAU currently provides a comprehensive briefing program to the Minister for Finance and Administration which includes a quarterly update about each GBE's latest financial estimates and key performance information together with a discussion of current issues facing each enterprise. ANAO considers that providing briefings on a regular basis to Cabinet could improve accountability and transparency to Government on the operations of GBEs.

**4.9 Finding:** Prior to the introduction of the current GBE Governance Arrangements in July 1997, it was the practice of the then Department of Finance, following the publication of GBE annual reports, to prepare a submission to Cabinet containing an assessment of past and expected future financial performance of GBEs. The March 1997 report on the *Review of GBE Governance Arrangements* noted the practice and argued that it should be continued. DOFA advised ANAO that this practice has been discontinued under the current GBE accountability framework. ANAO considers that that providing briefings on a regular basis to Cabinet could improve accountability and transparency to Government on the operations of GBEs.

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<sup>55</sup> *Review of GBE Governance Arrangements*, March 1997, Mr Richard Humphry AO, p.55 and Recommendation 27.



## External reporting mechanisms

**4.10** During the period in which the 1993 oversight arrangements applied, there were two external reporting mechanisms, GBE's annual reports tabled in Parliament and the annual report published by the Steering Committee on National Performance Monitoring of Government Trading Enterprises (GTEs). With the achievement of substantial GTE reform and the privatisation of a number of enterprises, the Steering Committee recommended in 1997 that it should be disbanded. At the time that formal agreement for disbandment was sought, the Productivity Commission indicated that it would continue to monitor GTEs under its general research program. In July 2000, the Commission released its first such report, *Financial Performance of Government Trading Enterprises, 1994–95 to 1998–99*.<sup>56</sup>

### Statements of Corporate Intent

**4.11** On the recommendation of the March 1997 report on the *Review of GBE Governance Arrangements*,<sup>57</sup> the 1997 GBE Governance Arrangements introduced the requirement for wholly owned Commonwealth GBEs to annually provide a Statement of Corporate Intent (SCI) to be tabled in Parliament. The SCI is a forward looking document against which future GBE performance can then be considered. Telstra, as a partly Commonwealth-owned GBE, is not required to provide an SCI. In the case of ATG, which is 99.9 per cent Commonwealth-owned a Shareholders Agreement exists between minority shareholders and the Commonwealth. In general the Governance Arrangements apply to ATG but where inconsistencies exist the Shareholders Agreement takes priority. ATG also submits SCIs.

**4.12** The Governance Arrangements provide that the directors of each wholly owned GBE and the Shareholder Ministers are to agree on a SCI which is to be a public document tabled in the Parliament. The SCI is required to be a brief document (no more than five pages) which provides high level information about outputs and outcomes for the GBE. While it is to be an integral part of the GBE's Corporate Plan, the SCI does not include commercial-in-confidence information. SCIs are normally expected to contain a business description and mission statement, corporate vision, objectives, code of ethics, statement of accountability (including reporting obligations) and broad expectations on financial and non-financial performance.

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<sup>56</sup> Three Commonwealth GBEs are included in the Productivity Commission's report. SMHEA is included in the review of electricity and gas GTEs. Telstra and Australia Post, together with Air Services Australia are considered in a separate chapter examining Commonwealth GTEs.

<sup>57</sup> *Review of GBE Governance Arrangements*, Richard Humphry AO, March 1997, Recommendation No. 15.

**4.13** The Governance Arrangements provide that SCIs will be tabled in Parliament within 15 sitting days of the Parliament, following the start of the new financial year although Shareholder Ministers may agree to later tabling, in which case Parliament should be informed. The first GBE SCIs were due to be tabled following the conclusion of the 1997–98 financial year. The calling of the 1998 Federal Election and the transition of the Government into caretaker mode delayed tabling of the SCIs until after the Election. Accordingly, the fifteenth sitting day following the start of the new financial year did not occur until 25 November 1998.

**4.14** Ministers exempted ADI Limited from the requirement to produce an SCI pending completion of its sale in November 1999. Telstra, not being subject to the GBE Governance Arrangements, is not required to agree a SCI with Shareholder Ministers. DOFA advised ANAO that the Shareholder Minister, consistent with the decision not to require EAL to provide a corporate plan, has agreed that EAL does not have to table a SCI while the future of EAL is uncertain. Consequently, no SCI has been tabled for EAL since the introduction of the requirement. The Minister for Finance and Administration, on behalf of Shareholder Ministers, advised ATG that the Ministers preferred to delay tabling of the 1998 SCI for the company until after the completion of a scoping study of the Commonwealth's shareholding in ATG to be undertaken by OASITO commencing in August 1998. The first SCI for ATG, relating to the 1999–2000 Corporate Plan, was tabled in Parliament on 4 April 2000.

**4.15** Only in the case of Medibank Private has the GBE Governance Arrangements' deadline of tabling SCIs by the fifteenth sitting day after the commencement of the new financial year been effectively met in both 1998 and 1999. Australia Post also met the 1998 deadline and Australia Post and SACL were next closest to achieving the 1999 deadline, missing it by 22 and 23 sitting days respectively or some 11 weeks. The Minister for Finance and Administration approved a revised deadline for SACL's 1998 SCI of the first session of Parliament in 1999, which was advised to Parliament. However, SACL's 1998 SCI was not tabled until 30 June 1999. Following the tabling in April 2000 of the 1999 SCIs of ARTC, SMHEA and ATG, only HSA's 1999 SCI remains outstanding, as the Minister for Finance and Administration has agreed that EAL need not table an SCI while its future remains uncertain and that EN should currently focus on its restructuring activities following the outcome of the second Job Network tender.

**4.16** The current GBE Governance Arrangements state that an SCI does not contain commercial-in-confidence information but would normally contain, among other things, broad expectations on the GBEs expected financial and non-financial performance for the period covered by the SCI. By contrast, under the New Zealand *State-Owned Enterprises Act 1986*, the SCIs prepared by all state-owned enterprises (SOEs) must include the performance targets and other measures by which the performance of the SOE may be judged in relation to its objectives and the ratio of consolidated shareholders' funds to total assets.<sup>58</sup>

**4.17** Figure 4.1 contrasts the financial performance information provided by Australia Post and New Zealand Post<sup>59</sup> in compliance with the respective SCI requirements applying to these entities. New Zealand Post's SCI for the transitional quarter 1 April to 30 June 2000 provides quantitative targets as opposed to the qualitative statements of Australia Post's 1999 SCI. In addition, New Zealand Post's SCI includes specific financial performance measures outlined and targets for out-years for both financial performance and capital structure.

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<sup>58</sup> *State-Owned Enterprises Act 1986*, New Zealand, section 14.

<sup>59</sup> New Zealand Post will change its balance date in 2001 from 31 March to 30 June. Accordingly, it prepared an SCI for the transitional quarter from 1 April to 30 June 2000. This is the New Zealand Post SCI used in the Figure 4.1.

**Figure 4.1**

**Australia Post and New Zealand Post SCI reporting on financial performance under the differing SCI reporting requirements applying to the two entities.**

<b>AUSTRALIA POST</b> 1999/2000—2001/2002																																		
<p><b>Financial Outcomes</b> Australia Post is also required to operate commercially, aim for a reasonable rate of return on the assets it uses and pay a reasonable dividend to the owner, the Government.</p> <p>Since 1992, Australia Post has maintained price restraint—in particular, the basic letter rate of 45 cents has remained frozen. The enterprise has committed itself to continue the freeze on the 45 cent rate to 2003 provided there are no unforeseen circumstances.</p> <p>The profit (before tax) of Australia Post in the past three years has been around \$350 million, with a rate of return on assets between 12.8 to 14.6 per cent, and ordinary dividends paid to the Government at 60 per cent of profit after tax and abnormals. In addition, two special dividends of \$80 million each were paid in 1996/97 and 1997/98.</p> <p>The cost of meeting CSOs is of the order \$70 million per year.</p>																																		
<b>NEW ZEALAND POST</b> Transitional Quarter 1 April to 30 June 2000																																		
<p><b>Performance Targets and Measures</b></p> <p>The financial performance measures to be adopted are:</p> <p>(a) Net Profit After Tax (NPAT): Average Shareholders' Funds</p> <p>(b) Earnings Before Interest and Tax (EBIT): Total Tangible Assets (TTA) (Year-End)</p> <p>(c) Earnings Before Interest, Tax Depreciation and Amortisation (EBITDA): Turnover</p> <p>The financial performance targets are:</p> <table border="1"> <thead> <tr> <th>Period Ending 30 June</th> <th>2000TQ</th> <th>2001</th> <th>2002</th> <th>2003</th> </tr> </thead> <tbody> <tr> <td>NPAT (excl. Extraordinary)</td> <td>3.0%</td> <td>19.8%</td> <td>22.7%</td> <td>22.8%</td> </tr> <tr> <td>EBIT:TTA (Year-End)</td> <td>2.4%</td> <td>13.5%</td> <td>15.2%</td> <td>15.5%</td> </tr> <tr> <td>EBITDA:Turnover</td> <td>10.2%</td> <td>12.1%</td> <td>12.9%</td> <td>13.2%</td> </tr> </tbody> </table> <p>Note: The 2000 transition Quarter (2000TQ) ratios have not been annualised</p> <p><b>Ratio of Shareholder's Funds to Total Assets</b></p> <p>The Company's targets for the ratio of Total Shareholder's Funds to Total Assets is as follows:</p> <table border="1"> <thead> <tr> <th>As at 30 June</th> <th>2000</th> <th>2001</th> <th>2002</th> <th>2003</th> </tr> </thead> <tbody> <tr> <td>Total Shareholder's Funds: Total Assets</td> <td>36.7%</td> <td>37.9%</td> <td>39.7%</td> <td>41.6%</td> </tr> </tbody> </table>					Period Ending 30 June	2000TQ	2001	2002	2003	NPAT (excl. Extraordinary)	3.0%	19.8%	22.7%	22.8%	EBIT:TTA (Year-End)	2.4%	13.5%	15.2%	15.5%	EBITDA:Turnover	10.2%	12.1%	12.9%	13.2%	As at 30 June	2000	2001	2002	2003	Total Shareholder's Funds: Total Assets	36.7%	37.9%	39.7%	41.6%
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Source: Australia Post SCI 1999/2000—2001/2002 and New Zealand Post SCI Transitional Quarter 1 April to 30 June 2000.

**4.18** Under the New Zealand Act, New Zealand SOEs are required to report<sup>60</sup> back in their annual report against the performance measures included in their SCIs.<sup>61</sup> ANAO considers that the usefulness of Commonwealth GBEs' SCIs in providing accountability to Parliament could be improved by the introduction of a requirement for GBEs to report, in their annual reports, on their performance against the broad expectations on financial and non-financial performance included in the previous year's SCIs.

**4.19 Finding:** The requirement for wholly-owned Commonwealth GBEs to provide SCIs, which are tabled in the Parliament, presents an opportunity for increased transparency and accountability regarding these very significant Commonwealth investments. However, the benefits of such openness can be reduced if SCIs are not tabled in a timely manner in accordance with the requirements of the GBE Governance Arrangements. Only in the case of Medibank Private has the GBE Governance Arrangements' deadline of tabling SCIs by the fifteenth sitting day after the commencement of the new financial year been effectively met in both 1998 and 1999. Australia Post also met the 1998 deadline and Australia Post and SACL were next closest to achieving the 1999 deadline, missing it by 22 and 23 sitting days respectively or some 11 weeks.

**4.20** ANAO considers that transparency and accountability to Parliament could be further enhanced by the introduction of a requirement for GBEs to include in their annual reports reporting on their performance against the broad expectations on financial and non-financial performance included in their SCIs.

<sup>60</sup> *State-Owned Enterprises Act 1986*, New Zealand, section 15.

<sup>61</sup> The Controller and Auditor-General of New Zealand reported in his Third Report for 1998 on a special study his office had carried out on *Statements of Corporate Intent: Are they working?* As the SCI is an important part of the framework for managing ownership interest, the Controller and Auditor-General recommended, among other things, that entities review to ensure that performance measures address all the entities objectives and are capable of providing a useful (and understandable) basis for comparing expected and actual performance and that shareholders ensure that the entities have procedures and practices in place to ensure that they prepare and report against their SCIs in compliance with the legislative requirements. *Report of the Controller and Auditor-General, Third Report for 1998, Article 5, Statements of Corporate Intent: Are they working?* pp. 105-107.

## Recommendation No.3

4.21 ANAO *recommends* that DOFA, in order to enhance accountability to Parliament for the significant Commonwealth investments and roles performed by GBEs, consider recommending an amendment to the GBE Governance Arrangements requiring GBEs to include their annual reports specific reporting against the broad expectations about key financial and non-financial performance included in the previous year's Statements of Corporate Intent.

### 4.22 Agencies' responses:

- DOFA whole of government response: Agree
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Canberra, ACT  
9 November 2000

P. J. Barrett  
Auditor-General

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