

Department of Treasury and Finance

Address to the Chartered Secretaries Australia

Annual Public Sector Update

“Reflections on Public Sector Governance”

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Today will be the last of the many occasions as a senior bureaucrat that I have addressed an audience. The part of my working life that has been in the bureaucracy has spanned just over 25 years. For this reason, I thought I might share with you some reflections on public sector governance and its evolution over the 25 year period since 1985.

Governance – what does it mean? Wikipedia tells us that governance is derived from the Greek verb meaning to steer. For my purpose today, I am going to use the term governance to mean how the public sector is controlled such that it acts in the best interests of the community.

My focus will be on Tasmanian public sector governance mainly as it relates to the executive arm of Government. More particularly, I want to address how Tasmanian public sector agencies, statutory authorities and government businesses are controlled and to look at the responsibilities and accountabilities between Ministers, heads of agency, boards, CEOs and the Parliament.

This is a large canvas but I will structure my remarks around:

- what has changed significantly in respect of Tasmanian public sector governance since 1985;
- why these changes have occurred; and
- how can we improve Tasmanian public sector governance?

What has changed?

At a high level we still have the same building blocks now as in 1985 – we still live in a federation; the Constitution is pretty much unchanged and the institutional arrangements are little different. However, there have been important changes.

One of the more significant changes has been the increasing dominance of the Australian Government in respect of its revenue raising capacity, compared to its expenditure responsibilities. This has arisen from a succession of High Court judgments interpreting the constitution in favour of the national government. A consequence has been increased duplication of services between the two levels of Government. The recent health agreement between the then Rudd Government and the States and Territories, other than Western Australia, is a manifestation of attempts to resolve this issue - albeit a very clumsy one. Another result has been a steady centralisation of power at the national level – both financially as well as in other areas including education, industrial relations and the environment. The result has been to seriously diffuse the accountability to the community of the two levels of government.

At the State level, the most obvious governance change has been a structural change - the big reduction in the number of government departments and statutory authorities. Twenty five years ago we had 36 departments while now we have 9*. The number of Government businesses has fallen from 26 to 15.

There have also been classification changes with some departments, or parts of them moving along the continuum from departments to statutory authorities to Government businesses to state owned companies and in some cases private ownership. For example, Forestry Tasmania was the Department of Forestry in 1985 but subsequently became a Government business. Similarly, the then Transport Department included what is now TT Line. There have also been changes in the composition of Government businesses with the loss of some old favourites such as the Grain Elevators Board and the Soft Fruit Industry Board and the sale of others, including the TGIO, Civil Construction Corporation, the Printing Authority, State Purchasing and Sales and Hobart Airport.

Many of these structural changes for agencies and statutory authorities were implemented during the Field Government through a series of administrative arrangements orders. Changes to the structure of Government businesses were given effect through the State Authorities Financial Management Act 1991 and the Government Business Enterprises Act 1995 and a number of specific pieces of legislation.

These changes to agencies and authorities have led to the centralisation of functions in fewer and larger departments with these entities having greater autonomy, but also greater accountability.

One of the key legislative reforms underpinning these significant changes in the governance framework for agencies arose from the Financial Management and Audit Act 1990.

The philosophy behind the introduction of this Act was to:

- define principles of financial administration to be applied to the public sector; and
- establish procedures, supported by legislation, concerning the accountability of agencies for the administration of public funds.

The legislation replaced some of the provisions of the Audit Act 1918, much of which had not received any attention since that Act was proclaimed.

Features of this legislation are that it:

- strengthened the financial accountability of the Executive by charging designated Ministers and officers with responsibility for the services under their control;
- required Heads of Agency to submit an annual report to Parliament
- standardised financial accounting, reporting and audit provisions; and
- defined the role of the Auditor General as the external auditor for Government.

Further improvement to the Financial Management and Audit Act was foreshadowed in the 2006 State of the State Speech by the then Premier, Paul Lennon. The intention was to ensure that the Tasmanian community is better informed in regard to

public sector finances by modernising the FMAA and separating the Financial Management Act from the Audit Act.

The new legislation is intended to improve:

- financial transparency;
- fiscal integrity; and
- responsibility and accountability.

The first stage of this modernisation process was completed with the passage in 2009 of a new and separate Audit Act. This Act strengthened the independence of the Auditor General, gave him additional powers and extended his remit to include the audit of all Government bodies. It established a role for Parliament through the Public Accounts Committee in the appointment process of the Auditor General and the approval of the Auditor General's annual work plan.

We currently have under development the second stage of the process of modernising the financial management legislation. The Treasurer will soon issue a Discussion Paper on a new Financial Management Act, to stimulate public discussion on the framework and gain feedback on our proposals.

This new Financial Management Act will take a more streamlined, principles based, and less prescriptive approach to public sector financial management. It entails a move away from fund based accounting and reflects the major developments in uniform government financial reporting since 1990.

The new Financial Management Act is intended to:

- clarify the responsibilities and strengthen the accountability of Heads of Agencies under the financial management framework;
- enhance governance arrangements for agencies;
- provide an appropriate reporting framework for statutory authorities;
- provide for increased transparency in public sector reporting; and
- enable the efficient management of resources, in the interests of enhancing the long term financial viability of the State.

Other improvements in accountability occurred as a result of Premier Lennon's 2006 State of the State address, including:

- the introduction of separate budget appropriations for the Auditor General, the Ombudsman, the Office of the Governor and the parliamentary agencies, which have subsequently been extended to include the Director of Public Prosecutions and, from next year, the Integrity Commission;
- changes to procurement policy to enhance the community's access to information on government procurement and ensure that unnecessary confidentiality

provisions do not fetter the public scrutiny of government procurement contracts; and

- the introduction of a Charter of Budget Responsibility that:
 - ❖ requires Governments and Opposition parties to develop and publish a fiscal strategy;
 - ❖ requires the preparation and publication by the Treasury Secretary of independent pre-election financial outlook statements; and
 - ❖ provides for the election policies of all recognised political parties to be costed and published by Treasury.

The State Authorities Financial Management Act of 1990 and its successor, the Government Business Enterprises Act 1995, were major legislative initiatives to commercialise and create the governance framework for the State's government businesses.

The GBE Act provides an operating environment for GBEs which encourages economic efficiency by:

- providing clear commercial objectives for GBEs;
- requiring the Government to set the strategic direction and operating framework for GBEs through a Ministerial Charter and well-articulated corporate planning processes;
- establishing that board members are chosen for their expertise and not as representatives of special interest groups, and specifying the duties and accountabilities of boards;
- providing a clear accountability framework for all GBEs. The GBE Act provides a large measure of managerial and operational autonomy to GBE boards and CEOs. However, there is a clear chain of accountability from CEO to Board, from board to portfolio minister and from Minister to Parliament;
- providing a full competitive neutrality regime which includes guarantee fees, tax equivalent payments and dividends; and
- establishing Community Service Obligation arrangements and specifying a funding regime for them.

The accountability framework for Government Business Enterprises is completed by the requirement for Annual Reports to be tabled in Parliament and for the Portfolio Minister, GBE Board Chair and CEO to appear when required before the Government Business Scrutiny Committees of the Parliament.

Our State-Owned Companies operate under a very similar governance framework, though there are some variations in the implementation to fit within the Corporations Act which provides the over-arching governance framework for our SoCs.

The Government committed in the 2010 State Budget to further reform of the governance framework for Government businesses and announced its intention to adopt the Corporations Act as the sole governance model for all government businesses. It will no longer maintain a separate Government Business Enterprises Act. This GBE to SoC conversion project is gathering momentum, and we will shortly be putting out a position paper for comment and feedback.

In addition to changes to the structure and legislative framework for agencies and government businesses there have been other changes that have strengthened the accountability of the Executive to Parliament and the community that already existed through the operation of Parliament and its committees, the Auditor General and the Ombudsman. The most significant of these are:

- the Freedom of Information Act 1991 and its successor, the Right to Information Act 2009;
- the establishment of (Budget) Estimates Committees of both Houses of Parliament in 1993; and
- the recent establishment of the Integrity Commission.

We have also seen a significant expansion in the role and activism of Parliamentary Committees, particularly the standing Joint Committees and those of the Legislative Council.

There have also been changes to the legislature during this time. These include:

- a reduction in the number of parliamentarians in 1998 from 35 to 25 in the House of Assembly and 19 to 15 in the Legislative Council; and
- increasing prominence of minor parties with 3 minority governments since 1989 (including of course the current government) which has shifted the power balance in favour of Parliament and away from the Executive;

A very recent development was the agreement on 2 September 2010 by the leaders of the three Tasmanian political parties to support an increase in the size of the House of Assembly back to 35. The reasons for this appear to include a desire to increase the talent pool within Parliament for ministerial positions and increased scrutiny of the Executive. The three leaders also agreed to progress other changes to improve parliamentary accountability including political donations, candidate expenditure during elections, fixed terms of Parliament, a code of conduct for all members of Parliament, resources available to members of Parliament and the powers of parliamentary committees.

Let me now turn to look at why these changes have occurred.

Over the period of 25 years since 1985, there have been very significant structural changes and changes to the governance framework within which our Executive Government operates. These have been prompted by:

- financial imperatives at the State level;

- a national micro-economic reform agenda to improve the performance of the public sector; and
- increasing community expectations of governments.

The Field Government reforms were accompanied by a substantial expenditure reduction and redundancy program. The amalgamation of agencies and commercialisation of businesses supported these expenditure reductions. This was prompted in part by a sustained reduction in Australian Government grants to Tasmania during the late 1980s. Interestingly, this lower funding trend was dramatically reversed from about 1999, and gathered pace with the transfer of GST revenue to the States, only to be spectacularly reversed with the GFC and its aftermath.

Another national trend to affect the State was that for State Governments to approach the debt markets directly for funding rather than borrowing under the Commonwealth Government umbrella, as had been the sole source of debt funding since the Financial Agreement of 1927. This trend led to the creation of State borrowing authorities such as Tascorp which was established in 1985. Subsequently, in the early 1990s, the Australian Government decided to completely withdraw support for State borrowings, requiring that States borrow solely on their own account, under their own credit rating and not that of the national government. This resulted in an important addition to the economic and financial governance framework of the Executive through independent continuous scrutiny by two rating agencies of the State Government's financial and economic performance.

Another major influence on the governance arrangements particularly for Government businesses was the national microeconomic reform agenda that commenced around 1990. One of the earlier forums in which this was discussed was the 1990 Special Premiers Conference where two of the key items were microeconomic reform, later to become National Competition Policy and resolution of the duplication of services between the Commonwealth and State governments. We have made a lot of progress on the former but rather little on the latter.

Microeconomic reform included the structural separation of publicly-owned monopolies; consistent application of the competitive neutrality principle to the financial governance framework for Government businesses; and reforms to ensure more effective and competitive functioning of markets. Both the SAFMA and GBE Act reforms established a framework for performance, accountability, autonomy and made government businesses subject to similar incentives as their private sector counterparts through the introduction of income tax equivalents, dividends and guarantee fees. These developments also involved the sale of Government businesses. More recent influences have been the Corporations Act 2001, the various stages of the Commonwealth's Corporate Law Economic Reform Program, and the ASX Corporate Governance Guidelines.

An example of the establishment of effective markets was the development of the national electricity market. Another addition to the economic governance framework was the introduction of price regulation where markets did not work properly, such as where monopolies exist. This removed prices from direct Ministerial influence and

provided for prices to be determined having regard to the need to balance the financial requirements of businesses with consumers' interests.

Let me turn to the question of how we might improve Tasmanian public sector governance. This is a potentially big subject so let me pick on just two issues which I find interesting.

Firstly, let's look at the governance framework for public sector employment in Tasmania. We got a new State Service Act in 2001 replacing the 1984 Act. The 2001 Act was introduced to provide greater flexibility and was less prescriptive than its predecessor. It applies to statutory authorities and agencies but not to most government businesses.

It introduced a set of principles regarding the nature and operation of the State Service and the expectations of those who work in it. These principles include workplace diversity, leadership, accountability and ethics. The Act provides for:

- a Code of Conduct that applies to all employees;
- the Minister administering the State Service Act to be the employer on behalf of the Crown for all employees;
- employment decisions to continue to be based on merit, albeit with a revised and more flexible definition than previously;
- agency heads to determine the duties of positions and their classification; and
- no maximum age for employment.

The State Service Act is a very elaborate framework which creates for the Tasmanian public sector a set of employment powers, arrangements and accountabilities. It is precisely in parallel with, but different to, the ordinary employment and industrial relations framework within which other employers operate, including all private sector employers.

In governance, certainty is paramount. Regrettably, the State Service Act does not in the main replace the ordinary employment and industrial relations framework. Rather, it creates an "underlay". An employee unhappy with the outcome of State Service Act processes has further redress through the industrial relations system. The representatives of the employer have no certainty that a process, properly conducted under the State Service Act will bring to completion an employment matter.

This underlay creates undesirable uncertainty. My question is: would we be better served with a simple employment power and a means to impose whole-of-government employment policies? Why not simply expose public sector employers to the ordinary employment and industrial relations law? The governance would be simpler, more certain and less costly. It is hard to see what we would lose.

Secondly, let's consider the governance framework for government-owned businesses from the perspective of the incentives for behaviour it creates.

In principle, government should be able to be a business owner and induce behaviour in themselves, their board and the business no different to that which applies to listed companies. The practice is different, for two reasons

First, the formal governance arrangements for government owned businesses typically involves departures from the standard Corporations Act arrangements, in particular the corporate takeover and compulsory acquisition provisions.

These make quite significant changes to the incentives under which state owned businesses operate. The threat of takeover provides powerful incentives for enterprise maximising behaviour. There is no equivalent in the public sector.

No access to equity and debt markets for the majority of State owned businesses creates very different incentives. These businesses are unable to freely make decisions about divestment, acquisitions and diversification.

The process for removing an underperforming director or an entire board is rather simple for a listed company, but more complex for the shareholders of a state owned business given that the political environment substantially raises the costs of removing a non performing director.

A second way in which differences in behaviour arise between State owned businesses and listed companies is the extent of shareholder involvement in the operations of the business. For good reasons this involvement is much greater for State owned businesses. Shareholders of government businesses are not the owners of the business nor do they have a direct financial stake in the company. However, they do have a very high political stake and hence a strong desire to be kept informed of the activities and performance of the business.

State owned businesses are subject to scrutiny by the Auditor General, Parliament and its committees, the Ombudsman and the Integrity Commission. However, they are not subject to the continuous market monitoring associated with listed companies, reporting by analysts and the possibility of takeover.

These differences in the incentives inherent in the government business governance framework when compared to those facing privately owned Corporations Law companies, lead to differences in behaviour – on the part of government as owner, boards and management. The consequence is that, without special effort on the part of those players, government-owned businesses will not perform as well as their private sector counterparts.

Some would say that this points to an obvious conclusion – that governments should not own businesses. That is a bit too simplistic in my view, because there are some businesses government has to own – perhaps not many, but some.

To overcome the deficiencies in the governance framework puts quite heavy responsibilities on the boards of government businesses in particular.

They have to build into their decision-making processes a level of rigour far beyond that regarded as best practice in the private sector.

Similarly, the external scrutiny that comes from parliamentary committees, monopoly regulation and the like helps to make up for deficiencies in the governance framework.

The public sector governance framework has evolved very considerably over the 25 plus years of my time working in the bureaucracy. There is no doubt in my mind that this evolution is progress – today’s standards and expectations are a great deal higher; transparency and accountability is much improved; and, in the main, the incentives inherent in the framework produce better behaviour and improved outcomes. However, we cannot stand still. Governance should be subject to continuous improvement like everything else. There is a lot we can do to our Tasmanian public sector governance frameworks in that never-ending pursuit of best practice.

Thank you.

Note:

- * I have excluded from both counts a number of small pseudo-departments like the 3 Parliamentary Departments, the Office of the Governor, Ombudsman, Integrity Commission and the Auditor-General. I do on the grounds that they do not impact on the “governance load”. If they are included in both counts, numbers become 41 in 1985 and 17 in 2010.