

The Parliament of the Commonwealth of Australia
Joint Committee of Public Accounts



DEPARTMENT OF THE SENATE
PAPER No. 9342
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<i>Mary Evans</i>

REPORT 336

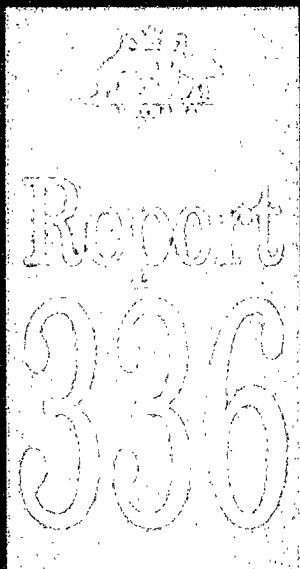
Public Business in the Public Interest:

**An Inquiry into Commercialisation
in the Commonwealth Public Sector**

April 1995

Australian Government Publishing Service
Canberra

THE COMMONWEALTH OF AUSTRALIA



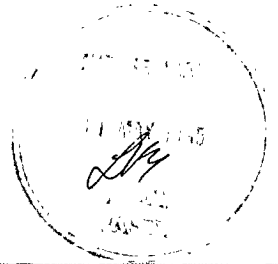
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Commonwealth Public Sector

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Canberra

MEMBERSHIP OF THE COMMITTEE

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Mr A M Somlyay, MP (Vice-Chairman)¹
Senator W R Parer (Vice-Chairman)²
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Senator R L Woods ¹⁹	Mr M A J Vaile, MP

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- 1 Vice-Chairman from 29 June 1994.
 - 2 Appointed 19 August 1993 and discharged 9 June 1994.
 - 3 Discharged 19 August 1993.
 - 4 Discharged 17 August 1993.
 - 5 Discharged 18 November 1993.
 - 6 Discharged 24 February 1994.
 - 7 Appointed 19 August 1993.
 - 8 Appointed 29 June 1994.
 - 9 Appointed 30 September 1993 and discharged 17 March 1994.
 - 10 Appointed 9 February 1994.
 - 11 Appointed 12 May 1994.
 - 12 Appointed 28 February 1994.
 - 13 Discharged 17 August 1993.
 - 14 Appointed 17 March 1994.
 - 15 Discharged 9 February 1994.
 - 16 Discharged 12 May 1994.
 - 17 Appointed 18 November 1993 and discharged 29 June 1994.
 - 18 Appointed 5 July 1993 and discharged 19 August 1993.
 - 19 Appointed 9 June 1994.

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Mr L J Scott, MP (Chairman)

Mr A M Somlyay, MP (Vice-Chairman)²⁰
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24 Appointed 2 March 1994

25 Discharged 9 February 1994

26 Discharged 9 February 1994

27 Discharged 2 March 1994

28 Mr E Figueredo, a secondee from the Australian National Audit Office, assisted the inquiry in the period from September 1993 to March 1994.

DUTIES OF THE COMMITTEE

The Joint Committee of Public Accounts is a statutory committee of the Australian Parliament, established by the *Public Accounts Committee Act 1951*.

Section 8(1) of the Act describes the Committee's duties as being to:

- examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of section 50 of the *Audit Act 1901*;
- examine the financial affairs of authorities of the Commonwealth to which this Act applies and of inter-governmental bodies to which this Act applies;
- examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- report to both Houses of the Parliament, with such comment as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Parliament should be directed;
- report to both Houses of the Parliament, any alteration which the Committee thinks desirable in the form of the public accounts or in the method of keeping them, or in the mode of receipt, control, issue or payment of public moneys; and
- inquire into any question in connexion with the public accounts which is referred to it by either House of the Parliament, and to report to that House upon that question.

The Committee is also empowered to undertake such other duties as are assigned to it by Joint Standing Orders approved by both Houses of the Parliament.

TERMS OF REFERENCE

On 16 June 1993 the Committee resolved to conduct an inquiry with the following terms of reference:

To inquire into issues raised by the provision of goods and/or services on a commercial basis by Government agencies, including:

- . the efficiency, effectiveness and appropriateness of corporations as a means of service delivery to the public; and
- . the accountability of commercialised Government agencies and the mechanisms needed to ensure their accountability.

While not limiting its scope, the Inquiry will focus on three Government agencies:

- . the Department of the Arts and Administrative Services;
- . the Civil Aviation Authority; and
- . the Federal Airports Corporation.

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LIST OF ABBREVIATIONS

AAIA	Australian Aviation Industry Association
AASA	Association of Aerial Surveyors, Australia
ACEA	Association of Consulting Engineers Australia
ACS	Australian Construction Services
ACSA	Association of Consulting Surveyors of Australia
ADI	Australian Defence Industries Limited
AFAP	Australian Federation of Air Pilots
AGAL	Australian Government Analytical Laboratories
AGPS	Australian Government Printing Service
AIDC	Australian Industry Development Corporation
Airways	New Zealand Airways Corporation
ALAEA	Australian Licenced Aircraft Engineers Association
AMSA	Australian Maritime Safety Authority
AN	Australian National
ANAO	Australian National Audit Office

ANL	Australian National Line
APAC	Australasian Pacific Aviation Consultants
APESMA	Association of Professional Engineers, Scientists and Managers Australia
APG	Australian Property Group
APS	Australian Public Service
AQIS	Australian Quarantine and Inspection Service
ARC	Administrative Review Council
ASIAL	Australian Security Industry Association Limited
Attorney-General's	Attorney-General's Department
ATUG	Australian Telecommunications Users Groups
AUSLIG	Australian Surveying and Land Information Group
AUSTEL	Australian Telecommunications Authority
BA	British Airways
BSTA	Business Services Trust Account
CAA	Civil Aviation Authority
CAC Bill	Commonwealth Authorities and Companies Bill
CBA	Commonwealth Bank of Australia
CEO	Chief Executive Officer

COAG	Council of Australian Governments
CRU	Central Redeployment Unit
CSL	Commonwealth Serum Laboratories
CSO	Commonwealth Service Obligation
CT	Career Transition
CTN	Consumers' Telecommunications Network
DAS	Department of Administrative Services
DASR	Directorate of Aviation Safety Regulation
Defence	Department of Defence
DITARD	Department of Industry, Technology and Regional Development
DPIE	Department of Primary Industries and Energy
DTC	Department of Transport and Communications
EFIC	Export Finance and Insurance Corporation
FAC	Federal Airports Corporation
FBCA	Federal Bureau of Consumer Affairs
Finance	Department of Finance
GBE	Government Business Enterprise
GOC	Government-Owned Corporation
GTE	Government Trading Enterprise
HLIC	Housing Loans Insurance Corporation

IEA	Institution of Engineers, Australia
Industrial Relations	Department of Industrial Relations
IT	Information technology
JCPA	Joint Committee of Public Accounts
LMAP	Labour Market Adjustment Program
MAB	Management Advisory Board
MBA	Master Builders Australia
MIAC	Management Improvement Advisory Committee
MOU	Memorandum of Understanding
National Rail	National Rail Corporation
NRA	National Registration Authority for Agricultural and Veterinary Chemicals
PIAC	Public Interest Advocacy Centre
PSA	Prices Surveillance Authority
PSC	Public Service Commission
PSU	Public Sector Union
PWC	Public Works Committee
REIA	Real Estate Institute of Australia
SAP	Staffing Adjustment Program
SOE	State-Owned Enterprise

SSCFPA	Senate Standing Committee on Finance and Public Administration
TAAATS	The Australian Advanced Air Traffic Systems
TACC	Telecom Australia Consumer Council
TPC	Trade Practices Commission
Transport	Department of Transport
Treasury	Department of the Treasury
TSEPP	Telecom Small Enterprise Policy Panel
USO	Universal Service Obligation

Glossary of Terms

Commercialisation Used in its broadest sense in this report to describe a wide range of circumstances, from minor user charging through fully commercialised activities undertaken within departments of state to corporatised and incorporated government business enterprises (GBEs) - see Figure 2.1, p. 16.

Business units Stand alone entities within departments of state which operate on commercial principles and operate through separate accounts (Group 2 Trust Accounts). Several business units may operate through a single Trust Account, for example, the DAS Business Services Trust Account. In all other respects, business units reflect the administrative structures of the 'parent' department of state and do not have a legal existence separate from the Commonwealth. The most highly developed examples of business units can be found in the Department of Administrative Services. Some of these business units have a notional capital structure, charge at market rates and are required to compete for all business. These entities are sometimes described as being 'fully commercialised'. The Commonwealth's business units are listed in Appendices IV and V.

Government business enterprises Commercial entities with a legal existence separate from the Commonwealth. The prime function of a GBE is to trade goods or services and to earn a commercial rate of return. Some GBEs are statutory authorities with their own enabling legislation and some are companies incorporated under the Corporations Law. Most GBEs are entirely owned by the Commonwealth and several have created subsidiary companies to deliver specific goods or services. A full list of Commonwealth GBEs is at Appendix VI.

Government businesses A generic term which includes all of the above.

Corporatisation Usually understood to refer to full commercialisation - that is, the introduction of both organisational and legal changes to an agency. Corporatised agencies are legal entities distinct from their owners, whereas other commercialised agencies remain as elements within departments of state. Corporatised agencies are either incorporated under Corporations Law or established as separate entities by enabling legislation.

Commercialised entities have been operating within government for over one hundred years in Australia. The railways in Victoria and New South Wales have been run as government trading enterprises since they were acquired from their former private sector owners who encountered financial difficulties in the mid 1850s. The earliest commercial operations run by the Commonwealth Government included the postal and telegraphic services, which were transferred to it from the States shortly after Federation. The Commonwealth Bank was established in 1911.

Although commercialisation is not a new concept, it has become a key element of the public sector reforms which have been underway in the Commonwealth Public Service over the last decade.

Today there are 14 discrete businesses in the Department of Administrative Services and a further 13 operating within other departments of state. Nineteen corporatised government business enterprises operate as separate legal entities within the Commonwealth. In addition, many mainstream departments have adopted elements of commercialisation by implementing user charging for some of the services they provide.

The prime motivation behind the recent activity to commercialise government operations has been to increase the efficiency and effectiveness with which public resources are used.

The Committee decided to conduct an inquiry into the commercialisation of Commonwealth public sector operations in order to assess:

- whether the legislative, policy and administrative frameworks currently in place are adequate for their purpose;
- whether lessons are being learned from the successes and failures of commercialisation; and
- whether commercialisation is resulting in the more efficient production of public services and goods.

The evidence gathered by the Committee during its Inquiry indicated, generally, that commercialisation has produced efficiencies for the Government. However, the process has not been without its critics. It has been said that:

- the framework for commercialisation is incomplete, particularly for businesses operating within departments;
- some businesses are confused as to their principal objectives;
- the regimes for accommodating the delivery of community service obligations by government businesses need further refinement;
- government businesses have an unfair advantage when competing with private sector firms;
- the accountability of some government businesses is inadequate; and
- valuable skills and expertise are being lost from the public sector.

This Report provides a general overview of the many issues which arise in the commercialisation of government operations. While some specific and technical issues, particularly in relation to financial matters, were considered to be beyond the scope of the Inquiry, the report addresses each of the main points of criticism. I believe the recommendations will help improve the operating environment for government businesses, while also ensuring that they are accountable to their shareholders and ultimately to the taxpayers of Australia.

The Committee has been assisted in its Inquiry by private individuals, businesses, industry and professional organisations, unions, the State governments and Commonwealth agencies. The Committee appreciates the help that these people and organisations have provided.

Les Scott MP
Chairman

EXECUTIVE SUMMARY

Introduction

1. Commercialisation and corporatisation have undoubtedly led to major improvements in the efficiency and effectiveness with which Commonwealth Government agencies provide goods and services to the public and other government agencies. Improvements in the financial performance of commercialised agencies have been impressive, with deficits being reversed and healthy returns made to the Government. Even commercialised areas that continue to lose money are now recording smaller losses. At the same time, prices charged to the customer have generally risen at a rate lower than the CPI and in some cases have fallen. Non-financial indicators of performance have also shown improvement.

2. The Australian public has gained from commercialisation in financial terms: goods and services are cheaper than before or at least less expensive than they would otherwise have been. Australian industry has also gained in international competitiveness with lower costs for some of its inputs. The Government is no longer faced with as large a bill as before for the support of businesses in financial difficulties, and it earns a substantial income from some of them. As a result, funds are available for other purposes: to offset the deficit, reduce taxes or support other programs.

3. The move to commercialise and corporatise the Government's supply of goods and services has raised debate about the appropriateness of governments using the corporate model.

- Should the Government be involved in running businesses?
- In order that its businesses have the flexibility to be commercially successful, the Government has adopted

an 'arm's length' approach to their operation. How, in this situation, does it ensure that adequate accountability exists to protect the taxpayer from undue risk?

- The departments of state that once supplied goods and services often combined that function with other roles: providing policy advice, supporting particular sections of the community through welfare or industry programs, or regulating the industry of which they were part. What happens to these other roles when the supply function is commercialised?

Should the Government be Involved in Business?

4. In recent times, the Government has sold a number of its government business enterprises (GBEs). Its program of asset sales is based on considerations of whether the public interest is still best served by owning these businesses. The Committee believes that the Government's commitment to a continuing examination of its involvement in commercial activities is appropriate.

5. A number of roles for the Government vis a vis business activities were identified to the Committee. They include:

- providing services that are not available from the private sector;
- fostering emerging markets, but withdrawing from them as the private sector develops sufficiently to compete;
- facilitating the private sector's work through joint ventures, export enhancement and technology transfer;
- monitoring and regulating; and
- having in place appropriate policies for Australian businesses to flourish.

6. To carry out these tasks, the Government requires access to well honed expertise which, in many cases, is best maintained by ongoing involvement in business. While some of the necessary expertise may be available from private sector consultants, this may not always be so. In addition, it is necessary to have sufficient skilled people in-house to monitor the quality of the work carried out by consultants, assess its significance and ensure a degree of consistency in the approach taken by the Government.

7. The Committee accepts the argument that it is appropriate for the Government to be involved in commercial activities for purposes such as those listed above. It is clear, however, that the judgement of precisely how involved the Government should be is difficult and is subject to change over time. Furthermore, these judgements should only be made on a case by case basis.

Accountability

8. It was realised from the outset that the greater freedom given to commercialised entities compared with departments of state would need to be balanced by appropriate accountability arrangements. Recent developments have seen the promulgation of new accountability and ministerial oversight arrangements for GBEs and the introduction of legislation that will tighten the accountability regime applying to them. The Committee has recommended that further measures should be instituted, including amendments to the annual reporting guidelines for GBEs. In the case of monopolies, whether they are GBEs or business units in departments of state with tied customers, an extensive system of consultation with customers is needed.

Non-Commercial Activities

9. One of the important factors contributing to the success of government businesses is a single-minded focus on commercial activity. This is achieved by removing from commercialised agencies any responsibility for regulation or

providing policy advice. If these responsibilities are not removed, the businesses may face a conflict of interest. While the principle of separation of conflicting functions is widely recognised, it has not been adequately effected in all cases. As a result, problems have arisen as, for example, with the Civil Aviation Authority, and it is possible that others may arise.

10. In the case of social welfare programs that were previously delivered by the predecessors of commercialised agencies, the agencies continue to provide them under the system of community service obligations (CSOs). This entails the precise definition of the services required and the methods for costing and funding them. Where costing CSOs is difficult, funding by cross subsidy may be preferable to budget funding. The Committee found that more work was needed to fully institute this system in some organisations. The Committee also recommended that there be greater involvement of community groups in defining and monitoring the delivery of CSOs. The Auditor-General should also monitor the operation of the CSO system.

Conclusion

11. The Committee believes that, in general, the introduction of commercialisation has been executed competently and the Government's businesses are well run. The one exception here is that the Department of Finance has been slow to provide guidance on commercialisation within departments of state.

12. This summary covers the major concerns identified by the Inquiry and the Committee's response to them. A more comprehensive summary of the Report's contents appears in Chapter 10.

RECOMMENDATIONS

Recommendation 1

The Department of Finance should give priority to the finalisation and implementation of *A Policy Framework for Commercialisation* which was issued as a discussion paper in 1993. (paragraph 2.71)

Recommendation 2

The Department of Finance should expedite the publication of its proposed practical guide to commercialisation. (paragraph 2.72)

Recommendation 3

The Department of Finance should ensure that the final versions of *A Policy Framework for Commercialisation* and the proposed practical guide to commercialisation include references to and advice about the industrial relations issues which can arise during the commercialisation of government operations. (paragraph 2.75)

Recommendation 4

The Department of Finance should coordinate a review to examine all agencies with regulatory and commercial functions, with a view to separating these functions. (paragraph 3.26)

Recommendation 5

The Department of Finance, in producing the final versions of the paper entitled *A Policy Framework for Commercialisation* and the proposed practical guide to commercialisation, should include specific sections on the issue of establishing clear and non-conflicting objectives for commercialised entities, and should also provide guidance on how conflicting objectives can be avoided. (paragraph 3.32)

Recommendation 6

The Department of Administrative Services should examine the *Principles for the Operation of Services to Government Agencies*, in light of its experience with commercialisation since those guidelines were issued, to ascertain whether these general principles should be revised. (paragraph 3.41)

Recommendation 7

The Attorney-General's Department should examine whether clearer separation between the commercial and non-commercial objectives of the Legal Practice is needed. (paragraph 3.47)

Recommendation 8

The Department of Administrative Services should review the relevant sections of its draft *Guidelines for Business Conduct* with a view to ensuring that all steps have been taken to minimise the possibility of conflict of interest. (paragraph 3.64)

Recommendation 9

The Department of Administrative Services should appoint an independent panel comprising representatives from the Department and relevant industry groups to investigate the extent to which conflicts of interest exist for its businesses, and whether the mechanisms established by the Department of Administrative Services are adequate to resolve any conflicts that arise. The panel should aim to recommend measures to reduce the likelihood of conflict. (paragraph 3.66)

Recommendation 10

The Government should examine the advisability of creating an agency separate from the Australian Surveying and Land Information Group to carry out such functions as providing advice, coordinating national mapping activities and maintaining the database. This study should be carried out in conjunction with State and private sector mapping interests. (paragraph 3.79)

Recommendation 11

In identifying new community service obligations, the Department of Finance, in conjunction with relevant government business enterprises and portfolio departments, should:

- (a) seek and consider input from relevant community groups and interested parties; and
- (b) analyse the proposed new community service obligations in the light of the Government's broad social justice policy objectives. (paragraph 4.17)

Recommendation 12

The Department of Finance should coordinate a review of all activities by commercialised entities which appear to be 'implicit' community service obligations. The review should make explicit the exact nature of any such community service obligations and recommend how they should be costed and funded. (paragraph 4.25)

Recommendation 13

Before the future of the airports currently operated by the Federal Airports Corporation is settled, the Departments of Transport and Finance should:

- (a) identify and assess any 'implicit' community service obligations in the operations of the airports; and

- (b) agree on appropriate methods for the future delivery and funding of the community service obligations. (paragraph 4.27)

Recommendation 14

Before any government business enterprise is privatised, the Department of Finance and relevant portfolio departments should review the community service obligations, both explicit and implicit, delivered by the government business enterprise and determine:

- (a) whether the community service obligations should be provided after privatisation; and, if so
- (b) how they will be delivered and funded. (paragraph 4.29)

Recommendation 15

Each relevant department should review the public information prepared by government business enterprises within its portfolio about the nature of the goods and services produced by those businesses. The review should consider whether:

- (a) the information is clear about the standards to which the goods and services will be produced;
- (b) the information is clear about the nature of any community service obligations and the standards to which such obligations will be produced or provided; and
- (c) the information is available on request and widely disseminated. (paragraph 4.51)

Recommendation 16

The Department of Finance should revise:

- (a) the annual reporting requirements relating to departments to require them to include in their annual reports, details about their performance in delivering any community service obligations required of any of their business units; and
- (b) the annual reporting requirements relating to government business enterprises to require them to include in their annual reports, details about their performance in delivering any community service obligations required of them. (paragraph 4.56)

Recommendation 17

Each relevant department, in conjunction with government business enterprises within its portfolio and the Department of Finance, should:

- (a) review the community service obligations currently delivered by its government business enterprises and business units to consider the impact of the community service obligations on the Government's broader social justice policy;
- (b) seek and consider input from relevant community groups and interested parties;
- (c) report the findings of the reviews to Parliament; and
- (d) repeat the review periodically. (paragraph 4.62)

Recommendation 18

The Department of Finance should consider whether to recommend amending the Auditor-General Bill 1994 to allow the Auditor-General to conduct performance audits of the community service obligations of government business enterprises. (paragraph 4.67)

Recommendation 19

When introducing commercialisation, the Government should:

- (a) in consultation with interested parties, examine carefully whether the former public interest activities of commercialising agencies should continue; and
- (b) make appropriate alternative arrangements when it decides to continue an activity in the public interest. (paragraph 5.13)

Recommendation 20

The Government should:

- (a) urge its businesses to give careful consideration to the long term advantages of supporting Australian industry;
- (b) extend to all government businesses its request that, if appropriate, they develop and implement Australian industry development plans; and
- (c) reiterate its request to government business enterprises that they develop and implement Australian industry development plans. (paragraph 5.24)

Recommendation 21

The Department of Finance should coordinate a review of the costing and pricing techniques used by government businesses with a view to providing comprehensive guidance on best practice in the costing and pricing of government produced goods and services. (paragraph 6.35)

Recommendation 22

All departments of state which operate business units should, on a regular basis, submit the business plans of those business units or other commercial activities to the Department of Finance for comment. (paragraph 6.84)

Recommendation 23

The Department of Finance should:

- (a) consult widely in revising the annual reporting guidelines relating to government business enterprises;
- (b) ensure that the new guidelines are consistent with the provisions of the new Commonwealth authorities and companies legislation, when enacted; and
- (c) issue the new guidelines as soon as possible. (paragraph 7.60)

Recommendation 24

The Department of Finance should:

- (a) constantly monitor the operation of the *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*; and
- (b) formally review the operation of the Arrangements at least every four years. (paragraph 7.93)

Recommendation 25

The Departments of Transport and Finance should establish a regulatory regime to ensure that the new owners and operators of airports operated at present by the Federal Airports Corporation are required under the conditions of their leases to run these airports in a manner that is transparent, responsive and reasonable. (paragraph 7.123)

Recommendation 26

Pending the implementation of the National Competition Policy, the Department of Finance should coordinate a review of all government businesses to ensure that they are operating in a manner consistent with the competition principles adopted by intergovernmental agreement between the States and the Commonwealth. (paragraph 8.16)

Recommendation 27

All departments which operate business units should review the operational environment of their business units, in conjunction with the Department of Finance, to ensure that competitive neutrality is established as rapidly as possible. (paragraph 8.26)

Recommendation 28

The Government should request the Prices Surveillance Authority or its successor to inquire into any business unit that is the subject of intense criticism in relation to its pricing practices. (paragraph 8.52)

Recommendation 29

Agencies, which have made or are in the process of making the transition to commercialised operations, and their portfolio departments should:

- (a) study the impact of staff reductions on the skills and experience profiles of these agencies;
- (b) assess the appropriateness of the profiles; and
- (c) develop strategies to rectify any human resource deficiencies identified. (paragraph 9.42)

Recommendation 30

The Department of Finance should include in its guidance on pricing by government businesses information on best practice for managing redundancy costs. (paragraph 9.88)

Recommendation 31

The Department of Industrial Relations should ensure that the experience of public sector enterprises, which have successfully managed the staffing aspects of the transition to commercial operations, is made available to all other Commonwealth organisations affected by staff reductions. (paragraph 9.91)

Recommendation 32

The Department of Finance, in conjunction with relevant portfolio departments, should review the operations of all business units within departments with a view to determining whether the business units would operate more efficiently and effectively as corporations. (paragraph 10.32)

Recommendation 33

When reviewing business units in the Department of Administrative Services, the Departments of Finance and Administrative Services should consider whether there is a public interest in these businesses being carried out by government owned businesses. (paragraph 10.46)

What is Commercialisation?

1.1 In a discussion paper on commercialisation, the Department of Finance (Finance) commented that 'there does not seem to be a precise and universally accepted definition of commercialisation in the public sector'.¹ However, the term is widely used to describe what happens when governments decide to allow their agencies to charge the public (or other agencies and entities) for the goods and services they produce, and to adopt, to varying degrees, other features of the commercial environment. Commercialisation includes a wide range of circumstances from minor user charging to fully commercialised activities within departments of state. The term also sometimes covers fully corporatised entities such as government business enterprises (GBEs).²

1.2 Typically, some, if not all, of the following private sector management practices can be found in commercialised public sector agencies:

- competition with private enterprise to supply the agency's traditional clients;
- charging for all services with the objective of at least recovering costs and, in some cases, making a financial return to the Government;
- powers to reinvest or retain a proportion of any profits earned;
- recording costs and revenues on an accrual accounting basis;
- receiving government funding for those services that are deemed to be in the public interest; and

1 Finance, *A Policy Framework for Commercialisation*, August 1993, p. 1.

2 Finance, *Submission*, p. S1423 (Vol. 4 of Submissions).

- establishing management structures and planning mechanisms typical of the private sector, such as boards, strategic plans and business plans.³

1.3 As with the term, commercialisation, there is no one definition of corporatisation.⁴ However, corporatisation is usually understood as referring to full commercialisation - that is, the introduction of both organisational and legal changes to an agency. Corporatised agencies are legal entities distinct from their owners, whereas other commercialised agencies remain as elements within departments of state. Corporatised agencies are either incorporated under Corporations Law (for example Telstra Corporation Ltd, which trades as Telecom Australia), or established as separate entities by enabling legislation, (for example the Federal Airports Corporation (FAC), which was established by the *Federal Airports Corporation Act 1986*).

1.4 An important feature of these incorporated companies and corporatised statutory authorities, when they are compared with their departmental predecessors, is the replacement of extensive control by the Government with a more arm's length arrangement comprising:

- a board of directors and management team that takes full responsibility for the operations of the business; and
- accountability mechanisms commensurate with the independence given to the board and management by corporatisation.⁵

The Government removes itself from the day to day operation of the business and acts more as a shareholder providing strategic directions to the business.

³ Australian National Audit Office, *Submission*, pp. S296-7 (Vol. 1 of Submissions); DAS, *Submission*, p. S335 (Vol. 1 of Submissions); Finance, *A Policy Framework for Commercialisation: Issues for Discussion*, August 1993, p. 2.

⁴ Public Bodies Review Committee of the Parliament of Victoria, *Discussion Paper on Corporatisation*, October, 1991, p. 6.

⁵ Administrative Review Council, *Administrative Review of Government Business Enterprises: Discussion Paper*, pp. 6-7; Public Bodies Review Committee of the Parliament of Victoria, *op. cit.*, pp. 64-5.

1.5 Commercialisation is an evolving area of activity in which the central concern of government is to put into place arrangements that will put pressure on managers to produce goods and services as efficiently as possible. The absence of precise definitions of commercialisation and corporatisation is less important than the focus on efficiency which is at the core of these concepts.

Commercialisation in the Australian Public Sector

1.6 Commercialisation is not new to the Australian public sector. Its history extends over one hundred years from the formation of public sector trading enterprises to run the railways of Victoria and New South Wales. Banking, telegraphic services and the postal service were subsequently added to the commercial operations of the Commonwealth Government and, more recently, the Government's commercial activities have been further extended.

1.7 The recent extension of commercialisation has occurred in the context of broader changes in public sector management which are designed to increase the efficiency and effectiveness with which resources are used. Commercialisation and corporatisation complemented other public sector reforms such as the Financial Management Improvement Program which was launched in 1984 with the objectives of:

- developing budgetary and regulatory processes which encourage efficient and effective management practices in departments;
- promoting techniques and systems that focus attention on results;
- improving administrative practices so that public servants are more aware of resources costs and have incentives to manage them well; and
- enhancing public accountability and parliamentary scrutiny by clarifying objectives, setting targets and evaluating performance.⁶

⁶ Finance, *Submission*, pp. S1424-5 (Vol. 4 of Submissions).

The Australian National Audit Office has drawn attention to another key element of the reform program - the management, rather than avoidance, of risk.⁷

Benefits of Commercialisation

1.8 The proponents of commercialisation claim that it provides greater incentives to manage costs and improve the quality of the goods and services provided. Faced with charges for goods and services, users and suppliers become more aware of costs and of the need to allocate resources efficiently. As Finance pointed out:

*Users are more likely to ensure that their demand for services is appropriate to their needs when they expect to pay for what they consume, and suppliers are more likely to provide the right level and quality of services when they are aware of the preferences of consumers.*⁸

1.9 It is also argued that commercialisation:

- makes the assessment of performance easier than in traditional public sector programs because, through the medium of charging, costs are explicit and client response obvious; and
- focuses the attention of decision makers on the public interest components of service delivery through the need to fund them from budget appropriations.⁹

1.10 In addition to these general advantages, the corporatisation of government businesses is said to generate further efficiencies in management. By conferring a greater degree of operational independence on GBE boards and management, and by clearly defining financial and other objectives, GBEs are able to operate in a more focussed, cost effective and competitive fashion.

7 Australian National Audit Office, *Submission*, p. S296 (Vol. 1 of Submissions).

8 Finance, *Submission*, p. S1426 (Vol. 4 of Submissions).

9 *ibid.*, loc. cit.

1.11 As the Industry Commission has commented, the performance of GBEs is of particular importance to Australia's economic well being.

Poor performance by these enterprises has significant implications for the competitiveness of Australian industry and calls on taxpayers' resources. Governments may need to increase taxes or reduce their spending in other areas in order to underwrite loss-making public enterprises. Alternatively, if the costs of public enterprises are higher than necessary, user industries pay higher prices and will be disadvantaged in competing with overseas suppliers. They will also find it more difficult to compete for labour and capital resources with other domestic industries ...

*Governments have recognised that economic efficiency and the international competitiveness of Australian industries can be considerably enhanced by improving the performance of public enterprises.*¹⁰

Background to the Inquiry

Initial Background

1.12 In June 1993 the Committee decided to carry out an inquiry into the commercialisation of public sector operations. A number of factors contributed to the Committee's decision. First, the Committee was aware of a number of efficiency audit reports from the Auditor-General which raised concerns about the operation of business units in departments of state. Specifically the Auditor-General referred to issues such as conflicts of interest, the handling of regulatory and policy functions, constitutional limitations on government businesses, and financial management.¹¹

10 Industry Commission, *Submission*, pp. S1891-2 (Vol. 5 of Submissions).

11 Auditor-General, *Efficiency Audit, An Audit Commentary on Aspects of Commercialisation in the Department of Administrative Services*, Audit Report No. 16, 1992-93, AGPS, Canberra, 1992; *Project Audit, Department of Administrative Services, Conflict of Interest: A Matter of Principle*, Audit Report No. 43, 1991-92, AGPS, Canberra, 1992; *Efficiency Audit, Auscript: Commercialisation of the Commonwealth Reporting Service*, Audit Report No. 6, 1992-93, AGPS, Canberra, 1992; *Efficiency Audit, Department of Primary Industries and Energy, Australian Quarantine Inspection Service, Quarantine Division*, Audit Report No. 35, 1991-92, AGPS, Canberra, 1992.

1.13 Secondly, nearly seven years had elapsed since the Government had established its policy framework for GBEs. The Committee considered that sufficient time had elapsed to justify a comprehensive external review of the framework. The Committee was also aware of concerns within the community about the operation of particular GBEs - namely the FAC and the Civil Aviation Authority (CAA).

1.14 Accordingly, the Committee established broad terms of reference which focused on the efficiency and effectiveness of all Government businesses, and on the appropriateness of their accountability requirements. The terms of reference made particular mention of the Department of Administrative Services, because of that Department's experience in operating business units, and of the FAC and the CAA, because of the concerns about their operations. The general aim of the Committee's Inquiry was to assess the extent of any problems which had emerged and to suggest improvements to the operation of the Government's businesses.

1.15 The Inquiry has been restricted to the operation of the business units in departments, and GBEs. Evidence has not been taken on commercial activities such as contracting out and the sale of expertise by departments. To have included these matters in the Inquiry would have stretched the Committee's resources and capacity to report in a timely manner.

Subsequent Developments

1.16 There were several developments during the course of the Inquiry which caused the Committee to reassess the scope of its activities.

1.17 The first was that, not long after the Inquiry was announced, the Government issued revised arrangements for GBE accountability and ministerial oversight. In broad terms, the new arrangements strengthened the accountability requirements for GBEs and increased the oversight to which GBEs are subject. The Committee considered that, despite the issuing of new oversight and accountability requirements, it

was appropriate to continue with a review from a parliamentary perspective on the operating environment for GBEs. Furthermore, it was evident that there was considerable public concern about the operation of the FAC and the CAA.

1.18 However, the Committee did decide to change the scope of the Inquiry in relation to the FAC and the CAA after a series of decisions and events which changed the circumstances of both authorities. The Committee had intended to examine in detail the operations of both the FAC and the CAA and report on these examinations as case studies. During the course of the Inquiry:

- the Government decided to privatise, or lease to private operators, the airports currently managed by the FAC, and to restructure the commercial and air safety functions formerly performed by the CAA; and
- a review of aviation safety was commenced by the House of Representatives Standing Committee on Transport, Communications and Infrastructure.

As a consequence, the Committee decided to use the experience of these authorities as the basis for general comments rather than specific case studies.

Conduct of the Inquiry

1.19 The Inquiry received one hundred and eighty-two submissions, and held 16 public hearings, received 7 private briefings and made four inspections between October 1993 and March 1995. Details of the submissions, exhibits, public hearings, private briefings and inspections are included in Appendices I to III.

1.20 Information and opinion were supplied to the Inquiry by the Government's businesses, their portfolio departments and the central agencies responsible for the framework within which they operate. Business competitors, business clients and the unions also provided the Committee with their views of both the general operation of the Government's businesses and the functioning of specific businesses.

Outline of the Report

1.21 The chapters which follow consider in detail the operational framework which has been established for Commonwealth GBEs and business units (Chapter 2), and then consider a number of areas where significant problems remain to be addressed if the Commonwealth's business activities are to be pursued as efficiently and effectively as possible. The first of these areas, setting clear objectives for business, is discussed in Chapter 3. It is essential that the objectives of commercialised entities are clearly defined. In some cases, Government agencies have more than one function; for example, they may be required to undertake a policy or regulatory role in addition to a commercial one. Different roles such as these may conflict with one another, a conflict that can be resolved best by separating responsibility for them.

1.22 A second topic, community service obligations (CSOs) is covered in Chapter 4. CSOs are a mechanism set up to enable government businesses to deliver a social welfare function without compromising their commercial operation. Under this system, businesses receive payment from the Budget or are permitted to reduce their target rate of return. This allows them to provide services at less than cost to the public. Australia Post's letter post and the provision of pay phones and phones to homes throughout Australia are examples of CSOs.

1.23 Chapter 5 considers two matters relating to the public interest. The first is whether commercially oriented government agencies can be expected to behave ethically. The second topic is the need to consider carefully how the non-commercial functions of commercialising agencies should be handled. Should these functions, which include policy advice and regulation, be retained in the portfolio or dropped altogether as a Government responsibility?

1.24 The financial arrangements for GBEs and business units are described in Chapter 6. The chapter deals with asset valuation, target rates of return, dividends, and capital structure. It also discusses one of the more controversial aspects of government business operation, pricing policies.

1.25 A discussion on accountability follows in Chapter 7. This chapter deals with the traditional accountability measures that apply to public sector bodies, and explores impediments to accountability to the Parliament. It also explores an idea proposed by the clients of monopoly government businesses, that of accountability to the customer. This entails the monopoly consulting about actions planned and supplying information to the customers so that they can judge the reasonableness of the monopoly's behaviour.

1.26 Recent developments in the establishment of a national policy on business competition are discussed in Chapter 8. It also considers the question of how far, if at all, government businesses are advantaged or disadvantaged in competing with the private sector.

1.27 As sections of former departments of state have been commercialised, considerable changes have been experienced by their staff. These include the need to learn new, commercial skills, the loss of other skills from businesses, and redundancy and retrenchment. Chapter 9 covers these topics.

1.28 The final chapter in the Report draws together the Committee's key findings and makes some general comments about the past experience and future directions in the commercialisation of GBEs and business units. It addresses the Committee's terms of reference in considering the efficiency, effectiveness and appropriateness of commercialisation and corporatisation. It also considers the extent to which the Government should be involved in commercial activity, and the role played by Finance.

FRAMEWORK FOR COMMERCIALISATION OF COMMONWEALTH GOVERNMENT BUSINESSES

Introduction

2.1 In this chapter the Committee describes and discusses the framework that the Commonwealth Government has established for the commercial operation of its business undertakings. The chapter begins by describing the various elements of the legal and administrative framework. This leads to a discussion of the Government's approach to commercialisation and a general description of the organisational form of the agencies involved in commercial activities. The chapter then focuses on some of the details of the operational frameworks for government business enterprises (GBEs) and business units in departments of state. Next, the role of the central coordinating agencies and the various portfolio departments in guiding and overseeing the operation of commercial entities is considered. The chapter concludes with a discussion of the legal and constitutional environment in which the Commonwealth's commercial entities operate.

Key Elements of the Framework

2.2 A key element in the Government's operational framework for its GBEs is the *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, which were agreed to by the Government in May 1993 and distributed to all GBEs in June 1993.

2.3 The framework for business activities within departments of state is still being developed. A discussion paper entitled, *A Policy Framework for Commercialisation: Issues for Discussion*, was released by the Department of Finance (Finance) in October 1993. It covers the more complex commercial activities undertaken by departments. A further

key document for these departmental activities will be the practical guide to commercialisation, which Finance is preparing in consultation with a number of agencies.

2.4 The principles underpinning the general arrangements for GBEs and business units are, where necessary, specified and supplemented in memoranda of understanding, articles of association or enabling legislation for each individual business entity. In the absence of general guidance, some of the portfolio departments which operate business units have developed specific management frameworks for their own business units. The accountability framework established by the Department of Administrative Services (DAS) is one such example.

2.5 The Government has recently moved to draw together the reporting and accountability requirements for all Government entities into one core set of requirements to be specified in new legislation. The Commonwealth Authorities and Companies (CAC) Bill will apply to all authorities and companies, including GBEs. Business units will be governed by the general requirements applying to departments of state, which will be laid down in the Financial Management and Accountability Bill. Both bills are currently before the Parliament and have been the subject of a separate report from the Joint Committee of Public Accounts.¹

2.6 Various elements of the framework are described further in this chapter and referred to throughout the Report.

The Commonwealth Government's Approach to Commercialisation

2.7 One of the key agencies responsible for developing policy in relation to commercialisation in Commonwealth agencies is the Department of Finance. In evidence to the Committee, the Secretary of Finance explained his

¹ Joint Committee of Public Accounts, *An Advisory Report on the Financial Management and Accountability Bill 1994, the Commonwealth Authorities and Companies Bill 1994 and the Auditor-General Bill 1994, and on a Proposal to Establish an Audit Committee of Parliament*, Report 331, AGPS, Canberra, September 1994.

Department's overall view of commercialisation in the following terms:

Finance sees commercialisation as a way of making available to public sector managers a range of techniques and approaches that can be employed to improve the way in which some of the outputs which are required by government can be delivered. We see room for a variety of approaches to commercialisation, so long as they are consistent with an underlying accountability framework.²

2.8 At a later hearing, he expanded on the principles which he believed should influence the evolution of commercialisation policy.

The first [principle] is that commercialisation is not an end in itself. Improved performance is the objective. By empowering clients and creating incentives for suppliers to manage costs and deliver a quality service, commercialisation can generate efficiency gains from improved resource allocation and better value for money. ...

The second of these principles is that our approach to commercialisation must be pragmatic. ... The commercialisation framework has got to be sufficiently flexible to allow tailoring to the specific needs of this vastly different group of [commercialised] activities.

The third is that commercialisation does not imply judgments of itself about the most appropriate organisational form for an activity. ... Nor does commercialisation necessarily represent the first step in an inevitable evolution to corporatisation or privatisation.

The fourth principle is that accountability arrangements need to have regard to the scale and the nature of the commercialised activities themselves.³

2 Finance, *Transcript*, p. 49, (Canberra 8 November 1993).

3 Finance, *Transcript*, pp. 2387-8 (Canberra, 17 October 1994).

2.9 The pragmatism embodied in the second principle implies that, as circumstances change over time, adjustment and modification of the arrangements should be made in response to such factors as developing business opportunities, changes in the market demand for services, or new priorities in government.⁴ Furthermore, this principle allows the Government the capacity to consider from time to time how appropriate it is for it to continue to be involved in each of its business undertakings. As the Chairman of the Industry Commission pointed out to the Committee:

In our inquiry program we are continually being confronted with some very difficult questions like: why is government in this particular business at this time? It may have been quite appropriate for them to be in that particular business 10, 20, 30 years ago ... re-evaluation should be continuous; it should go on all the time.⁵

Forms of Commercialisation

Overview

2.10 In its submission, Finance noted that:

There is a considerable diversity in the nature of commercialised activities within the Commonwealth public sector and in the ways in which they are provided. ... commercialised activities can be located on a continuum ranging from partial cost recovery and minor user charging at one end to the fully commercialised activities of agencies and entities at the other.⁶

4 Finance, *A Policy Framework for Commercialisation: Issues for Discussion*, August 1993, p. 23.

5 Industry Commission, *Transcript*, p. 731 (Canberra, 4 February 1994).

6 Finance, *Submission*, p. S1427, (Vol. 4 of Submissions).

2.11 Figure 2.1 illustrates the range of funding mechanisms and organisational arrangements which are used to deliver commercialised activities in the Commonwealth public sector. It shows that commercialised activities in the Commonwealth sphere can be provided by departments of state, statutory authorities, companies and other corporate forms. While in many cases commercialised services are provided by an agency or entity as a whole, they are sometimes provided from a discrete or identifiable business unit within the agency on the basis of separate accounting arrangements.

2.12 As shown in the Figure, commercialised activities can be funded through:

- normal parliamentary appropriations in the Budget, including appropriations in accordance with section 35 of the Audit Act (which enables receipts to be re-appropriated and spent by the agency);
- Group 2 Trust Accounts,⁷ as is the case with the business units within DAS; and
- entities operating outside the Commonwealth Public Account, for example incorporated companies, such as Qantas, and statutory corporations.

2.13 As Finance explained in its submission:

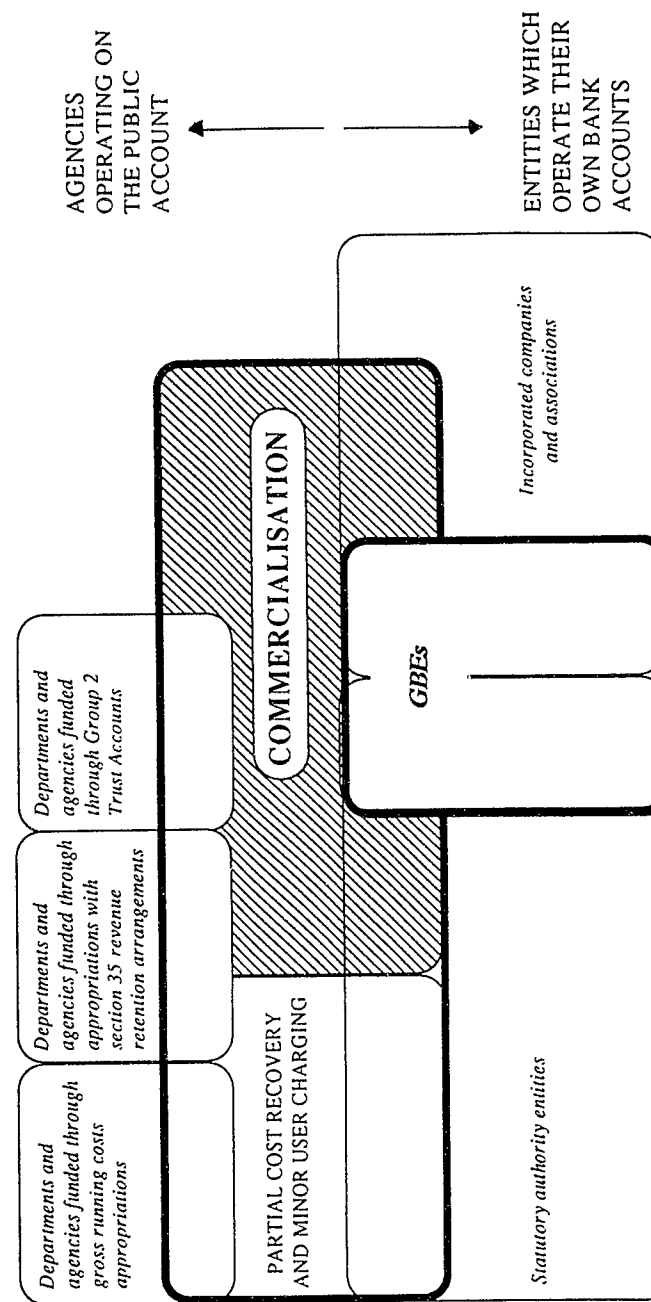
The variety of arrangements shown in the diagram reflects the diverse nature of the goods and services produced by government, the different markets in which they are provided and the circumstances of each agency when it begins the process of commercialisation.⁸

⁷ Group 2 Trust Accounts are working accounts covering certain factories, stores and services and are established by the Minister for Finance under section 62A of the *Audit Act 1901*. Money standing to the credit of a trust account may be spent only for the purposes of the account or may be invested by the Minister or his or her delegate (Finance, *Commonwealth Financial Management Handbook*, AGPS, Canberra, 1992, pp. 37, 51).

⁸ Finance, *Submission*, p. S1427 (Vol. 4 of Submissions).

Table 2.1

COMMERCIALISATION OF COMMONWEALTH GOVERNMENT ACTIVITIES



2.14 In summary, there are four major forms of commercialised operations, as Figure 2.1 suggests:

- Minor cost recovery and simple user charging. These arrangements involve the collection from clients of at least part of the cost of providing particular goods or services.
- More complex forms of user charging. Examples of these are the arrangements whereby the Australian National Audit Office (ANAO) charges departments the full cost of financial statement audits, and the Australian Bureau of Statistics charges at commercial rates for customised products from its databases. A more developed form of user charging is employed by the Australian Quarantine and Inspection Service (AQIS), which has introduced both full cost charging of external clients and the use of a new financial and operational framework.
- Business units established in departments of state. Although these enterprises operate within a departmental structure, they have management and operational systems more typically found in a business, and have a commercial approach to pricing and customer service. The most developed business units have been established in DAS.
- GBEs. These enterprises are separate Commonwealth legal entities operating in the open market and earning a commercial rate of return. They can be public companies or statutory corporations/authorities.⁹

2.15 In its 1993 discussion paper *A Policy Framework for Commercialisation*, Finance described the major considerations in choosing an appropriate form of organisational and funding arrangements as including:

the extent to which Ministers wish, for public policy purposes, to become involved in operational decisions associated with the commercialised activity

⁹ Finance, *Submission*, pp. S1427, S1429 (Vol. 4 of Submissions)

- *the form that accountability to Ministers and the Parliament should take*
- *the degree of risk associated with the commercialised activities*
- *the extent to which the commercialised activities are likely to make calls on the Budget in terms of community service obligations, non-commercial services for the Government, or operational subsidies*
- *the extent to which the services are contestable or provided in a competitive market.*¹⁰

A further factor is the Government's needs as an owner and purchaser of the services supplied by commercialised agencies.¹¹

Business Units in Departments of State

2.16 Fully developed business units are stand alone entities within a departmental structure which have a business oriented philosophy. They operate on separate accounts (Group 2 Trust Accounts) and are expected to keep these accounts in accordance with commercial practice, using accrual-based accounting and information systems. The creation of business units generally implies considerably more change to traditional public sector ways of providing goods and services than is involved in simple user charging or cost recovery.

2.17 Business units exist in nine departments, as shown in Appendix IV. Five of these departments provided information about their business units to the Inquiry; they are DAS, the Attorney-General's Department (Attorney-General's), the Department of Defence, the Department of Primary Industries and Energy (DPIE) and the Department of Human Services and Health. Evidence from DAS, Attorney-General's

¹⁰ Finance, *A Policy Framework for Commercialisation: Issues for Discussion*, August 1993, p. 23.

¹¹ Finance, *Submission*, p. S1440 (Vol. 4 of Submissions).

and DPIE has been drawn on extensively in producing this Report. The business units in these three departments are described briefly below.

2.18 As mentioned earlier, business units are most highly developed in DAS which, with its predecessor agencies, has been engaged in providing goods and services to other Commonwealth organisations for many years. Between 1988 and 1991, DAS converted the greater part of its service operations from budget funded divisions to business units. DAS now operates 14 business units, including Australian Construction Services, the Australian Surveying and Land Information Group, COMCAR, and DASFLEET. A complete list of DAS business units and a description of their activities is at Appendix V.

2.19 The DAS business units provide services primarily for other Commonwealth agencies and entities, but have some clients outside the public sector. The most fully commercialised of the units have a notional capital structure, charge at market rates and are required to compete for business. Each business has an advisory board comprising internal and external representatives, and produces an annual business plan.¹²

2.20 In its submission, DAS commented that:

Commercialisation of department of state functions at least to the degree it has occurred in DAS, is relatively unusual as the scope for extensive commercial practices within a department of state is fairly limited in many of the core areas of public administration. However, the common services provided by the DAS businesses are generally amenable to supply under competitive, self-funding conditions, allowing market forces to be used to achieve significant gains.¹³

¹² DAS, *Submission*, p. S2320, (Vol. 7 of Submissions).

¹³ DAS, *Submission*, p. S337 (Vol. 1 of Submissions).

2.21 The Attorney-General's Department includes three businesses which operate either fully or partially on a commercial basis within the departmental structure. The business units are:

- the Australian Protective Service, which provides protective security services in areas of special importance or sensitivity such as diplomatic protection and counter-terrorism response at certain airports;
- AUSCRIPT, which was formerly the Commonwealth Reporting Service and which provides reporting and transcription services to the courts, and to tribunals and inquiries; and
- the Legal Practice, which provides legal services to the Commonwealth and is the newest of the Attorney-General's business units.

2.22 Both AUSCRIPT and the Australian Protective Service run fully commercialised operations, with minimal budget funding. While the Protective Service has a number of tied clients, AUSCRIPT does not. Additional funding is provided to AUSCRIPT for undertaking community service obligations (CSOs), such as public address systems in court buildings and maintaining the infrastructure for the recording of proceedings. The Legal Practice commenced a user pays regime in July 1992 for many of the legal services it provides to budget-dependent Commonwealth agencies. From July 1995, clients will be free to choose other legal services with certain exceptions. Group 2 Trust Accounts have been established for each of the Attorney-General's business units.¹⁴

2.23 Although the Department of Primary Industries and Energy is essentially a policy department, a number of its operational units are dedicated to service delivery. One of the major units, AQIS, moved towards full recovery of user-attributable costs in the 1993-94 financial year.

¹⁴ Attorney-General's, *Submission*, pp. S1142-7 (Vol. 3 of Submissions).

Government Business Enterprises

2.24 At present there are 19 solely owned GBEs in the Commonwealth public sector, and one GBE which the Commonwealth jointly owns with some State governments. They are listed in Appendix VI. Four of the GBEs have been partly privatised: the Australian Technology Group, the Australian Industry Development Corporation (AIDC), the Commonwealth Bank and Qantas. The Government has announced its intention to sell its interest in some of the above GBEs, as well as Aerospace Technologies of Australia Ltd, AIDC, Qantas, and ANL Ltd.¹⁵ It is expected that the airports owned by the Federal Airports Corporation (FAC) will be leased.

2.25 The key characteristics common to all GBEs is that each has a separate legal existence from the Commonwealth and its own board of management. However, as Finance indicated in its submission to the Committee, GBEs differ from one another in some important respects. For example:

- most GBEs are expected to earn a commercial return, although some (such as the Snowy Mountains Hydroelectric Authority) are currently constrained from earning a commercial return by legislation or by legally binding agreements;
- some GBEs are statutory authorities with their own enabling legislation (such as the Civil Aviation Authority - CAA - and the FAC) and some are companies incorporated under the Corporations Law (such as Telstra Corporation Ltd);
- some GBEs provide services in monopoly markets while others operate mainly in competitive markets; and
- most GBEs are fully owned by the Commonwealth, the main exceptions being Qantas and the Commonwealth Bank of Australia.¹⁶

15 The Government is also in the process of winding down the Pipeline Authority.

16 Finance, *Submission*, pp. S1429-30 (Vol. 4 of Submissions).

2.26 The Government's GBE reforms are viewed by Finance as 'steps towards creating an environment which enables GBEs to operate more efficiently and provide improved levels of service while increasing their accountability to the Government for performance'.¹⁷ An important element of GBE reform policy since 1987 has involved clarifying the responsibilities of the relevant portfolio Minister, GBE boards and GBE management. The fundamental principle is that:

*Ministers responsible for the oversight of GBEs exercise strategic control consistent with their accountability to the Parliament and the public, while Boards develop business strategies and handle day-to-day management.*¹⁸

2.27 This principle is incorporated in the enabling legislation of a number of GBEs. In addition, special accountability and ministerial oversight arrangements for Commonwealth GBEs were promulgated by the Minister for Finance in October 1987 in a document entitled *Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises*. These guidelines were developed further in the 1993 statement *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*.¹⁹

2.28 The Accountability and Ministerial Oversight Arrangements elaborate the division of responsibilities between Ministers and boards and provide other guidance on the expected mode of operation of GBEs. The main features of these arrangements are that:

- Ministers set a clear mandate and objectives for each GBE, influence strategic directions proposed by boards, agree financial targets and dividend policy and approve borrowing limits, subject to Loan Council processes;

17 *ibid.*, p. S1429.

18 Department of Transport and Communications, *Submission*, p. S1842 (Vol. 5 of Submissions).

19 The Arrangements are reproduced in Appendix VII of this Report.

- boards contain an appropriate balance of people with relevant expertise and sound business acumen;
- boards are clearly responsible and accountable for the performance of the GBE and are given the necessary freedom to develop strategies and to direct the management of the enterprise;
- boards report regularly to Ministers on strategic plans for meeting the GBE's objectives and performance targets;
- Ministers initiate quick remedial action if appropriate;
- Responsible Ministers consult with the Minister for Finance on all major matters and ensure that the Prime Minister and the Treasurer receive relevant information; and
- the Minister for Finance, after consultation with the relevant portfolio minister, has the authority to request financial information directly from GBEs.²⁰

2.29 The most significant change between the original 1987 policy guidelines and the 1993 Accountability and Ministerial Oversight Arrangements is the strengthening of the role of the Minister for Finance. Under the current arrangements the relevant portfolio Minister is required to consult with the Minister for Finance on all major matters affecting a GBE. As well, the Minister for Finance may, after consulting the responsible Minister, request financial information direct from that GBE.

2.30 The Accountability and Ministerial Oversight Arrangements are not designed to apply to partially privatised GBEs and business entities that are jointly owned by the Commonwealth and States, and some of the provisions are inappropriate for such circumstances. Finance has advised that, 'the Government has yet to finalise its consideration of the application of the GBE accountability arrangements to

20 Finance, *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, p. 1.

partially privatised and jointly owned GBEs'.²¹ At present, each of these GBEs operates under its own accountability regime. This matter is discussed further in Chapter 6.

2.31 Included in these requirements will be a description of the standards of conduct expected of executive officers in Commonwealth authorities and companies, and a statement of the penalties associated with breaches of the standards.

The Central Coordinating Agencies

2.32 The commercialisation of public sector operations has been overseen by the central agencies within the Commonwealth public service. Chief among these agencies is Finance; the others are the Department of the Treasury (Treasury), the ANAO, the Department of Industrial Relations (Industrial Relations) and the Public Service Commission (PSC).

The Department of Finance

2.33 At a public hearing before the Committee, Finance explained that although it had a major role in the public sector reform process and was a contributor to the commercialisation agenda, the responsibility for implementing the process has rested with the portfolio Ministers. The Secretary told the Committee about its approach in these terms:

*We certainly sought to share best practice and to develop those parts of the system that we controlled directly, to maximise the opportunities and incentives that were available for agencies. This is one of those things that evolved. ... I cannot claim that there was a master plan from day one. ... As it became clear that the system was capable of adjusting, more adjustment was attempted and the management of the transition was something that was important for achieving the result.*²²

21 Finance, *Submission*, p. S2267 (Vol. 7 of Submissions).

22 Finance, *Transcript*, p. 54 (Canberra 8 November 1993).

2.34 Finance expects that the practice of commercialisation will continue to evolve as a result of experience gained by public sector agencies and the Government's recognition of the validity of different models of commercialisation. As part of the process of guiding commercialisation, Finance will need to review periodically the guidance that it provides.

The Treasury

2.35 In an initial response to the Committee's invitation to make a submission to the Inquiry, Treasury indicated that it did not consider a submission from that Department to be appropriate. However, in later correspondence, Treasury did provide information on a number of specific issues relevant to the Inquiry. One of these issues related to Treasury's role in the Government's public sector commercialisation program:

Treasury sees its role in this area as predominantly one of policy advice on aspects of economic efficiency, competition and GBE reform. Treasury is not involved in the day to day issues of commercialisation or its implementation. This function is carried out, and has been in the past, by the Department of Finance and the relevant portfolio Departments. Nevertheless Treasury has contributed to policy development of GBE reforms in four broad areas: target rates of return, competition policy, capital structure reviews and Loan Council arrangements.²³

The Australian National Audit Office

2.36 The Auditor-General and the ANAO are fundamental to the maintenance of accountability of government officials and instrumentalities to Parliament. The *Audit Act 1901* gives the Auditor-General responsibility for auditing the financial statements of Commonwealth departments, statutory authorities and almost all Commonwealth owned or controlled companies and statutory marketing authorities. The *Audit Act* also authorises the Auditor-General to conduct efficiency

²³ The Treasury to Secretary, JCPA, *Correspondence*, 23 May 1994.

audits of Commonwealth entities, although in practice he does not carry them out on GBEs.

2.37 In June 1994 the Government introduced the Auditor-General Bill 1994. This Bill proposes to redefine the Auditor-General's mandate by making the Auditor-General responsible for auditing the financial accounts of all Commonwealth entities, and for conducting performance audits of all Commonwealth entities, other than GBEs. The legislation proposes that the Auditor-General will only be able to conduct a performance audit of GBEs at the request of the Parliament or the responsible Minister. In its Report 331 on the new financial management and audit legislation the Committee supported the proposed mandate in relation to financial statement audits, but recommended that the mandate in relation to performance audits of GBEs be widened to include references from an audit committee of Parliament.²⁴

2.38 As business units have been established, the ANAO has monitored their success in implementing the systems needed to support a more commercial manner of operating than was characteristic of the provision of goods and services by a department of state. In a series of audit reports tabled in 1992, the Auditor-General contributed to the body of knowledge about introducing commercialisation by identifying some of the difficulties that have been encountered. They included problems in:

- charging and cost recovery arrangements;
- management information systems;
- debt management;
- outdated Finance Regulations and Directions;
- conflict of interest;
- restrictions imposed by constitutional and legal considerations; and
- unclear policies.²⁵

²⁴ Joint Committee of Public Accounts, *An Advisory Report on the Financial Management and Accountability Bill 1994, the Commonwealth Authorities and Companies Bill 1994 and the Auditor-General Bill 1994, and on a Proposal to Establish an Audit Committee of Parliament*, Report 331, AGPS, Canberra, September 1994.

²⁵ The Auditor-General, *Financial Statement Audits, Department of Administrative Services, 1990-91 Financial Statements of Business Units*, Audit Report No. 24 1991-92, AGPS, Canberra, 1992; *Efficiency Audit, Department of Primary Industries and*

2.39 On the basis of his findings, the Auditor-General propounded a series of key success factors for commercialisation in departments of state. These are:

- identification of the factors likely to work against the successful move to commercialisation and a timetable for their resolution;
- early development of an appropriate financial and administrative framework;
- existence of, or the early capacity to develop, adequate financial and management accounting systems to identify full costs of operation, and to provide timely and accurate financial information to management and for preparation of full accrual financial statements;
- employment of commercially experienced key staff, including managers and accountants, at an early stage of the process;
- recognition by management that the preparation of commercial financial statements requires reliable accounting systems and specialist skills; and
- phased untying of clients to assist business units in establishing a clientele and adjusting to a regime of full cost recovery before the full force of competition is felt.²⁶

These points are explored in more detail in later chapters.

The Public Service Commission

2.40 In its submission to the Inquiry, the PSC described its role in the following terms:

Energy, Australian Quarantine Inspection Service, Quarantine Division, Audit Report No. 35 1991-92, AGPS, Canberra, 1992; Project Audit, Department of Administrative Services, Debt Management, Audit Report No. 42, 1991-92, AGPS, Canberra, 1992; Project Audit, Department of Administrative Services, a Conflict of Interest: A Matter of Principle, Audit Report No. 43, 1991-92, AGPS, Canberra, 1992; Efficiency Audit, Department of Defence, Commercial Activity in the Defence Science and Technology Organisation, Audit Report No. 2 1992-93, AGPS, Canberra, 1992; Efficiency Audit, Auscript, Commercialisation of the Commonwealth Reporting Service, Audit Report No. 6 1992-93, AGPS, Canberra, 1992.

²⁶ The Auditor-General, *Efficiency Audit, an Audit Commentary on Aspects of Commercialisation in the Department of Administrative Services*, Audit Report No. 16 1992-93, p. ix.

... the Public Service Commission (PSC) has a statutory responsibility for the policy aspects of the key areas of personnel management (other than pay and conditions of employment, which rest with the Department of Industrial Relations and certain other functions which rest with the Department of Finance). The PSC sees its policy responsibility largely in terms of setting the strategic framework for human resource management, within which individual departments and managements can manage their people on a consistent basis and within which they are accountable.²⁷

2.41 Departments with business units are advised by the PSC on general human resource management issues. These issues include performance management, redundancy, staffing arrangements and human resource development, as well as developing broad and flexible management arrangements. Corporatised entities are no longer part of the Australian Public Service (APS), and have the power to make staffing arrangements to suit their own requirements. The PSC is involved with them, however, in managing the transition of staff to them when they are set up. The PSC's involvement also includes managing staff that are excess to the requirements of the commercialised operations, and facilitating staff movement between corporations and the APS.²⁸

2.42 The impact of commercialisation on public sector staff is discussed more fully in Chapter 9.

The Department of Industrial Relations

2.43 The submission from Industrial Relations outlined the Department's role in the public sector reforms that have been implemented over the last decade. Industrial Relations' principal concern in relation to commercialisation has been to establish appropriate frameworks for managers to manage the new challenges facing them. The managers of commercialising agencies have needed to learn what they and their staff should

²⁷ PSC, *Submission*, p. S1245 (Vol. 3 of Submissions).

²⁸ *ibid.*, pp. S1246-9.

do to operate commercially, and to develop suitably flexible, innovative arrangements and conditions to promote commercial success. Managers within departmental business units have had to develop these attributes while preserving traditional public sector values. In addition, the restructuring that has accompanied commercialisation has also thrown up the challenge of dealing with staff reductions.

2.44 Industrial Relations advised the Committee that, in the face of these challenges, it has striven to:

- ensure that the industrial relations framework operating in the Commonwealth reflects the Government's industrial relations policies, remains relevant to the needs of public sector managers and is at least consistent with current best practice;
- provide policy advice to the Government regarding the industrial relations arrangements to apply in circumstances where the organisational form for the delivery of government services is under consideration; and
- provide advice and assistance to organisations which are establishing or reviewing their industrial relations arrangements.²⁹

2.45 The advisory nature of Industrial Relations' activities was emphasised by officers at a public hearing who pointed out to the Committee that:

*We are ... in a situation where increasingly ... central agencies are not the hands-on interventionist bodies that they were, and the primary responsibility for placing these actions into effect rests with line managers ...*³⁰

The Role of Portfolio Departments

2.46 The role of portfolio departments in overseeing the development and operation of commercialised entities varies

²⁹ Industrial Relations, *Submission*, pp. S1386-7 (Vol. 3 of Submissions).

³⁰ Industrial Relations, *Transcript*, p. 157 (Canberra, 8 November 1993).

according to whether the entity is a business unit within the department or a GBE within the broader portfolio. With business units, departmental managers and staff are generally closely involved in their operation. The units operate within the normal decision-making and accountability structures that apply to departments and budget-dependent statutory authorities. By contrast, the relationship between the portfolio department and a GBE is generally more at arm's length, with the department monitoring rather than directing activities.

2.47 In evidence to the Inquiry, Transport described how it monitors its GBEs according to the nature of the activity that they undertake.

Qantas ... is really a wholly commercial enterprise and operates in a highly commercial fashion in a competitive marketplace. It is not providing any community service obligations and it is not fulfilling a social responsibility, so the department's monitoring of Qantas would be more at arm's length. The commercial performance of Qantas is very much a matter for the board and management.

*In relation to the CAA and AMSA [Australian Maritime Safety Authority], which have significant public responsibilities and which have a very important safety regulation role ... , the policy content of those GBEs is a matter of great importance to the minister. So the department would advise the minister on those GBEs and the way in which they are performing in their public responsibilities.*³¹

2.48 The significant interest shown by the Department in the performance of its regulatory agencies raised the question of whether there was duplication of effort with the watchers being watched. In response, Transport said, in relation to its own monitoring resources:

³¹ Transport, *Transcript*, pp. 1069-70 (Canberra, 13 April 1994).

*I think the evidence would show ... that the departmental staff with the function of overseeing these GBEs has been progressively reduced ..., particularly those GBEs moving into more of a market environment.*³²

2.49 Another view of the role played by Transport was mentioned by the Australian National Railways Commission (AN) in discussions with the Committee. AN viewed the role the Department plays as significant, particularly in relation to the administration of the accountability and oversight arrangements and in the policy aspects of achieving AN's commercial objectives. The Committee was informed that Transport's role is often one of ensuring that the central agencies, particularly Treasury and Finance, are aware of AN's requirements and strategic directions as well as ensuring that AN is aware of any changes in government policy which may impact on that organisation.

Legal and Constitutional Issues

2.50 A significant part of the framework for the Commonwealth's commercial activities is the constitutional backing for those undertakings. A paper providing guidance on the constitutional principles applying to commercialisation was produced for DAS by Attorney-General's Senior General Counsel in 1992.³³ This paper sets out the fundamental legal and constitutional principles applying to Commonwealth agencies engaged in or contemplating commercialisation. It establishes that commercial activities may only be undertaken in areas where the Commonwealth has constitutional powers. The areas most relevant to Commonwealth activities are:

- dealing with other Commonwealth departments and authorities;
- any activities in a Territory;
- any activities in a 'Commonwealth place' (a place acquired by the Commonwealth for public purposes;

³² *ibid.*, p. 1073.

³³ D Jessop, Senior General Counsel, Attorney-General's, 'Commercial Activities of the Commonwealth: Constitutional Principles', November 1992; the paper formed Attachment I to DAS's initial submission (*Submission* pp. S375-6, Vol. 1 of Submissions).

- overseas and interstate trade and commerce;
- postal, telecommunications and broadcasting services;
- defence;
- banking;
- insurance;
- railway construction in a State with that State's consent;
- matters referred to the Commonwealth Parliament by a State Parliament; and
- matters incidental to any area of Commonwealth power.

The Commonwealth's GBEs are active in many of these areas.

2.51 High Court decisions have provided additional guidance on the limits to the Commonwealth's activities. The first of these is that:

*... a business activity that would otherwise be beyond power will be regarded as incidental to a Commonwealth power if it is undertaken using resources that are usually used, or reasonably expected to be used, but not presently required, for a purpose within Commonwealth constitutional power.*³⁴

This means, for example, that commercialised units in departments of state, that provide services to other government agencies under the first dot point above, may only undertake work for non-Commonwealth customers if it is incidental to providing services to the other Commonwealth agencies. Thus, private sector work may only be undertaken using spare capacity not required at the time to fulfil core responsibilities (the 'Spare Capacity Principle').

2.52 A second principle relates to the last dot point above and establishes that 'a business activity cannot be regarded as incidental to a Commonwealth constitutional power merely because it raises income that may assist the exercise of a Commonwealth power'.³⁵

³⁴ *ibid.*, p. 376.

³⁵ *ibid.*, loc. cit.

2.53 In its submission to the Inquiry, the FAC commented on the implications of the constitutional restrictions for its operations.³⁶ It pointed out that, because the Commonwealth does not have a general power to engage in commercial activities, nor the specific power to operate airports, it cannot grant the FAC a general power to engage in such activities. These activities can only be undertaken under heads of power granted to the Commonwealth by the Constitution. These heads of power are the powers relating to external affairs, trade and commerce with other countries and States, and activities in a Territory and places belonging to the Commonwealth. These powers have been included in the FAC Act.

2.54 Within airports and the airport sites that it owns, however, the FAC is not inhibited in any way in the commercial activities that it can undertake. It is only outside these places that it is restrained by constitutional and statutory limitations. The FAC drew attention to the fact that its Act prevents it from providing services to important client groups, even though the provision of such services would probably be within Commonwealth constitutional power. The FAC concluded that its position could be 'contrasted with the position of private sector entities which can diversify and redirect resources into activities, constrained only by the market'.³⁷

2.55 Because the legal and constitutional environment in which the Commonwealth's commercial activities operate is a complex one, it has presented difficulties to commercialising agencies. In two recent reports, the Auditor-General has drawn attention to cases where it appeared that inadequate attention had been given to legal and constitutional issues.³⁸ There are also areas where it is not clear what the proper course of action should be. An example of this is provided by the

36 FAC, *Submission*, pp. S651-5 (Vol. 2 of Submissions).

37 *ibid.*, p. S655.

38 The Auditor-General, *Efficiency Audit, Auscript, Commercialisation of the Commonwealth Reporting Service*, Audit Report, No. 6, 1992-93, AGPS, Canberra, 1992; *Efficiency Audit, Department of Defence, Commercial Activity in the Defence Science and Technology Organisation*, Audit Report No. 2, 1992-93, AGPS, Canberra, 1992.

Attorney-General's Legal Practice. In its submission, Attorney-General's pointed out that:

*Quite clearly, there is no doubt about the capacity of the Legal Practice to act in a matter in which the Commonwealth or a Commonwealth-funded agency are involved. However, difficult questions arise when it is asked whether the Legal Practice can act for a State, or a State agency, or for a private sector litigant.*³⁹

2.56 A further area in which confusion has arisen is the constitutional distinction between taxes and charges. Under the Constitution, any moneys that are regarded as taxes flow directly into the Consolidated Revenue Fund and so are unavailable for spending by the agency collecting them unless the moneys are re-appropriated to it by the Parliament.

2.57 An instance of this distinction between taxes and charges was brought to the Committee's attention by the CAA. At the time of the Inquiry, the CAA had two distinct roles: to provide air traffic services on a fully commercial basis and return a profit to the Government, and to regulate aviation safety on the basis of partial cost recovery. Since the formation of the CAA, a marked reduction has been made to the amount of surveillance undertaken for safety regulation. At the same time, the provision of air traffic services has returned dividends to the Government. Critics of the CAA's reduced level of safety surveillance have questioned whether some of the profits from air traffic services could be used to cross-subsidise air safety regulation activities. The CAA informed the Committee that it had received advice that this was not possible. Its Act requires that its charges be reasonably related to costs, and those sections of the Constitution relating to taxation (ss 53, 55) allow the imposition of taxes only through taxation laws. It is therefore illegal for the CAA to cross-subsidise its different activities.⁴⁰

39 Attorney-General's, *Submission*, p. S1154, (Vol. 3 of Submissions).

40 CAA, *Answer to question taken on notice*, p. Q105 (Vol. 1 of Answers to Questions Taken on Notice).

Commercialisation in Other Jurisdictions

2.58 A more commercial emphasis to the provision of goods and services by governments has been introduced in many parts of the western world. The experience of other jurisdictions can provide useful information about best practice and potential problems in commercialising government services. This section considers some of the features of the approaches adopted by New Zealand and the Australian States which differ from the Commonwealth's approach.

2.59 A significant characteristic of commercialisation in other jurisdictions has been a more centrally driven approach at an early stage in the introduction of commercialisation and corporatisation. In several cases, umbrella legislation governs the establishment and operation of government businesses, for example, New Zealand's *State-Owned Enterprises Act 1986*, New South Wales' *State Owned Corporations Act 1989*, Victoria's *State Owned Enterprises Act 1992* and Queensland's *Government Owned Corporations Act 1993*. Such legislation is likely to produce a more uniform result than separate legislation for each business.⁴¹ The CAC Bill, now before the Federal Parliament, will introduce a more consistent regime in the Commonwealth sphere.

2.60 Another feature of certain jurisdictions are units within the central agencies that are dedicated to guiding the introduction of commercialisation and corporatisation and monitoring the performance of government businesses. In New Zealand, for example, the State-Owned Enterprises (SOE) Unit was established to put in place the machinery required to establish new corporations.⁴² The Crown Company Monitoring Advisory Unit within the Treasury now oversees SOE planning and reporting processes, and advises the Minister of Finance and the Minister for State-Owned Enterprises.

41 Queensland Treasury, *Corporatisation in Queensland: Policy Guidelines*, March 1992, p. 41.

42 P Lister, M-J Rivers & A Wilkinson, 'The management of change: the social and personnel perspective', in *Reshaping the State: New Zealand's Bureaucratic Revolution*, (ed. J Boston, J Martin, J Pallot & P Walsh), Oxford University Press, Auckland, 1991, p. 299.

2.61 Similar arrangements have been put in place in some of the Australian States. In Queensland, the Treasury's Government Owned Enterprises Unit oversees the implementation of corporatisation, while in New South Wales the Commercial Sector Division of Treasury monitors the financial performance of dividend paying GTEs and state owned corporations for the Treasurer and Premier and provides shareholder advice to the Government.⁴³ Similar arrangements apply in Victoria, where the Office of State Owned Enterprises, which was established within Treasury in 1992, is the central performance monitoring unit for SOEs.⁴⁴ A GTE monitoring unit within the Western Australian Treasury oversees the performance of GTEs in that State.

2.62 At one stage, the New Zealand Government carried one step further the process of centralising responsibility for its SOEs. It established a Ministry for State-Owned Enterprises which assumed responsibilities that were formerly in the hands of the portfolio ministries.⁴⁵ The shareholding function for these SOEs then fell to the Minister for State-Owned Enterprises and the Minister of Finance. This arrangement differs from that in the Commonwealth where the shareholder for the Government is the portfolio Minister.⁴⁶

2.63 Several jurisdictions also make use of advisory committees of business people and financial experts to assist Ministers, Treasuries and GBE boards. New Zealand and Queensland have systems of this kind and, following the West Australian Government's acceptance of the recommendations

43 NSW Treasury, Office of Financial Management, *Annual Report 1992-93*, p. 16.

44 Department of the Premier and Cabinet, Victoria, to JCPA Secretariat, *Correspondence*, 24 February 1995; Department of the Treasury, Victoria to JCPA Secretariat, *Correspondence*, 10 March 1995.

45 The Minister for State-Owned Enterprises is no longer supported by his own ministry, but is served by the Crown Company Monitoring Advisory Unit.

46 R C Mascarenhas, 'State-owned Enterprises', in *Reshaping the State: New Zealand's Bureaucratic Revolution*, (ed. J Boston, J Martin, J Pallot & P Walsh), Oxford University Press, Auckland, 1991, p. 38.

of the Independent Commission to Review Public Sector Finances, a committee has been established in that State to oversee the implementation of corporatisation and commercialisation.⁴⁷

2.64 In other respects, the regimes established elsewhere resemble the Commonwealth's. Most of them employ some form of contract between the business and the Government to prescribe the activities that the business is to carry out. This contract may include reference to the delivery of CSOs. Financial arrangements cover such details as target rates of return and dividends, capital structures, asset valuation, and the payment of taxes.

2.65 In the course of examining the evidence provided to the Inquiry by Australian sources, the Committee considered whether some of the practices employed elsewhere might be useful in the Commonwealth context. It is important, however, in looking at commercialisation elsewhere to recognise local differences that may make it inappropriate to directly translate alternative practices to the Commonwealth sphere. This topic is explored further in Chapters 4, 7 and 10.

Conclusion and Recommendations

Framework for Business Units

2.66 The delivery of government goods and services in a commercial manner is an evolving practice. What was an appropriate practice or corporate structure five years ago may be inappropriate now, and what is best practice now may be superseded in five years time. In this situation, it is important that clear and consistent guidance is supplied to those operating business units. This guidance should be revised regularly to keep pace with changes in business practices.

47 Report of the Independent Commission to Review Public Sector Finances, *Agenda for Reform*, Vol. 2, August 1993, pp. 17, 27; Office of the Premier of Western Australia, *Submission*, p. S 1463 (Vol. 4 of Submissions).

2.67 The Committee has been impressed by the work done within DAS over the last seven years to produce and maintain a management framework for its businesses. In 1988, the Government endorsed a set of 23 principles which has provided the foundation for the reforms that led to the formation of DAS's business units.⁴⁸ DAS also responded to challenges presented by commercialisation in other key areas.

- It developed redundancy arrangements for excess staff.
- Its 1991 *Code for Handling Conflict of Interest*⁴⁹ was produced in response to the need to give guidance to officers faced with balancing the demands of commercially oriented behaviour with traditional public service standards of conduct. This Code will be replaced early in 1995 by *Guidelines for Business Conduct*, which includes a code of ethics, a code of conduct, guidelines to DAS's suppliers and a guideline for taking risk-managed decisions.⁵⁰
- It strengthened its accountability framework by establishing charters which have been approved by Cabinet for each of its businesses. Business plans for each DAS business and reviews every three to five years ensure that businesses adhere to their charter, as well as to DAS's overall corporate plan.⁵¹

2.68 The Committee believes that all departments which operate business units should provide guidance of the type provided by DAS to its business units. There would also be value in such advice being consolidated into a service-wide policy statement. This would enable departmental managers to build upon the experiences of others and help ensure that good practice is repeated and mistakes avoided. The 1992 evaluation

48 *Principles for the Operation of Services to Government* are provided as Attachment D to DAS' initial submission (*Submission*, pp. S360-3, Vol. 1 of Submissions). These principles formed the basis for establishing detailed charters for the businesses.

49 The Code was provided as Attachment K to DAS' initial submission to the Inquiry (*Submission*, pp. S385-96, Vol. 1 of Submissions).

50 DAS, *Submission*, pp. S2305-6 (Vol. 7 of Submissions). The draft Guidelines are provided at Attachment D to DAS' final submission (*Submission*, pp. S2333-55, Vol. 7 of Submissions).

51 DAS, *Submission*, p. S364 (Vol. 1 of Submissions).

of reform in the Australian Public Service also emphasised the need for more coherent policy development and the sharing of best practice.⁵²

2.69 In the Committee's view it is less than ideal that there is no current public service-wide policy statement on the operation of business units within departments of state. Nor is a practical guide to commercialisation available yet. Finance's discussion paper on policy, *Policy Framework for Commercialisation*, and its proposed practical guide to commercialisation will go a long way toward providing the sort of consistent advice that has been lacking in recent times.

2.70 The Committee encourages Finance to give priority to finalising and implementing its revised policy framework and the associated practical guide for Commonwealth agencies and entities.

2.71 Recommendation 1

The Department of Finance should give priority to the finalisation and implementation of 'A Policy Framework for Commercialisation' which was issued as a discussion paper in 1993.

2.72 Recommendation 2

The Department of Finance should expedite the publication of its proposed practical guide to commercialisation.

2.73 The Committee understands that the practical guide to commercialisation which Finance is preparing will cover the constitutional and legal issues that may face commercialising agencies. The Committee regards this as a useful inclusion in the guide.

2.74 Another matter which could usefully be included in both the Policy Framework and the proposed practical guide is some discussion of industrial relations issues. At present neither document makes reference to these issues which, given

⁵² Task Force on Management Improvement, *The Australian Public Service Reformed: An Evaluation of a Decade of Management Reform*, AGPS, Canberra, 1992, p. 285.

the significance of the staffing and industrial relations issues which can arise in the commercialisation of public sector operations, is a clear deficiency. In evidence to the Committee, representatives from Industrial Relations observed that they and Finance should work more closely together than they had done to date in finalising the document.⁵³

2.75 Recommendation 3

The Department of Finance should ensure that the final versions of 'A Policy Framework for Commercialisation' and the proposed practical guide to commercialisation include references to and advice about the industrial relations issues which can arise during the commercialisation of government operations.

Framework for Government Business Enterprises

2.76 The framework for GBEs is in a far more advanced and settled state than that for business units. The Accountability and Ministerial Oversight Arrangements contain a comprehensive set of requirements to guide the operation of GBEs. The Committee believes it appropriate that the arrangements provide for a stronger role for the Minister for Finance than was evident in the original 1987 guidelines.

2.77 It is important, of course, that the arrangements be monitored to ensure that they continue to be appropriate. One issue which is already under review is the need to help directors understand better their obligations to notify responsible Ministers about significant initiatives which the directors propose to take.⁵⁴

2.78 Finance has advised the Committee that work is also underway to address a number of other issues, including:

- arrangements for partially privatised GBEs;
- the implications of national competition policy;

⁵³ Industrial Relations, *Transcript*, pp.156-7 (Canberra 8 November 1994).

⁵⁴ Finance, *Submission*, p. S2233 (Vol. 7 of Submissions).

- circumstances where tying clients to government businesses is appropriate;
- monitoring GBE performance; and
- technical issues associated with setting financial targets.⁶⁵

2.79 The Committee believes that Finance should regularly review the Accountability and Ministerial Oversight Arrangements, and revise and expand them as changing circumstances require. This issue is discussed further in Chapter 7, where the Committee recommends that the Accountability and Ministerial Oversight Arrangements be monitored, on a regular basis, and revised and extended when needed.

2.80 The Committee believes that the reporting and accountability regime proposed to be established by the Commonwealth Authorities and Companies Bill will represent a significant enhancement of the current arrangements.

2.81 The Bill proposes to draw together the accountability requirements for Commonwealth authorities and companies, which are presently scattered through numerous enabling Acts, company memoranda and articles. The Bill will establish, for the first time, a single set of reporting and accountability requirements.

⁶⁵ Finance, *Transcript*, pp. 2389-91 (Canberra 17 October 1994).

3

SETTING OBJECTIVES FOR GOVERNMENT BUSINESSES

Introduction

3.1 A key prerequisite for the efficient operation of any organisation is clear specification of its objectives. In the case of government entities, there are frequently multiple roles for a single organisation, all of which need clear definition. This chapter reviews the evidence taken by the Committee on how clearly the objectives for the Government's businesses have been defined, and how the potential for any conflict between multiple objectives has been dealt with. Where problems have been identified, the Committee has suggested how they might be rectified.

Objectives for Commonwealth Government Business Enterprises

The Theory

3.2 The need for clearly defined objectives is widely recognised. In its submission, the Industry Commission set out the administrative reforms which it saw as necessary to improve the performance of government business enterprises (GBEs). These reforms included the establishment of clear and non-conflicting objectives and the resolution of any potential conflicts between commercial, social and regulatory objectives:

Improved performance requires that each enterprise has a clear understanding of the objectives which its owning government wishes pursued. Social objectives should be

clearly specified and costed. Where conflicts among commercial, social and regulatory objectives exist, it is important that the enterprise has clear guidance on any trade-offs that may be necessary.¹

3.3 Clarity may not be sufficient in itself, according to the Industry Commission, which advocated the separation of ministerial responsibility for commercial performance of an enterprise from the responsibility for associated regulatory functions and negotiating the delivery and funding of community service obligations (CSOs):

Any policy or regulatory function traditionally undertaken by the enterprise should be removed to separate specialist agencies subject to direct ministerial accountability.²

The Secretary of the New South Wales Treasury wrote in a similar vein in a 1992 document on the theory and practice of commercialisation and corporatisation.³

The Practice

3.4 The particular objectives of each Commonwealth GBE are set out in its enabling legislation, company memorandum or articles of association. General guidance on how those objectives should be made explicit are included in the revised and strengthened *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, which were issued by the Government in June 1993. One of the fundamental principles embodied in these Arrangements is a requirement that the responsible Minister provide each GBE with a clear mandate and set of objectives.⁴ The Arrangements also recognise that, as well as commercial objectives, GBEs could have 'explicitly stated' social and

¹ Industry Commission, *Submission*, p. S1895 (Vol. 5 of Submissions).

² *ibid.*, p. S1896.

³ P Allan, Secretary, NSW Treasury, *A Guide to the Theory and Practice of Commercialisation and Corporatisation in NSW*, 19 May 1992, p. 2.

⁴ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, p. 1.

economic objectives as well as CSOs imposed by the Government.⁵ The FAC for example, lists its objectives under the headings, social, financial, and management and efficiency.⁶

3.5 While the Arrangements do recognise the existence of multiple objectives for GBEs, they do not discuss the potential conflicts which may arise where commercial objectives are combined with regulatory objectives, CSOs or policy objectives in a single organisation. The Prices Surveillance Authority (PSA), however, drew the Committee's attention to the difficulties that multiple roles may cause GBEs.

GBEs frequently claim that their legislation and operating environment are providing them with conflicting signals. They argue that at times Government policy can be either contrary to the GBE's legislation or simply unclear. The question of the delivery of CSOs is one example of conflicting objectives. ...

The difficulties in establishing and interpreting government policy are sometimes compounded by multiple roles for ... the GBE. ... On the one hand, it is required to act commercially and earn a commercial rate of return. On the other hand, it is aware of government policy regarding competition as well as the national interest arguments.⁷

3.6 An example of the confusion that can arise with inadequately defined objectives was uncovered by the Industry Commission in relation to the scope of Australia Post's community service obligations to provide a letter service. In its report on mail, courier and parcel services, the Industry Commission claimed that the confusion had led to a conflict between the commercial and non-commercial objectives of the enterprise.⁸ It recommended, among other things, that Australia Post's CSOs should be more clearly specified to

⁵ *ibid.*, pp. 1-2.

⁶ FAC, *Submission*, p. S605 (Vol. 2 of Submissions).

⁷ PSA, *Submission*, pp. S1738-9 (Vol. 4 of Submissions).

⁸ Industry Commission, *Submission*, p. S1895 (Vol. 5 of Submissions).

minimise this conflict. Clear definition of objectives for the provision of services is also helped by the definition being made public and the services being separately funded, both of which the Industry Commission also recommended.⁹ Australia Post has responded to the recommendations by drawing up detailed strategies and policies for its CSOs, which it published in its 1991-92 annual report.¹⁰ These performance standards were endorsed by the Government when the package of postal reforms was announced in November 1993.¹¹

3.7 The Committee has considered the problems caused by inadequately defined social objectives for GBEs in greater detail in Chapter 4.

Conclusion

3.8 The Committee considers that the Accountability Arrangements should include references to the potential for conflict when businesses have multiple objectives and should underline the importance of minimising these conflicts.

Separation of Conflicting Objectives for Government Business Enterprises - The Objectives of the Civil Aviation Authority

Introduction

3.9 In some cases, the various roles of an organisation are so different from one another and the conflict between them is such that it is inappropriate for them to remain in the same organisation. The Industry Commission and the Secretary of the New South Wales Treasury both pointed out the need for the separation of such roles into different organisations.

9 Industry Commission, *Mail, Courier and Parcel Services*, Report No. 28, October 1992, pp. xiv-xv.

10 Australian Postal Corporation, *Annual Report 1992*, pp. 61-4.

11 Australia Post, *Submission*, p. S2212 (Vol. 6 of Submissions).

3.10 As the portfolio with the most and largest GBEs, the then Department of Transport and Communications (DTC) was particularly aware of this point. In its submission, it indicated that:

Separation of functions underlies the organisational changes made since the establishment of the portfolio in 1987. Changes to structural arrangements in the portfolio have been guided by the following principles:

- *large commercial service delivery functions can be more efficiently and cost effectively run under a commercial board and outside normal public service budgetary arrangements;*
- *detailed industry regulation, requiring technical judgement or case by case adjudication, is best managed separately from policy development and implementation;*
- *an organisation which provides commercial services in competition with others should not regulate its competitors; and*
- *the same agency should not be responsible for both industry safety regulation, and safety regulation review.¹²*

3.11 The Committee believes, however, that, until recently, the Department of Transport (Transport) had not recognised that separation was also needed for the Civil Aviation Authority's (CAA) dual functions as a commercial provider of aviation services and an air safety regulator. This issue is explored further in the next section as it illustrates how regulation can be adversely affected by being linked with commercial activities.

The Civil Aviation Authority's Functions

3.12 At the time of this Inquiry, the *Civil Aviation Act 1988* required the CAA to provide services to the aviation industry and to regulate it. At that time, the CAA was classed

12 DTC, *Submission*, p. S1835 (Vol. 5 of Submissions).

as a GBE because it charged for most of its services. However, its main function was regulatory. At a public hearing, the CAA's Chief Executive Officer described the Authority's roles in the following terms:

I highlight to the Committee and the public that the CAA has two very distinct roles. We are first and foremost a safety regulator. We regulate the Australian aviation industry to achieve high levels of safety. That is a requirement under our Act and we also provide services to the Australian aviation industry. ... our safety regulation functions account for about 10 per cent of our staff and about 10 per cent of our budget. The service side of our business, which is the provision of aviation services such as air traffic control, rescue and firefighting services and technical support, is about 90 per cent of our budget and business.¹³

3.13 A similar combination of regulatory and service functions characterises comparable bodies in the United Kingdom, Canada and the USA. Only in New Zealand do separate bodies provide air traffic control services and conduct safety regulation.¹⁴

3.14 Transport pointed out that combining the commercial and regulatory services of Australia's CAA produced efficiencies deriving from the GBE framework within which they were delivered, and the reliability and effectiveness of a coordinated system.

The judgment was made at the time of the establishment of the CAA that those two types of services were very closely integrated and that they complemented each other and should be kept together. ...

When addressing this in a policy statement, the then Minister said: 'The question of whether safety regulation should be subsumed within the Authority or, rather, be a function continuing to be separately exercised by the ...

¹³ CAA, *Transcript*, pp. 1410-1 (Sydney, 20 May 1994).

¹⁴ CAA, *Submission*, p. S510 (Vol. 2 of Submissions).

[then] Department of Transport and Communications has been the subject of some debate. I believe, however, that there is strong logic in the view that the task of regulating aviation safety must be regarded as an integrated system in which all elements are coordinated to achieve maximum reliability and effectiveness'.¹⁵

3.15 The CAA commented that:

Our Act, at the moment, says that we provide both functions. So we have put no effort at all into looking at what would be the effect if they were separate. While they are different functions, there are complementary skills in the services side of the organisation and the safety regulation side. The fact that we are all together means that those composite skills are available for safety regulation. ...

The other issue is that the general overheads of the organisation are split between the services side and the safety regulation side. If they were separate - I am not saying this would necessarily be so; we would have to look at it - you could end up with increased overheads in both parts of the organisation because, at the moment, they do share overheads.¹⁶

Comments from Civil Aviation Authority Clients and Other Interested Parties

3.16 The Association of Professional Engineers, Scientists and Managers Australia (APESMA) also argued in favour of the safety regulation function remaining in the CAA.¹⁷ However, several witnesses to the Inquiry identified factors associated with the location of the Government's air safety regulation function in a GBE, which in their view prevented that regulation function being carried out in the most effective

¹⁵ Transport, *Transcript*, p. 1073 (Canberra, 13 April 1994). The advantage in terms of increased efficiency of combining commercial and non-commercial functions was also made with respect to Australia Post (Finance, *Submission*, p. S2262, Vol. 7 of Submissions) and AUSLIG (DAS, *Transcript*, p. 523, Canberra, 31 January 1994).

¹⁶ CAA, *Transcript*, p. 1416 (Sydney, 20 May 1994).

¹⁷ APESMA, *Transcript*, pp. 2007-8 (Canberra, 6 July 1994).

way possible. They focussed on the confusion that resulted from the collocation of two disparate functions. As the Australian Federation of Air Pilots (AFAP) pointed out, 'service and regulation together produce and compound role confusion'.¹⁸

3.17 The location of the air safety regulator within a GBE misled some of those being policed. According to the Australian Licenced Aircraft Engineers Association (ALAEA):

If you have a perception that the regulator is impotent and susceptible to economic pressure then if you are an unscrupulous operator the tendency is to take the risk and break the law.

... the impression in many areas of industry is that because the CAA can be potentially sued for millions of dollars that they are unwilling to adopt the policing role. ...

*It would therefore, we believe, be in the public interest to revert the DASR [Directorate of Aviation Safety Regulation] function back into the public service arena so as to provide the perception that regulations are enforceable and capable of successful prosecution.*¹⁹

The AFAP took a similar stand: 'regulation rests easily in the Department structure'.²⁰

Restructuring of the Civil Aviation Authority and Inquiries into Safety Regulation

3.18 During the course of the Inquiry, the Government announced that the safety regulation function would be transferred from the CAA into an independent statutory authority, funded from the Budget. This action separates commercial and regulatory objectives and enables the CAA to focus completely

¹⁸ AFAP, *Submission*, p. S2048 (Vol. 6 of Submissions).

¹⁹ ALAEA, *Submission*, p. S2052 (Vol. 6 of Submissions).

²⁰ AFAP, *loc. cit.*

on its services to the aviation industry, such as air traffic control, for which it charges on a commercial basis.

3.19 In a letter to the Committee written after this decision was taken, the acting Chief Executive of the CAA asserted that the creation of two separate bodies for the two functions should 'overcome the potential conflicts of interest between regulation and service provision that we have had to deal with as an organisation'.²¹ He admitted that 'the safety regulatory and service provider functions were not managed sufficiently differently to each other during the early years of the Authority's existence'. This had meant, in the words of another CAA officer, that 'it was very difficult to get that cultural balance right, trying to run two cultures in the same organisation'.²²

3.20 The Committee concurs with this view; it believes that the Government's decision was a wise one in that it:

- removes the regulation of air safety from the environment of a commercial operation;
- places air safety regulation in an organisation with only one focus; and
- eliminates the possibility of confusion between regulatory and commercial roles in the minds of the public, the aviation industry and its employees.

This last point is of particular importance in maintaining the public's confidence in the safety of air transport which, as the CAA pointed out in its 1992-93 annual report, is a significant issue for the Authority.²³

3.21 The Committee notes that there are several inquiries currently being conducted into the CAA's administration of safety regulation in Australia. These include the inquiry into aviation safety in the commuter and general aviation sectors of the industry by the House of Representatives Standing Committee on Transport, Communications and Infrastructure.

²¹ CAA to Secretary, JCPA, *Correspondence*, 24 February 1995.

²² CAA, *Transcript*, p. 2503 (Canberra, 23 March 1995).

²³ CAA, *Annual Report 1992-93*, p. 12.

Other Examples of Regulatory and Commercial Objectives

3.22 As mentioned in paragraph 3.13 above, only New Zealand has established separate bodies to provide services to the aviation industry and to regulate that industry. In its submission, Australasian Pacific Aviation Consultants (APAC) drew the Committee's attention to the functions of the New Zealand Airways Corporation (Airways), which is a state-owned, fully commercialised provider of air traffic control services. Airways is separate from the authority responsible for safety regulation, which is the New Zealand Civil Aviation Authority.²⁴

3.23 The advantages and benefits of the New Zealand model of separation between regulatory and commercial functions were summarised in a paper presented to the Air Transport Action Group, Seattle, in June 1992 by Mr A J Makin, Chief Executive, Airways Corporation of New Zealand.

*The decision to separate the regulators from the operators was one which we believe has helped to reduce costs and clarify roles in New Zealand, as it could do in many other countries. ... We lead the world with this concept of separating the responsibility for safety and the public interest from the efficient commercial operation of the airways system. The tension which exists in New Zealand between the regulator and the service provider, combined incidentally with a user-pays philosophy for both, is not only health [sic], but helps to ensure that the benefits of regulation outweigh the costs.*²⁵

3.24 In Australia, the Australian Maritime Safety Authority (AMSA) is, in some respects, similar to the original concept of the CAA, in that its functions comprise both regulatory and cost recovery operations. There was no indication during the course of the Inquiry to suggest that AMSA had experienced

²⁴ Australasian Pacific Aviation Consultants, *Submission*, p. S802 (Vol. 2 of Submissions)

²⁵ A J Makin, Paper presented to the Air Transport Action Group, Seattle, June 1992; reproduced as part of APAC's submission (APAC, *Submission*, p. S829, Vol. 2 of Submissions).

problems comparable to those of the CAA. The Committee is concerned, however, about the potential for such difficulties to arise.

Conclusion

3.25 The Committee believes that the perceived failure of the CAA to regulate aviation safety as effectively as it should have was, in part, the result of combining two disparate functions in the same organisation. It is the Committee's view that regulation is most effectively pursued in an organisation which has that function as its sole focus. The Government should move to ensure that all Government businesses focus solely on commercial objectives and that any regulatory functions be established and funded separately.

3.26 Recommendation 4

The Department of Finance should coordinate a review to examine all agencies with regulatory and commercial functions, with a view to separating these functions.

Objectives for Commercialised Undertakings in Departments of State

The Framework

3.27 The need for clear, non-conflicting objectives, and the principle that different functions be separated from one another, apply just as well to business units in departments of state as they do to GBEs. For example, the Auditor-General commented in light of the AUSCRIPT's experience of commercialisation that:

The adoption of commercial practices can achieve a number of ends and it is important that the expected outcomes are made explicit in the policy direction.

... The policy direction should give clear guidance on what outcomes are expected and the relative priority of the

*expected outcomes. ... For example, Audit Report No. 6, 1992-93 noted with regard to AUSCRIPT that there was ambiguity in the agency's broad policy direction and no clear statement of expected outcomes.*²⁶

3.28 Other organisations also stressed the importance of clearly defining the functions of the Government's commercial undertakings and separating responsibility for potentially conflicting objectives. Among them were the Real Estate Institute of Australia (REIA) and the Institution of Engineers.²⁷

3.29 While guidelines for the operation of GBEs are available, as described above, an overall framework relating to business units is less well developed. In October 1993, Finance produced a discussion paper entitled *A Policy Framework for Commercialisation*. The paper set out a proposed policy framework for commercialisation in the Australian Public Service, excluding Commonwealth GBEs and simple user-charging arrangements. In addition, the Department is at present working on a practical guide to commercialisation, which is seen 'as providing introductory material on practical issues which agencies are likely to need to address during commercialisation of their activities'.²⁸ Both documents have been circulated to a number of government agencies for comment, and updated versions are being produced.

3.30 There are passing references in both documents to public interest aspects under commercialisation and to the constraints placed by government on fully-commercialised activities, for example in the Department of Administrative Services (DAS) and units of the Attorney-General's Department (Attorney-General's):

These agencies and entities are creations of the Commonwealth and to varying degrees Ministers will want to retain an ability to influence their commercial activities

²⁶ Australian National Audit Office, *Submission*, p. S301 (Vol. 1 of Submissions).

²⁷ Institution of Engineers Australia, *Transcript*, p. 428 (Canberra, 6 December 1993); REIA, *Submission*, p. S469 (Vol. 2 of Submissions).

²⁸ Finance, *Submission*, p. S2248 (Vol. 7 of Submissions).

*within the terms of any enabling legislation or general principles agreed by the Government. Ministers might for example have public policy reasons for wanting to ensure that sections of the community have access to a particular service or access to a service at a price that is less than would otherwise be charged.*²⁹

Conclusion

3.31 Such comments do provide some, albeit brief, guidance to Commonwealth agencies on the need to identify and separate commercial and non-commercial objectives. Furthermore, the Committee understands that the proposed practical guide will contain more detailed advice on the setting of financial and other objectives for commercialised agencies. The Committee believes that this is essential and recommends that both papers, and especially the practical guide, should include a specific section on the issue of clear and non-conflicting objectives by departments undertaking commercial activities, and should provide guidance on ways in which these conflicts can be avoided.

3.32 Recommendation 5

The Department of Finance, in producing the final versions of the paper entitled 'A Policy Framework for Commercialisation' and the proposed practical guide to commercialisation, should include specific sections on the issue of establishing clear and non-conflicting objectives for commercialised entities, and should also provide guidance on how conflicting objectives can be avoided.

The Approach Adopted by the Department of Administrative Services

3.33 As one of the leaders in making the transition from department of state to commercialised operation, DAS's business units were the first to face the need to develop

²⁹ Finance, *A Policy Framework for Commercialisation: Issues for Discussion*, 1993, p. 10.

guidelines for introducing a more commercial approach to their operations. Their experience provides useful guidance for other organisations about the factors to be considered in the commercialisation process, and is explored in the remainder of this section. As far as the Committee is aware, none of the other commercialising departments has developed or issued guidelines comparable to the ones developed by DAS as a basis for structural reform in a commercialised environment.

3.34 The objectives of common service reform in DAS were clearly stated by the then Prime Minister in a letter to the then Minister for Administrative Services:

... "to set in train a fundamental reappraisal of the provision of common services to Government agencies".

The touchstones of this reappraisal were the dual objectives of efficient utilisation of resources and effective delivery of services.³⁰

3.35 During the early stages of commercialisation, DAS developed a set of principles for providing services to government agencies, which were endorsed by the Government in 1988. The document, entitled *Principles for the Operation of Services to Government Agencies*, divided these principles into three groups:

- principles applicable to all DAS services (Principles 1-8);
- principles relevant to those DAS services for which the Government decides it is appropriate to charge (Principles 9-13); and
- principles relevant to those DAS services which the Government decides should operate on a quasi-commercial basis (Principles 14-23).³¹

3.36 The DAS Principles made reference to circumstances where commercial and non-commercial objectives are combined in the one entity. Principle 14, for example, states that, where

³⁰ DAS, *Submission*, p. S338 (Vol. 1 of Submissions).

³¹ DAS, *Submission*, pp. S360-3 (Vol. 1 of Submissions).

the Government decides to commercialise a service, the relevant service agency should be structured with a distinct identity within the departmental framework. Principle 7 indicates that, if the Government decides that policy objectives or functions extending beyond the supply of basic services to clients are to be pursued, these should be identified explicitly in the management charter and corporate plans for the responsible entity.

3.37 In its initial submission, DAS stated its view of the separation of policy advising and service delivery roles in the following terms:

While there are certain advantages to be gained through policy advising functions being carried out by units organisationally close to delivery agencies, it is important that the desirable level of independence is maintained and seen to be maintained. In DAS, for example, the major Government policy function within the department - procurement policy - is carried out by Purchasing Australia, which reports directly to the Secretary.³² Being Budget funded, Purchasing Australia is financially and operationally independent of the supply functions in the DAS BSTA [Business Services Trust Account] businesses. Similarly the Corporate Policy and Government Relations Division is Budget funded and has a reporting line separate to that of the DAS businesses. ...

In those limited areas where DAS businesses retain some policy advising responsibilities, care is taken to ensure that such activities are not compromised by the primary commercial objectives of the businesses concerned. For the most part and wherever possible such advice is obtained as part of the commercial functions of the business on a fee for service basis, with the service being provided in competition with private sector competitors.³³

³² On 30 September 1993, the Secretary, Mr N Tanzer, announced a restructure of DAS. Under the revised arrangements, Purchasing Australia no longer reports directly to the Secretary but falls within the responsibility of the DAS Corporate Executive General Manager (DAS, *Submission*, p. S1801, Vol. 5 of Submissions).

³³ DAS, *Submission*, pp. S348-9 (Vol. 1 of Submissions).

3.38 Recognising the potential for conflict of interest where commercial and other objectives operate together, DAS issued its *Code for Handling Conflict of Interest* in October 1991. The intention of the document was to guide DAS managers and staff in ethical business conduct and to provide a statement to DAS clients of the Department's mode of operation. In the foreword to the Code, the Secretary of the Department indicated that:

The code ... forms part of the wider accountability framework of DAS, which recognises and defines its commercial objectives within the context of its status as a Department of State. ...

*Recognising the considerable changes occurring in the public sector, DAS will keep its code under review.*³⁴

3.39 In February 1995, DAS produced a document entitled *Guidelines for Business Conduct*, which supersedes the *Code for Handling Conflict of Interest*. The guidelines include a code of ethics, a code of conduct, guidelines for suppliers to DAS and a guideline for taking 'risk-managed' decisions.

Conclusion

3.40 The Committee commends DAS for its action in developing the *Principles for the Operation of Services to Government Agencies*, the *Code for Handling Conflict of Interest* and subsequent guideline material. Of these, only the *Principles for the Operation of Services to Government Agencies*, issued in 1988, has not been updated.

³⁴ DAS, *Submission*, p. S386 (Vol. 1 of Submissions).

3.41 Recommendation 6

The Department of Administrative Services should examine the 'Principles for the Operation of Services to Government Agencies', in light of its experience with commercialisation since those guidelines were issued, to ascertain whether these general principles should be revised.

The Framework Established for the Legal Practice of the Attorney-General's Department

3.42 The Government decided in August 1989 to establish a commercially focussed legal practice based on a user-pays system. In 1991, the Government approved a policy statement by the Attorney-General entitled *Guidelines for the Provision of Legal Services*. The Guidelines include principles governing the extent to which clients of Attorney-General's will be free to obtain legal services from sources other than the Department or their own in-house legal staff after 30 June 1995.

3.43 The Guidelines make clear that, even after full implementation of user-pays, all Commonwealth legal services must continue to be provided within a broad general framework which recognises the role of the Attorney-General as First Law Officer. In that role, the Attorney-General is responsible for ensuring protection of the Commonwealth's legal interests and determining overall Commonwealth legal stances. For example, the Attorney-General's role in relation to suits by or against the Commonwealth enables him to protect the Commonwealth against the possibility of taking action against itself in the Courts. This possibility could arise if departments were free to engage private solicitors to conduct litigation.³⁵

3.44 The Guidelines also specify that certain legal services provided by Attorney-General's will not be subject to the user-pays system nor to user choice. These monopoly services reflect:

... the very limited areas where Government policy interests

³⁵ Attorney-General's Department, *Submission*, p. S2371 (Vol. 7 of Submissions).

*dictate that it is either necessary or clearly desirable for legal services to be provided by the Government's own lawyers rather than by the private sector ...*³⁶

3.45 The Committee is not aware of any organisational or other means of separation for the commercial and public interest objectives of Attorney-General's Legal Practice, apart from the Guidelines discussed above. Nor is it clear to the Committee at this stage whether there is a need for such a separation, although it noted that the Lawyers Sub-Division of the Professional Division of the Public Sector Union hinted at such a need.³⁷

Conclusion

3.46 In the Committee's view, further attention should be given to assessing the need for a clear distinction between these objectives, determining whether conflicts may arise between them and making clear how any conflict should be handled.

3.47 Recommendation 7

The Attorney-General's Department should examine whether clearer separation between the commercial and non-commercial objectives of the Legal Practice is needed.

Experience with Setting Objectives

3.48 AUSCRIPT, which was formed from the former Commonwealth Reporting Service in 1990, is one of three business units in the Attorney-General's Department. The commercialisation of AUSCRIPT was the subject of an audit report in 1992, *Audit Report No. 6, 1992-93, AUSCRIPT, Commercialisation of the Commonwealth Reporting Service*. As noted in paragraph 3.27, in that report the Auditor-General

³⁶ *ibid.*, pp. 2372-3; the exceptions to the option of user-choice were listed in the submission from the Attorney-General's Department, pp. S1145-7 (Vol. 3 of Submissions).

³⁷ Lawyers Sub-Division, Professional Division, Public Sector Union, *Submission*, p. S2097 (Vol. 6 of Submissions).

noted that there was ambiguity in the broad policy direction set for AUSCRIPT and no clear statement of expected outcomes.³⁸

3.49 One area in which there was ambiguity in the setting of objectives was in relation to AUSCRIPT's initial long term strategy to develop a non-Commonwealth clientele. In focusing on attracting non-Commonwealth clients, AUSCRIPT had failed to take account of the constitutional framework within which all government entities must operate.³⁹ The Government may only carry out commercial activities in those areas where the Commonwealth has constitutional power to act. Moreover, the provision of commercial services to non-Commonwealth clients is limited to what can be accommodated by the resources that are maintained to meet the Government's demand for work.⁴⁰ This issue is discussed further in Chapter 2, paragraphs 2.50 - 2.57.

Experience of Dealing with Conflicting Objectives

3.50 In spite of DAS's efforts, as outlined in paragraphs 3.38 - 3.39 above, its commercialised ventures have been the subject of criticism. The most detailed study of the impact of conflicting objectives was carried out by the Auditor-General; his findings are detailed below. In addition, a number of private sector businesses, competitors to DAS businesses, complained to the Committee about:

- the conflict of commercial with social objectives in some businesses;

³⁸ Australian National Audit Office, *Submission*, p. S301 (Vol. 1 of Submissions).

³⁹ The Auditor-General, *Efficiency Audit, AUSCRIPT, Commercialisation of the Commonwealth Reporting Service*, Audit Report No. 6, 1992-93, AGPS, Canberra, 1992, p. 11.

⁴⁰ D Jessop, Senior General Counsel, Attorney-General's Department, 'Commercial activities of the Commonwealth: constitutional principles', November 1992; the paper formed Attachment I to DAS' initial submission (DAS, *Submission*, pp. S375-6, Vol. 1 of Submissions).

- the difficulty of DAS's businesses providing objective advice in relation to activities with which the businesses are competing for work with the private sector; and
- the absence of sufficient information about the mode of operation of DAS businesses.

Some of these complaints are dealt with in this section.

Comments by the Auditor-General

3.51 In his submission, the Auditor-General highlighted the potential for conflict of interest when a public sector entity adopts commercialisation and moves into a more competitive, service delivery mode of operation while retaining some traditional public service functions. He cited several examples of such potential conflicts, including the involvement of DAS as a tenderer and adviser in information technology (IT) acquisitions.⁴¹ In his Report No. 43 of 1991-92, he commented that, with DAS's establishment of 'chinese walls', 'it had done all it can within existing Administrative Arrangements to address the issues and concerns ... concerning the potential for conflict of interest in IT acquisitions'.⁴² However, the resultant arrangements relied for their success on the commitment, integrity and honesty of individual officers. The Auditor-General believed that the possibility of these officers being faced by a conflict of interest should be reduced to a minimum. He recommended that consideration be given to divesting DAS of one of the roles it currently performed.⁴³ The Committee notes that DAS's draft *Guidelines for Business Conduct* emphasises the explicit separation of procurement, supply and regulatory services.⁴⁴

41 Australian National Audit Office, *Submission*, p. S301 (Vol. 1 of Submissions).

42 The Auditor-General, *Project Audit, Department of Administrative Services, Conflict of Interest: a Matter of Principle*, Audit Report No. 43, 1991-92, AGPS, Canberra, 1992, p. 18.

43 *ibid.*, pp. 16-7.

44 DAS, *Submission*, p. S2306 (Vol. 7 of Submissions).

3.52 At a public hearing before the Committee, the Australian National Audit Office made the following general point about the potential for conflict of interest in newly commercialised areas of the public sector:

*... I think it is probably not unreasonable to say that the potential does exist. We were concerned, in this particular example, that it was an opportunity for us to raise the issue as a question of principle and say that, in going down the commercialisation path, it is fundamental that people recognise that this is a risk that has to be dealt with. In DAS's case we said that they had done all that we believed was possible within the current departmental structure to manage the risk. But given that it was a question of a matter of principle, we felt that there was a need to take it out of the administrative structure and place it somewhere else - at least one of those functions. But I think the principle is that organisations need to be conscious of that risk and guard against it.*⁴⁵

Comments by the Department of Administrative Services and its Businesses' Competitors

3.53 In commenting on the Australian Property Group (APG), Interiors Australia and Australian Construction Services (ACS), the REIA raised the existence of CSOs as a source of conflict. It suggested in relation to the APG that:

*Once it has that community service obligation within its charter, it pretty well cannot be considered as a commercial operation, unless you can clearly show what are the costs of that community service obligation and take those out of the accounts.*⁴⁶

As an alternative, REIA proposed that responsibility for CSOs be given to a non-commercial department or branch.

45 Australian National Audit Office, *Transcript*, pp. 106-7 (Canberra, 8 November 1993).

46 REIA, *Transcript*, p. 373 (Canberra, 6 December 1993).

3.54 The Committee notes that, where DAS businesses have CSOs, the CSOs have been defined and are funded from the Budget. The Committee believes that these arrangements remove the conflict that might face an agency charged with both commercial and social objectives. Furthermore, DAS reported that CSOs:

... remain under review in consultation between DAS and DoF [Department of Finance] to further refine the conditions under which work is carried out, and to maintain the transparency of costings and ensure effective lines of accountability for activities funded through this mechanism'.⁴⁷

3.55 DAS commented in this connection that:

Each businesses' performance in terms of asset utilisation and the appropriate expenditure of Budget funds on Community Service Obligations is much more clearly identified and analysed than was the case under the pre-commercialisation arrangements, when cash-based accounting and direct appropriation of funds to the mandated supplier meant that the true state of affairs was much more difficult to discern through normal scrutiny of the accounts. The net result is that DAS' commercialised activities are now more accountable than they were prior to commercialisation. While this carries with it inherent costs to the operations of the businesses, the Government has decided to retain a high level of accountability and external scrutiny for the commercial areas of DAS.⁴⁸

3.56 The steps taken by DAS and Finance appear to match those that the REIA called for in terms of reporting on CSO performance. The Committee commends the attempts by DAS and Finance to make the costs of meeting DAS business units' CSOs as transparent as possible.

⁴⁷ DAS, *Submission*, p. S2307 (Vol. 7 of Submissions).

⁴⁸ *ibid.*, p. S2305. Details of Budget funds appropriated for CSOs by each business unit are published in DAS' annual report.

3.57 In its submission, REIA questioned whether a government department could provide objective advice to the Government in relation to activities in which that department has business units competing with the private sector:

REIA considers that there would definitely be a conflict of interest in ... [such a situation]. It is important, that in the establishment of the commercial unit, any advisory or regulatory role be handed to another agency.⁴⁹

3.58 The Association of Consulting Engineers Australia (ACEA) made a similar point with respect to ACS:

A conflict of interest may arise, or be perceived, if [ACS] has the dual role of advising government on project definition and then competing with ACEA members for commissions. Clearly considerable commercial advantage would accrue to [ACS] under these circumstances and the result may not be in the best interest of the Government. [ACS] should separate its advisory and commercial functions, both of which must be fully accountable.⁵⁰

3.59 The Australian Security Industry Association (ASIAL), writing in relation to Australian Protective Services, claimed that it had evidence of just such a conflict of interest. Furthermore, it believed that 'virtually without exception, when commissioned to act as a consultant for the provision of security services, APS [Australian Protective Services] responds by recommending that it should provide the appropriate services'.⁵¹

3.60 DAS's draft *Guidelines for Business Conduct* provide guidance on identifying and resolving real or potential conflicts of interest. Apart from the explicit separation of procurement, supply and regulatory services, the Code requires DAS employees to ensure that:

⁴⁹ REIA, *Submission*, p. S469 (Vol. 2 of Submissions).

⁵⁰ ACEA, *Submission*, p. S230 (Vol. 1 of Submissions).

⁵¹ ASIAL, *Submission*, p. S1625 (Vol. 4 of Submissions).

- commercial-in-confidence information is restricted to the appropriate areas and staff; and
- the DAS businesses are not placed on a common use contract as a sole supplier.

The Code warns that:

On some occasions there may be a perceived or actual conflict of interest. Such conflicts or potential conflicts must be identified and referred up the management line for resolution as required.⁵²

3.61 The General Manager of Asset Services commented that Asset Services was not often confronted by conflicts of interest. He made the point that:

In a construction job, a customer may hire a consultant, such as ACS or DAS Interiors, as its designer and project manager for a particular job and we in Asset Services may tender to the customer for the actual construction of that job. We would not see any conflict of interest in that and the customers would not, or they would not permit it. Generally, under those circumstances, the customer would organise for tenders to be provided to their tender box rather than to, say, the ACS tender box so that the tenders were opened on the customer's premises.⁵³

The tenor of remarks by ACS's General Manger was similar; he claimed that conflicts of interest do not arise for ACS. He added:

Historically, we used to fulfil both roles, project manager and consultants, but it has become increasingly the case over the past two years that our clients, in particular Defence, appoint a separate project manager, normally from the private sector, and we will then act in the role of consultant to the project manager.⁵⁴

⁵² DAS, *Submission*, pp. S2347 (Vol. 7 of Submissions).

⁵³ DAS, *Transcript*, p. 322 (Canberra, 6 December 1994).

⁵⁴ *ibid.*, loc. cit.

Conclusion

3.62 It appears to the Committee that the arrangements that DAS has put in place, supplemented by vigilance on the part of the customer, should ensure that DAS businesses are not exposed to conflicts of interest.

3.63 However, ACS's competitors have a very different view of the extent to which ACS is exposed to conflicts of interest and the deleterious effect that it has on them. While not in a position to gauge the full extent of complaints from ACS's competitors, the Committee is concerned that organisations like the ACEA have reported complaints from a number of members of the Association. Irrespective of the merits of the individual complaints, it would appear that the perception of multiple roles for ACS creates suspicion and criticism from some members of the building and construction industry, and the existence of procedures for avoiding conflict of interest are not sufficient to remove this suspicion. In these circumstances, the Committee believes that DAS should consider whether the relevant sections of the draft *Guidelines for Business Conduct* should be modified to provide better guidance with respect to the alleged problems that have arisen.

3.64 Recommendation 8

The Department of Administrative Services should review the relevant sections of its draft 'Guidelines for Business Conduct' with a view to ensuring that all steps have been taken to minimise the possibility of conflict of interest.

3.65 The Committee has not carried out an in-depth investigation of the claims of the two sides in relation to ACS. However, because of the very different views that DAS business units and their competitors have of the extent of conflict of interest in the operations of these businesses, the Committee believes that such an investigation should be undertaken. Furthermore, the Committee is aware that other DAS business units may also be exposed to conflicts of interest and believes that the extent of this should be established and action taken to reduce it.

3.66 Recommendation 9

The Department of Administrative Services should appoint an independent panel comprising representatives from the Department and relevant industry groups to investigate the extent to which conflicts of interest exist for its businesses, and whether the mechanisms established by the Department of Administrative Services are adequate to resolve any conflicts that arise. The panel should aim to recommend measures to reduce the likelihood of conflict.

3.67 The Committee believes that DAS could also reduce some of the criticisms about conflict of interest that its competitors have levelled at the DAS businesses by explaining its current approach more effectively to the industry. The need for better explanations to the industry was made at a public hearing by the Association of Aerial Surveyors, Australia (AASA):

... AASA has been left with a strong impression of DAS giving explanations of what they are doing, rather than justifying or explaining why they are doing it. They are giving explanations, but no adequate reasons for it, no justifications.⁵⁵

3.68 On the other hand, DAS informed the Committee about the steps it had taken to inform the industry about its commercial and non-commercial functions and its cost structures compared with its competitors. In similar vein, Attorney-General's described action that had been taken to explain to ASIAL the situation of Australian Protective Services in relation to its costs compared with private sector competitors.⁵⁶

3.69 The Committee accepts as appropriate the steps taken by these departments to explain their approach to their competitors, and would expect further efforts along these lines to result in reduced levels of complaint.

⁵⁵ AASA, *Transcript*, p. 512 (Canberra, 31 January 1994).

⁵⁶ DAS, *Transcript*, pp. 316, 318-9 (Canberra, 6 December 1993), p. 478 (Canberra, 31 January 1994); Attorney-General's Department, *Submission*, pp. S2381, 2385-8 (Vol. 7 of Submissions).

3.70 The Committee notes that industry allegations of conflicts of interest were closely linked with complaints about unfair competition by government businesses. This topic is discussed in Chapter 8 of the Report.

The Case of the Australian Surveying and Land Information Group

3.71 The Australian Surveying and Land Information Group (AUSLIG) provides another example of where perceived conflict has arisen between public interest programs and commercial operations. AUSLIG is a DAS business which provides a wide range of land-related information services. In line with government decisions, AUSLIG has been charging clients for commercial services from 1 January 1989 and commenced operating on a trust account basis from 1 July 1989. From 1 July 1990, AUSLIG's former tied clients have been able to choose alternative suppliers. The balance of AUSLIG's funding is derived from its public interest program.⁵⁷

Complaints from Competitors of the Australian Surveying and Land Information Group

3.72 In submissions and at public hearings, the Committee learnt that the focus by AUSLIG on its commercial objectives was perceived to be at the expense of its public interest responsibilities, and was the subject of complaint from AUSLIG's competitors.

3.73 The principal concerns raised by AUSLIG's competitors were:

- the potential for conflict between AUSLIG's public interest and commercial activities;
- the disadvantage of competing with a body that is also the custodian of the national database; and

⁵⁷ AUSLIG, *Transcript*, p. 475 (Canberra, 31 January 1994); the public interest program constitutes about 70 per cent or \$25million of AUSLIG's overall business.

- the negative effect on the maintenance of the national database of AUSLIG's concentration on its commercial role.

3.74 In its submission, AASA stated its concerns about AUSLIG's role as the custodian of the national surveying and mapping databases to which its competitors require access in order to survive:

This [co-ordination and maintenance] role is compromised by AUSLIG being in competition with its private-sector counterparts because ...

Private surveying and mapping companies make use of national data kept by AUSLIG. Private companies now compete with AUSLIG. Consequently, private companies feel disadvantaged to be competing with the custodians of the information.⁵⁸

3.75 Both AASA and the Association of Consulting Surveyors Australia (ACSA) affirmed that the commercialisation of AUSLIG's operations had led to a deterioration in the quality of national mapping information, due to reduced production of public interest data. At a public hearing, ACSA claimed that:

... our maps are so far out of date. The reason for that is that in New South Wales and in many of the other states, as with AUSLIG, the main concentration now is not on the mapping of our country but rather on commercial activities.⁵⁹

Criticisms about the accuracy of some mapping series information maintained by AUSLIG were also raised at the public hearing.

58 AASA, *Submission*, p. 8 255-6 (Vol. 1 of Submissions). AASA also raised the issue of private sector businesses being required to inform AUSLIG of their intended use of any data they accessed; this was seen as giving AUSLIG an unfair advantage over its competitors. However, AUSLIG indicated that this requirement has been removed (DAS, *Transcript*, p. 524 (Canberra, 31 January 1994)).

59 ACSA, *Transcript*, p. 497 (Canberra, 31 January 1994).

Comments from the Surveyor-General of New South Wales

3.76 At a private meeting with the Surveyor-General of New South Wales, Mr D Grant, the Committee heard that the combination of commercial and public interest roles in AUSLIG had created difficulties. While AUSLIG competes for Commonwealth and private sector business in mapping, it also advises the Government on funding for the State mapping programs. Mr Grant maintained that this creates a conflict of interest, since AUSLIG cannot simultaneously perform the role of 'honest broker' in terms of the national interest at the same time as it is advising the Government and competing for work against the other tenderers, both private enterprise and State government agencies.

Response by the Australian Surveying and Land Information Group

3.77 AUSLIG acknowledged that 'under the existing level of resources we will never be able to have both scales [of maps, 1:100,000 and 1:250,000] completely up to date, digitised and in paper map form'.⁶⁰ It maintained, however, that its first priority 'is to continue to deliver an effective and efficient public interest program'.⁶¹

Possible Solutions

3.78 The Committee believes that a possible solution to these problems would be to separate the public interest and commercial functions of AUSLIG. One suggestion made to the Committee during discussions with the Surveyor General of New South Wales was the creation of the office of Commonwealth Surveyor-General, which would be organisationally separate from the survey and mapping operations of AUSLIG. It was envisaged that this office would advise the Government on national mapping issues, such as funds allocation to the States and to AUSLIG for public interest

60 AUSLIG, *Transcript*, p. 481 (Canberra, 31 January 1994).

61 AUSLIG, *Transcript*, p. 476 (Canberra, 31 January 1994).

survey and mapping programs. A Surveyor-General might also coordinate mapping activities in Australia, which is a field where the Committee heard claims of overlapping effort.⁶²

3.79 Recommendation 10

The Government should examine the advisability of creating an agency separate from the Australian Surveying and Land Information Group to carry out such functions as providing advice, coordinating national mapping activities and maintaining the database. This study should be carried out in conjunction with State and private sector mapping interests.

Conclusion

3.80 From its examination of the Commonwealth's experience of commercialisation, the Committee has concluded that the need for clear, non-conflicting objectives is understood, but has not been fully translated into practice. The Committee has made recommendations to that effect where it has identified shortcomings in the clear definition of objectives and the handling of conflict between multiple objectives.

3.81 In relation to GBEs, the Committee is of the view that GBEs generally have been established with clearly defined objectives. However, care needs to be taken in cases where multiple objectives are involved, to ensure that the objectives are complementary and not conflicting. The case of the CAA illustrated the importance of this principle.

3.82 The Committee identified another important factor in the successful operation of GBEs, which is that the primary focus should be placed on their commercial objectives, while

⁶² D M Grant and B Krogh, *Cadastral Development in New South Wales: Philosophy, Politics and Polarisation*, XXth International Congress of the International Federation of Surveyors, Melbourne, March 1994, p. 7. AUSLIG, however, disputed that duplication occurred (DAS, *Transcript*, pp. 478-9, Canberra, 31 January 1994).

any social obligations placed on them by the Government should be clearly defined and communicated. The problems caused by inadequately defined social objectives for GBEs are considered in detail in Chapter 4.

3.83 The Committee considers that the objectives of business units within departments of state are less well defined than for GBEs. Indeed, the need for clear, non-conflicting objectives, and the principle that different functions be separated from one another, apply just as much to business units as they do to GBEs. In the Committee's view, there is evidence of greater confusion between commercial and public policy objectives in the case of business units. This situation creates the risk of uncertainty in the minds of staff, clients and competitors, with the likely outcome of reduced efficiency and productivity.

3.84 The problems identified in AUSCRIPT and AUSLIG with respect to conflicting or unclear objectives, point to the need for further development of the policy framework for business units. All departments of state which contain business units also need to draw upon the experience gained by early leaders in the field of commercialisation, such as DAS, in order to develop clear policy guidelines in conjunction with the central coordinating agencies. The Committee has made several recommendations to this effect.

COMMUNITY SERVICE OBLIGATIONS

Introduction

4.1 There are a number of reasons why governments undertake to supply goods and services to the public and to their own agencies. It may be because the private sector is unable or unwilling to do so; it may be because governments consider that the presence of their businesses in the market will cause the market to operate more efficiently. Whatever the reason, the decision is made in the light of governments' perception of the public interest. When the supply of these same goods and services is commercialised, it is necessary to consider whether public interest considerations still apply to their provision. This is particularly the case in ensuring universal access to essential services, such as water, power and communications. A mechanism that has been developed to guarantee access for all to essential services is the community service obligation (CSO).

4.2 The Committee recognises that, as the Public Interest Advocacy Centre pointed out, CSOs are still a 'pioneering area' where much work is required to reach a satisfactory conceptual and practical framework for their delivery.¹ Accordingly, the Committee has devoted most of this chapter to discussing the issues involved and identifying where further work is needed. Given the complexities that exist in the area, finding robust solutions to the issues that CSOs raise will be challenging.

¹ Public Interest Advocacy Centre, *Transcript*, p. 2249 (Canberra, 18 August 1994).

Definition of Community Service Obligations

General Definitions

4.3 In a recent publication on CSOs, the Steering Committee on National Performance Monitoring of Government Trading Enterprises (GTEs) provided the following as its 'preferred definition':

A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it [the public enterprise] would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it [the public enterprise] would only do commercially at higher prices.²

4.4 The significant characteristics of a CSO are that:

- it arises as the result of a government directive relating to the conditions of supplying a specific service;
- the service would not otherwise be supplied under the same conditions, as a commercial decision; and
- the service provides an identifiable community or social benefit, which usually has distributional objectives relating to financial and geographic equity.

However, as the Steering Committee points out, 'there is considerable ambiguity associated with each of these characteristics and considerable scope for different interpretations of their practical meaning'.³

² Steering Committee on National Performance Monitoring of Government Trading Enterprises, *Community Service Obligations: Some Definitional, Costing and Funding Issues*, April 1994, p. 49.

³ *ibid.*, p. vii; Industry Commission, *Rail Transport, Volume I: Report*, Report No. 13, AGPS, Canberra, August 1991, p. 82.

4.5 CSOs may specify:

- that the service be supplied at a uniform or affordable price to all consumers; or
- that price concessions be granted to special groups of consumers; or
- that particular inputs be used.⁴

Specific Examples

4.6 The discussion above relates principally to GBEs that supply services directly and widely to members of the public. Examples of such CSOs are Telstra's telephone service and Australia Post's letter post. However, the term, CSO, is also used in a slightly different context to describe other activities carried out in the public interest. For example, the Department of Administrative Services (DAS) referred to its businesses' CSOs as 'work undertaken for the Commonwealth at large, as opposed to any single department or agency'.⁵ The Memorandum of Understanding between the Department of Finance (Finance) and DAS that relates to the financial framework for DAS's Business Trust Account indicates that CSOs are 'non-commercial activities undertaken by DAS businesses as required by government, for which no specific client can be identified or which cannot reasonably be charged to clients'.⁶

4.7 Specifically, DAS listed the CSOs of its businesses in 1993-94 as being:

- national mapping, geodesy and remote sensing by the Australian Surveying and Land Information Group (AUSLIG), which cost \$22.69m;
- protection of public health and Australian exports through analytical testing, specialist advice, industry standards and research by the Australian Government Analytical Laboratories (AGAL), at a

⁴ Steering Committee on National Performance Monitoring of Government Trading Enterprises, *op. cit.*, p. viii.

⁵ DAS, *Submission*, p. S347 (Vol. 1 of Submissions).

⁶ *ibid.*, p. S371.

- cost of \$5.6m;
- editorial and design, standards and guidelines, Commonwealth cataloguing, Ministerial Document Service, provision of legislation and Government information by the Australian Government Publishing Service, which cost \$5.96m;
- information and advice to Government, Government support to quality assurance in the building industry, and protection of public interest by the Australian Construction Service, costing \$2.6m;
- information and advice to Government, Government support to quality assurance in the building industry, and protection of public interest by the Interiors and Asset Services, at a cost of \$0.1m and \$1.87m respectively; and
- safety and security costs involved in COMCAR's provision of a chauffeured car service to the Governor-General, Members of Parliament and Senators, the Judiciary and VIP guests of the Government, which amounted to \$3m.

In 1993-94, DAS businesses expended \$39.3m, or 4.5% of DAS's total commercial revenue, on meeting their CSOs.⁷

4.8 The Australian Quarantine and Inspection Service (AQIS) anticipated spending approximately \$50m of its 1993-94 budget funds on its CSOs to provide:

- barrier control functions in the quarantine area;
- compliance functions relating to a royal commission into meat substitution;
- international activities; and
- services to Ministers and the Parliament.⁸

4.9 In the Attorney-General's Department (Attorney-General's), AUSCRIPT received \$0.8m of budget funding in 1993-94 for CSOs, such as providing public address systems in court buildings and maintaining the infrastructure for record-

⁷ DAS, *Submission*, pp. S2307-8 (Vol. 7 of Submissions).

⁸ Department of Primary Industries and Energy, *Submission*, p. S1238 (Vol. 3 of Submissions); *Transcript*, p. 616 (Canberra, 4 February 1994).

ing proceedings. In the same year, \$7.4m was appropriated to the Legal Practice for services to the Attorney-General or the Parliament and \$31.3m for certain legal services relating to:

- the provision of legal advice to Cabinet, Ministers, or departments on existing or proposed Cabinet submissions or memoranda and on legislative proposals and draft legislation;
- the provision of policy advice within the Attorney-General's portfolio;
- the provision of assistance with Government policy, program or administrative development; and
- the preparation of public international law and treaties, and drafting of subordinate legislation, proclamations and other types of legislative instruments.⁹

Identifying, Costing and Funding Community Service Obligations

Introduction

4.10 In the past when goods and services were supplied by a GBE in pursuit of the Government's social objectives, their cost was met by cross-subsidisation from the profitable areas of the GBE's operations or by a general government contribution towards operating deficits. More recently, the Government has sought to use its resources more efficiently by establishing precisely the nature and cost of goods and services provided as CSOs and, on the basis of that information, deciding whether subsidies for them are justified.

4.11 This process is described in the Accountability and Ministerial Oversight Arrangements. They require Ministers to be explicit about the objectives of CSOs within their

⁹ Attorney-General's Department, *Submission*, pp. S1145-7 (Vol. 3 of Submissions).

portfolios, to specify the nature of the obligations (which are to be met a minimum cost), and to make the costs transparent.¹⁰

Identifying Community Service Obligations

4.12 Identifying CSOs is important because it 'ensures there is no confusion about government intentions and the obligations of boards'.¹¹ It can, however, be difficult. As Finance pointed out to the Committee, there are times when a fine judgement must be made about whether or not an activity is a CSO:

... whether the organisation would have commercially followed a course in its own interest or not. For example, we have the sense that there is a greater degree of uniformity in pricing across the country in a lot of private companies that operate nationally than you might expect if they were just simply matching local costs with local prices, so they clearly do not do that. So being able to decide what degree of uniformity there is in pricing across the country, as an example, is a business judgment that the business would normally make and how much is something which the government has imposed is not necessarily easy either.¹²

4.13 Finance described how a new CSO is identified.

- A GBE and its portfolio department makes a case to their Minister for a particular activity to be considered as a CSO;
- The claim is checked by Finance and the Minister is advised accordingly; and
- The portfolio minister and the Minister for Finance take the proposal to Cabinet for approval.¹³

¹⁰ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, p. 2.

¹¹ Finance, *Submission*, p. S2259 (Vol. 7 of Submissions).

¹² Finance, *Transcript*, p. 2393 (Canberra, 17 October 1994).

¹³ Finance, *Transcript*, pp. 72-3 (Canberra, 8 November 1993).

4.14 In some cases CSOs are detailed in the legislation relating to the GBE. For example, the requirement for Australia Post to deliver letters to all homes and businesses in Australia is specified in the organisation's enabling legislation and amplified in other supporting documentation.¹⁴ Similarly, Telstra's obligation to provide a standard telephone service throughout the country (with financial support from its competitors) is prescribed in its enabling legislation.¹⁵

4.15 During the course of the Inquiry the Committee received representations from a number of community organisations arguing that, when identifying new CSOs, GBEs should consult with consumers and their representatives.¹⁶ The Committee acknowledges that some GBEs consult extensively in relation to their CSOs. For example, Telstra, and the telecommunications industry regulator, AUSTEL, have access to advice and the points of view from a number of groups that represent the interests of different groups of users. Australia Post has also sought community input on issues relating to the letter service by setting up the Postal Services Consultative Council.

4.16 The Committee applauds these initiatives but believes that more needs to be done:

- in the first place, to extend the system of consultation; and
- secondly, to analyse proposed new CSOs in the broader context of the Government's social justice strategy.

¹⁴ Australia Post, *Submission*, p. S2212 (Vol. 6 of Submissions).

¹⁵ AUSTEL, *Submission*, pp. S2175-6 (Vol. 6 of Submissions).

¹⁶ Australian Council for Social Services, *Submission*, p. S2125 (Vol. 6 of Submissions); Public Interest Advocacy Centre, *Submission*, p. S2147 (Vol. 6 of Submissions).

4.17 Recommendation 11

In identifying new community service obligations, the Department of Finance, in conjunction with relevant government business enterprises and portfolio departments, should:

- (a) *seek and consider input from relevant community groups and interested parties; and*
- (b) *analyse the proposed new community service obligations in the light of the Government's broad social justice policy objectives.*

Implicit Community Service Obligations

4.18 In spite of the requirement in the *Accountability and Ministerial Oversight Arrangements* that CSOs be specified, several GBEs pointed out to the Committee that, although they provided what they considered to be CSOs, these obligations were not explicitly required by law or agreement. The Australian National Railways Commission (AN) told the Committee that:

... there is no explicit recognition that the passenger business is a CSO. Nevertheless, we do get a revenue supplement for the business. But ... nothing was ever written down that said the passenger business is a CSO.¹⁷

4.19 Similarly, the Federal Airports Corporation (FAC) has no explicitly named CSOs. However, it does operate its loss making airports by cross subsidy from the profitable ones; this could be regarded as a CSO. Furthermore, it provides facilities for aircraft supplying emergency services as well as rent-free accommodation for customs, quarantine and immigration activities. In this connection, the Prices Surveillance Authority

¹⁷ AN, *Transcript*, p. 1704 (Sydney, 15 June 1994). In 1992-93, the Budget supplement to AN was \$59m (Transport and Communications, *Annual Report*, AGPS, Canberra, 1993, p. 98), and in 1993-94 was expected to fall to \$45m (*Program Performance Statements*, p. 326).

(PSA) commented that the FAC's provision of these latter services contains 'some element of a CSO'.¹⁸

4.20 The Civil Aviation Authority (CAA) also made the point to the Committee that it had no explicit CSOs, although its search and rescue and air safety regulation functions could be considered to be CSOs.¹⁹ It commented in its submission that the Government had not yet fully defined the community service and social objectives of the CAA.²⁰ In addition to search and rescue and air safety regulation, the CAA specified two further activities as also requiring clarification:

- network pricing of its air traffic services, under which system standard prices are charged in all parts of the network, irrespective of the costs of providing services at different locations;²¹ and
- 'how the CAA should actively participate in facilitating Australian industry development'.²²

4.21 In discussing the network pricing system used for the FAC's aeronautical charges, the PSA asked:

*... are some of these airports effectively providing community service obligations? What we say there is that if they are they should be very clearly identified. In other words, that requires a clear government specification that there is a CSO attached to those airports, that the CSO ought to be directly costed, and funded in the most appropriate way.*²³

¹⁸ PSA, *Inquiry into the Aeronautical and Non-Aeronautical Charges of the Federal Airports Corporation*, August 1993, p. 189.

¹⁹ CAA, *Transcript*, p. 1437 (Sydney, 20 May 1994).

²⁰ CAA, *Submission*, p. S527 (Vol. 2 of Submissions).

²¹ A similar arrangement existed in the FAC's aeronautical charges until recently when it responded to the PSA's report on its aeronautical and non-aeronautical charges by moving towards location specific, cost based pricing (FAC, *Transcript*, p. 1874, Canberra, 6 July 1994).

²² CAA, *Submission*, p. S527 (Vol. 2 of Submissions).

²³ PSA, *Transcript*, p. 664 (Canberra, 4 February 1994).

4.22 The Bankstown Airport Chamber of Commerce commented on similar lines that:

*The immediate priority of government to the general aviation industry and the wider Australian community must firstly be to identify all the CSOs for all to see and to classify who is responsible for each and every one of them.*²⁴

4.23 Finance observed that "implicit" CSOs relate to services which are not clearly identified by the Government as being CSOs.²⁵ The Committee agrees that this is true in some of the instances listed above, for example, the use of network pricing by the CAA and FAC. In other cases, there appears to be a gulf between Finance's and the businesses' views of what is or is not definitely a CSO. Finance states categorically that:

*Where CSOs are Budget funded (for example CSOs carried out by the Civil Aviation Authority, the Australian Maritime Safety Authority and the Australian National Railways Commission) they are specified in Budget Paper No 1.*²⁶

The CAA and AN were, by contrast, not clear on this point.

4.24 As one of the principal purposes of specifying CSOs is to clarify the intentions of the Government and the obligations of GBE boards, it is clearly unsatisfactory that there is some confusion over the provision of implicit CSOs. It is important that a more rigorous approach to the identification and classification of such CSOs be adopted. Without such an approach the GBE may be unclear about its responsibilities, costing the CSO will present problems and it will be difficult to assess the performance of the GBE in delivering the CSO.

²⁴ Bankstown Airport Chamber of Commerce, *Transcript*, p. 1658 (Sydney, 20 May 1994).

²⁵ Finance, *Submission*, p. S2259 (Vol. 7 of Submissions).

²⁶ *ibid.*, p. S2261.

4.25 Recommendation 12

The Department of Finance should coordinate a review of all activities by commercialised entities which appear to be 'implicit' community service obligations. The review should make explicit the exact nature of any such community service obligations and recommend how they should be costed and funded.

4.26 With the Government's recent decision to lease the airports operated by the FAC, the Committee believes that the need to examine the FAC's implicit CSOs assumes particular importance. The Committee understands that some of the implicit CSOs listed in paragraph 4.19 are being considered in the context of setting up a regulatory framework for the FAC's airports. If the Government accepts that these implicit CSOs are indeed CSOs, their mode of funding will need to be settled quickly. The Government will also need to consider whether the services should be provided under contract by the new owner, be written into the terms and conditions of the leases, or be provided by a separate Government agency.

4.27 Recommendation 13

Before the future of the airports currently operated by the Federal Airports Corporation is settled, the Departments of Transport and Finance should:

- (a) *identify and assess any 'implicit' community service obligations in the operations of the airports; and*
- (b) *agree on appropriate methods for the future delivery and funding of the community service obligations.*

4.28 The point made in paragraph 4.26 is one that applies generally in any case of GBE privatisation. The Committee's recommendation in respect of the FAC can therefore be cast in a more general form as follows.

4.29 Recommendation 14

Before any government business enterprise is privatised, the Department of Finance and relevant portfolio departments should review the community service obligations, both explicit and implicit, delivered by the government business enterprise and determine:

- (a) *whether the community service obligations should be provided after privatisation; and, if so*
- (b) *how they will be delivered and funded.*

Costing Community Service Obligations

4.30 In a submission to the Inquiry, Finance outlined the reasons for requiring CSOs to be costed. Information about CSO costs allows assessment of:

- the opportunity cost of providing CSOs;
- whether CSOs are being provided at minimum cost, as is required;
- whether the Government is over compensating GBEs for providing CSOs by excessive budget funding;
- the impact of those CSOs which are cross-subsidised on the overall performance of a GBE; and
- whether CSO funding is giving GBEs operating in competitive markets an unfair advantage.²⁷

4.31 The practical issue to be addressed in costing a CSO is by how much total costs change when that CSO is carried out, compared to any revenue derived from it. Technically, to cost CSOs can be a time consuming and expensive exercise. The Steering Committee on National Performance Monitoring of GTEs recommends the avoidable cost approach. However, the Steering Committee believes that the method should be modified to suit the circumstances of each GBE, and points out

²⁷ *ibid.*, p. S2264.

that the costing of CSOs raises a number of complex issues.²⁸ The important point, according to Finance, is to avoid cost plus pricing, as this approach dulls the incentive to improve efficiency.²⁹

4.32 The Steering Committee also commented that 'perhaps the most definite conclusion that can be made is that the pursuit of precision in the costing of CSOs is likely to prove fruitless and yet be very costly'.³⁰ The PSA made the same point:

*Invariably, estimation of the costs of providing a CSO will require some judgments about allocation of costs (such as what is avoidable and what is not), the level of service which would be on offer, and the level of demand in the absence of the CSO. In practice, there is likely to be some trade-off between precision and the time and resources devoted to such a measurement exercise.*³¹

4.33 An example of some of the difficulties that can arise in costing a CSO was provided by AQIS at one of the Committee's hearings:

*... part of our operations are cost recovered and the barrier operations are funded through the CSOs. It is not easy to look at a particular quarantine officer and say that he or she at some point in time is obviously one or the other. There will always be some grey areas in that.*³²

28 Steering Committee on National Performance Monitoring of Government Trading Enterprises, op. cit., p. 46.

29 Finance, *Submission*, p. S2261 (Vol. 7 of Submissions).

30 Steering Committee on National Performance Monitoring of Government Trading Enterprises, *Community Service Obligations: Some Definitional, Costing and Funding Issues*, April 1994, p. 45.

31 PSA, *Inquiry into the Aeronautical and Non-Aeronautical Charges of the Federal Airports Corporation*, August 1993, p. 186.

32 Department of Primary Industries and Energy, *Transcript*, p. 625 (Canberra, 4 February 1994).

A similar point was made by DAS in relation to businesses like AGAL or AUSLIG: 'what do you count on that side of the fence and what do you count on the other side of the fence?'³³

4.34 Australia Post expanded on the complexity of accurately costing CSOs in its 1992 Annual Report:

*The methodology prescribed for the estimation of the cost of CSOs is very complex. It requires the collection of considerable amounts of data and the making of a range of assumptions. ... Australia Post has reservations about the usefulness and realism of the results produced by this methodology.*³⁴

Telstra made a similar point in evidence to the Committee:

*Regarding USO [universal service obligation] costing in telecommunications, Telstra would comment that the process of costing, and the reimbursement of the universal service carrier via the universal service fund, has proven to be administratively complex and time consuming.*³⁵

4.35 Simply put, the telecommunications USO is to ensure that payphones and a standard telephone service are reasonably accessible to all Australians on an equitable basis. An elaborate model has been developed to cost the delivery of this USO. The operational experience of this model may give some indication of the types of problem that can arise in costing CSOs.

4.36 As AUSTEL pointed out, the model was developed in 1989; it was produced within a short time frame before competition was introduced and the network modernised. Both Vodafone and Optus have expressed their reservations about the methodology, while AUSTEL has indicated that the current framework for costing CSOs does not allow for the impact of competition on the calculation and should be

33 DAS, *Transcript*, p. 274 (Canberra, 8 November 1993).

34 Australian Postal Corporation, *1992 Annual Report*, p. 65, reproduced in Australia Post, *Submission*, p. S2224 (Vol. 6 of Submissions).

35 Telstra, *Submission*, p. S2120, (Vol. 6 of Submissions).

modified to do this. For example, AUSTEL believes there must be:

- a methodology that takes into account the effects of competition and clearly delineates USO responsibilities from commercially driven outcomes;
- scope for changing the methodology in the light of changes not anticipated at the time the framework was put in place;
- strong external scrutiny during the development of the USO costing methodology;
- procedures for checking claims that rely on confidential material; and
- an agreed dispute resolution mechanism.³⁶

The Committee notes that AUSTEL has launched a review of the methodology used to estimate the cost of Telstra's USO.

4.37 Although the Committee is concerned by the very considerable expense and effort required to cost some CSOs, the costing of CSOs is an integral part of improving GBE efficiency. Moreover, it is essential in any cases where private sector competitors contribute to the cost of meeting a CSO. It is to be hoped that the time and effort initially spent on costing CSOs will be more than offset by subsequent efficiency improvements in CSO delivery.

Funding Community Service Obligations

4.38 There are several methods currently used by the Commonwealth to fund CSOs:

- cross-subsidy between different users, as with the FAC's cross-subsidisation of its less profitable airports;
- levies on all users to subsidise services provided at less than cost to certain categories of users - this is an explicit form of cross-subsidy;

³⁶ AUSTEL, *Submission*, pp. S2182-3 (Vol. 6 of Submissions).

- direct subsidy to consumers as in concessional prices or vouchers for certain groups of people;
- direct funding from the Budget - this method is used for safety regulation by the CAA and Australian Maritime Safety Authority (AMSA) and has been used extensively with railways in Australia; and
- acceptance of a lower rate of return to the Government by the GBE to compensate for expenses incurred in providing a CSO - this approach is often adopted in conjunction with the use of cross-subsidy, as in the case of Telstra and Australia Post.

4.39 Under the current Accountability and Ministerial Oversight Arrangements, the Government requires that new CSOs will be 'normally financed from the Budget',³⁷ while allowing existing CSOs to continue to be funded by cross-subsidy from more profitable areas of the business and a reduction of the required rate of return. Although appropriation from the Budget is the method of funding CSOs that is preferred by central agencies, it is the exception rather than the rule and, in the opinion of the PSA, is likely to remain so.³⁸

4.40 The Steering Committee on National Performance Monitoring of GTEs commented that none of the funding methods listed above provide 'a complete solution to the problems encountered with CSOs. They all involve trade-offs between efficiency and other objectives.'³⁹ However, it is generally acknowledged that funding from the Budget has the advantage of leading to greater transparency and accountability. With budget funding, decisions about the appropriateness of CSOs are clearly made by the Government on an annual basis in the context of its social policy, and not by the GBE's board or management.⁴⁰ In addition, this funding method is likely to apply greater cost discipline on the provider and so

³⁷ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, p. 2.

³⁸ PSA, *op. cit.*, p. 188.

³⁹ Steering Committee on National Performance Monitoring of Government Trading Enterprises, *op. cit.*, p. x.

⁴⁰ Public Interest Advocacy Centre, *Submission*, p. S2146 (Vol. 6 of Submissions).

contributes to the more efficient use of resources. Budget funding also enables the Government to consider whether there may be more efficient means of delivering particular CSOs.

4.41 On the other hand, there are also disadvantages to funding CSOs from the Budget, which were brought to the Committee's attention. Organisations representing consumer interests expressed concern that when budget funding is required for CSOs:

- new initiatives are minimised unless the Government establishes ongoing consultation with consumer and community organisations;⁴¹
- CSOs may become increasingly remote from the businesses' 'core' activities, which may reduce social equity in the delivery of core services; and
- social goals tend to become subordinated to budgetary goals.⁴²

4.42 The Public Sector Union, as it then was, also subscribed to the view that budget funding of CSOs is:

*... subject to political vicissitudes or cycles. ... the government has an overall imperative of reducing budget deficits and so on. So the budget funding of CSOs is often pared back and pared back.*⁴³

4.43 Australia Post argued strongly in support of its practice of cross-subsidising between the profitable and unprofitable elements of its letter post network. It argued that the uniform cost of posting a letter in Australia is a more effective way of meeting its CSO than the more focussed method of budget funding. Specifically, it believed that budget funding would:

41 Communications Law Centre, *Submission*, pp. S2090-2 (Vol. 6 of Submissions).

42 Australian Council of Social Service, *Submission*, pp. S2124-5 (Vol. 6 of Submissions).

43 Public Sector Union, *Transcript*, p. 973 (Sydney, 25 February 1994).

- replace 'the current funding certainty for CSOs, arising from cross-subsidisation, with the uncertainty and risk associated with annual budget negotiation outcomes'; and
- contradict the Government's intention that corporatisation of its businesses should place them at arm's length, with the presence of 'budget handouts' posing 'a threat to the commercial culture and efficiency drive which have made Australia Post so successful after corporatisation'.⁴⁴

Australia Post also argued, as in paragraph 4.34, that estimating the magnitude of budget funds that would be needed for the letter post would be very difficult and costly.⁴⁵

4.44 While agreeing with the latter point, Finance denied that budget funding would increase the uncertainty and risk associated with maintaining the letter post. It also rejected the suggestion that budget funding would represent a threat to Australia Post's commercial orientation.⁴⁶

4.45 The Committee acknowledges that funding CSOs by a direct appropriation from the Budget allows for greater accountability and transparency than funding by cross-subsidy, and ensures that decisions about the nature and funding of CSOs are taken by the Government, not GBE managers. However, in those cases where a CSO is an integral part of the total operations of a business, as with Australia Post and Telstra, the Committee accepts that funding by cross-subsidy may be preferable.⁴⁷ The Committee believes that a flexible approach must be taken to the funding of CSOs with the most appropriate method of funding being selected on a case by case basis.

44 Australia Post, *Submission*, pp. S2213-4 (Vol. 6 of Submissions).

45 *ibid.*, p. S2214.

46 Finance, *Submission*, pp. S2262-3 (Vol. 7 of Submissions).

47 Finance also took the view that Budget funding may not be appropriate in all cases (Finance, *Submission*, p. S2261 (Vol. 7 of Submissions)).

Monitoring the Delivery of Community Service Obligations

Introduction

4.46 This section considers and comments upon the various mechanisms in place which allow an assessment to be made of the performance of commercialised entities in delivering CSOs.

Corporate Plans

4.47 The Accountability and Ministerial Oversight Arrangements indicate that a GBE's annual corporate plan should cover 'CSO details and costs, including strategies for minimising costs'. The plan should also cover 'pricing/service quality controls in the case of monopoly provided services', which include CSOs as well as other services.⁴⁸ This makes the corporate plan a key document in assessing GBE performance in relation to CSO delivery.

4.48 However, at present GBE corporate plans are confidential to the GBE and the relevant Ministers. There is no publicly available information about the nature of the undertaking between Minister and GBE for the supply of CSOs. This contrasts with legislative requirements in other jurisdictions that GBE statements of corporate intent be gazetted or tabled in Parliament. State owned enterprises in New Zealand and State owned corporations in New South Wales have their statements of corporate intent tabled and in Queensland the statements are gazetted.⁴⁹ The Committee discusses this topic further in Chapter 7.

4.49 The Committee notes that, in the absence of any requirement to do so at present, some Commonwealth GBEs have taken the initiative to make public information about levels and standards of service. In the case of Australia Post,

⁴⁸ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, p. 4.

⁴⁹ Respectively, *State-Owned Enterprises Act 1986*, *State Owned Corporations Act 1989*, *Government Owned Corporations Act 1993*.

such standards were endorsed by the Government in 1992 and published in Australia Post's 1992 Annual Report. In addition, AUSTEL's 'view' of Telstra's USO provides guidance on access to the telephone network and a definition of the standard telephone service. The 'view' provides a basis on which to judge Telstra's performance.

4.50 The Committee agrees with this type of information being made available about Australia Post and Telstra's CSOs. However, such information should be published and widely distributed by all GBEs and relevant business units. In this context, the use of consumer charters and guarantees of service may be relevant.⁵⁰ The publication of information about levels and standards of CSOs is important if GBE performance is to be fairly and accurately assessed. Such information should be readily available to the public in a concise and clear form.

4.51 Recommendation 15

Each relevant department should review the public information prepared by government business enterprises within its portfolio about the nature of the goods and services produced by those businesses. The review should consider whether:

- (a) *the information is clear about the standards to which the goods and services will be produced;*
- (b) *the information is clear about the nature of any community service obligations and the standards to which such obligations will be produced or provided; and*
- (c) *the information is available on request and widely disseminated.*

⁵⁰ Public Interest Advocacy Centre, *Submission*, p. S2142 (Vol. 6 of Submissions).

Annual Reports

4.52 The Committee also believes that it is important that comprehensive information about the past year's performance of CSOs is provided in the annual reports of government businesses. At present this is not generally the case, although details are given for some businesses, for example for AUSLIG in DAS's Annual Report for 1992-93.

4.53 In the context of reporting on CSOs, the Committee noted that the Victorian Government's recent statement on CSOs sets out what details CSO providers should report.⁵¹ The Committee urges government businesses to provide more information about the performance of their CSOs with a view to providing the public with a feeling for, where appropriate:

- the multiple roles of each business;
- the share of public interest and commercial activities in the business; and
- the effectiveness with which CSOs are provided.

4.54 In relation to business units within departments of state, the Committee believes that Finance should revise the departmental annual reporting requirements to require that each department reports details about the delivery of CSOs by all its business units.

4.55 Annual reporting requirements for GBEs are contained in the Accountability and Ministerial Oversight Arrangements and the Commonwealth Authorities and Companies (CAC) Bill. In addition, reporting arrangements in the Corporations Law apply to incorporated GBEs. While the CAC Bill and Arrangements refer to including CSOs in corporate plans, there is no requirement to specify and report on CSOs in annual reports. The Committee believes that GBEs, like business units, should detail how they have met their CSOs in

51 Office of State Owned Enterprises [of the Victorian Government], *Community Service Obligations: Policy Statement and Background to Policy*, August 1994, p. 4. Information to be reported includes target groups, financing and throughput, analysis of the effectiveness of CSO delivery using basic ratios such as average benefit in dollars per recipient, administrative costs per dollar of CSO benefit, and Ministerial directions.

their annual reports. Any government companies with CSOs should also be included in this requirement.

4.56 Recommendation 16

The Department of Finance should revise:

- (a) *the annual reporting requirements relating to departments to require them to include in their annual reports, details about their performance in delivering any community service obligations required of any of their business units; and*
- (b) *the annual reporting requirements relating to government business enterprises to require them to include in their annual reports, details about their performance in delivering any community service obligations required of them.*

Other Forms of Monitoring

4.57 Besides the corporate plan and annual report, other forms of monitoring exist. For example, the Steering Committee on National Performance Monitoring of GTEs produces an annual publication of performance information from Australian GTEs.⁵² The statistics in these publications provide a basis on which like enterprises in different jurisdictions can be compared with each other.

4.58 An example of industry-wide monitoring can be found in the work of AUSTEL, which oversees the costing, cost, and quality of Telstra's USO. As discussed earlier, AUSTEL's monitoring role extends to conducting periodic reviews of the adequacy of the current regime for identifying, costing and funding the USO. The need for close and frequent reviews is particularly important in the telecommunications industry where technology changes rapidly. As technologies develop and communities change, what was once appropriate as a USO may

52 Steering Committee on National Performance Monitoring of Government Trading Enterprises, *Government Trading Enterprises Performance Indicators 1987-88 to 1991-92* July 1993.

no longer be so. For example, the current definition of Telstra's USO relates to 'an extremely basic level of technological service' at a time when many new modes of communication are appearing on the market.⁵³

4.59 One of AUSTEL's principles for the fulfilment of the USO is that 'if a service is available to most consumers, Telstra shall put in place plans to implement *universal* access to the service for all consumers throughout Australia'.⁵⁴ This provides a mechanism for allowing new technologies to be introduced as a USO. The Committee notes that AUSTEL is currently reviewing its definition of the standard telephone service that Telstra must make available. Services that are being considered for inclusion as standard services include call waiting, forwarding and return, modem and facsimile usage and digital connection.⁵⁵

4.60 The Committee believes that reviews of CSOs should be carried out with extensive community involvement. It notes that this is happening in the case of Australia Post, with the recent decision by the Minister for Communications and the Arts that the House of Representatives Committee on Transport, Communications and Infrastructure will review the letter post CSO once in each Parliament, assisted by representatives of remote and rural communities.⁵⁶ As noted above, community groups, such as the Australian Telecommunications Users Group and the Consumers' Telecommunications Network, provide their views to both AUSTEL and Telstra, and AUSTEL has formed a Consumer Advisory Committee to assist it to meet its legislative functions to protect the interests of consumers.⁵⁷

4.61 The Committee commends these initiatives. It is important, however, that when reviewing current CSOs, the

53 Consumers' Telecommunications Network, *Reforming Universal Service: the Future of Consumer Access and Equity in Australian Telecommunications*, December 1993, p. 4.

54 AUSTEL, *Submission*, p. S2185 (Vol. 6 of Submissions).

55 *Financial Review*, 21 March 1995, p. 4.

56 Australia Post, *Transcript*, p. 2283 (Canberra, 18 August 1994).

57 AUSTEL, *Submission*, p. S2184 (Vol. 6 of Submissions).

relevant GBEs and portfolio departments consider the interplay between the CSOs and the Government's broader social justice objectives. Such an analysis will enable considered judgements to be made about how well CSOs are contributing to the achievement of what have been identified as broad social needs.

4.62 Recommendation 17

Each relevant department, in conjunction with government business enterprises within its portfolio and the Department of Finance, should:

- (a) *review the community service obligations currently delivered by its government business enterprises and business units to consider the impact of the community service obligations on the Government's broader social justice policy;*
- (b) *seek and consider input from relevant community groups and interested parties;*
- (c) *report the findings of the reviews to Parliament; and*
- (d) *repeat the review periodically.*

4.63 One final way of monitoring the performance of GBEs in delivering CSOs, would be to allow the Auditor-General to conduct an audit of the efficiency with which such obligations are carried out. Under the current arrangements the Auditor-General does not carry out efficiency or performance audits on GBEs unless the responsible Minister makes such a request. The Auditor-General has never received such a request.⁵⁸

4.64 The Auditor-General Bill 1994, which has been considered by the Committee,⁵⁹ proposes to modify the

58 Auditor-General, *Submission*, p. S304 (Vol. 1 of Submissions).

59 Joint Committee of Public Accounts, *An Advisory Report on the Financial Management and Accountability Bill 1994, The Commonwealth Authorities and Companies Bill 1994 and the Auditor-General Bill 1994, and on a Proposal to Establish an Audit Committee of Parliament*, Report 331, AGPS, Canberra, September 1994.

current arrangements slightly by allowing the Auditor-General to conduct a performance audit on wholly owned GBEs either:

- (a) at the request of the responsible Minister; or
- (b) by resolution of both Houses of Parliament (see clauses 14 and 15 of the Bill)

4.65 In its report on the new financial management and audit legislation, the Committee recommended that the Auditor-General Bill be amended to allow the Auditor-General to conduct a performance audit of a GBE in the circumstances described in the Bill and at the request of the audit committee of Parliament.⁶⁰ The Government has indicated it does not support this recommendation.

4.66 Even if the Government does not accept that the Parliament's capacity to request a performance audit of a GBE should be made easier, as proposed in Report 331, the Committee believes that there are strong grounds to assert that the Auditor-General should be able to examine the efficiency with which CSOs are delivered by GBEs. The Committee acknowledges that there may be some practical difficulties in carrying out such audits. As the Australian National Audit Office pointed out:

... in reviewing the appropriateness or otherwise of community service obligations, there would be a need to have a reasonable understanding of the entire operations of a GBE, not just those activities which have been categorised as community service obligations, this requiring the Auditor-General's access and information gathering powers to be sufficiently broad to allow this to occur.⁶¹

Nevertheless the feasibility of the Auditor-General carrying out performance audits of CSOs should be carefully examined.

⁶⁰ *ibid.*, p. 66.

⁶¹ Australian National Audit Office to Secretary, JCPA, *Correspondence*, 20 February 1995.

4.67 Recommendation 18

The Department of Finance should consider whether to recommend amending the Auditor-General Bill 1994 to allow the Auditor-General to conduct performance audits of the community service obligations of government business enterprises.

OTHER PUBLIC INTEREST ACTIVITIES

Introduction

5.1 The previous chapter dealt with an important mechanism by which the public interest is ensured with respect to access for all Australians to essential services. In addition to universal social welfare functions, government businesses have in the past pursued other outcomes besides the purely commercial. They have provided advice, given preference to purchasing locally made goods, targeted disadvantaged groups for training, and represented Australia at international meetings. These activities are at odds with the current strictly commercial focus of government businesses and yet they are important.

5.2 This chapter examines how these other aspects of the public interest have been handled when former departments of state are commercialised. It also considers government businesses as good corporate citizens .

Lessons from the Experience of the Department of Administrative Ser- vices

5.3 An area of concern noted by the Committee is that, when agencies with multiple roles are commercialised, their non-commercial functions may be lost or downgraded. This issue was raised with the Committee in relation to some of the former regulatory, policy and social welfare roles undertaken by the Department of Administrative Services (DAS).

5.4 The Auditor-General observed in relation to DAS's former **regulatory role** that:

... with the cessation of a regulatory role by DAS business

units there is an increased risk that responsibility for discharging the regulatory functions which continue to exist will not be taken up by individual agencies. In the areas of energy management and accommodation standards, for instance, this has resulted in a regulatory vacuum. The ANAO [Australian National Audit Office] considers that at the time commercialisation is introduced, particular consideration needs to be given to how and by whom regulatory activities should be discharged.¹

5.5 Similar concerns were raised with the Committee relating to DAS's contribution to the **development of policy**. An example of this type of concern was brought to the Committee's attention by Master Builders Australia (MBA). MBA argued in its submission that, as a result of commercialisation and devolution, Australian Construction Services (ACS) had lost the ability to influence government policy decisively. MBA regarded ACS's former role as a valuable one.² According to the Association of Professional Engineers and Scientists, Australia, not only had the Government lost an independent source of expert advice on construction industry matters, it had deprived other government departments of the independent briefing advice that was once available to them.³ The importance of independent advice being on hand for the Government was also mentioned in submissions to the Inquiry by the Institution of Engineers, Australia (IEA) and, in relation to legal matters, by the Legal Sub-Division of the Public Sector Union's (PSU) Professional Division.⁴

5.6 It was recognised that it would be possible for the Government to purchase advice from its businesses if there was none available from within its central agencies. Indeed, some of the community service obligations (CSOs) of DAS businesses are to supply advice to the Government. However,

¹ The Auditor-General, *Efficiency Audit, An Audit Commentary on Aspects of Commercialisation in the Department of Administrative Services*, Audit Report No. 16 1992-93, AGPS, Canberra, 1992, p. 19.

² MBA, *Submission*, pp. S758-61 (Vol. 2 of Submissions).

³ Association of Professional Engineers and Scientists, Australia, *Submission*, p. S1650 (Vol. 4 of Submissions).

⁴ IEA, *Transcript*, p. 435 (Canberra, 6 December 1993); Professional Division, Legal Sub-Division, PSU, *Submission*, p. S2098 (Vol. 6 of Submissions).

there are potential problems with this approach. The advice given under user pays arrangements is clearly limited by what can be afforded by the client, which may result in inadequate advice being purchased, or none sought at all.⁵ Furthermore, there is a possibility that the advice provided to the Government might be tailored to favour the commercial interests of the adviser.

5.7 Many departments have established their own in-house capabilities to handle matters which were once DAS's responsibility. Witnesses to the Inquiry claimed that such in-house units were likely to be less well equipped for the tasks they undertook than a large central agency. One of these witnesses suggested an audit of how well the current system was working.⁶ The IEA went one step further and proposed that:

In the interest of protecting taxpayer investment in Commonwealth owned buildings and other facilities ... there needs to be a central agency with well-defined powers to set standards and oversee the procurement, management and maintenance of Commonwealth assets.⁷

5.8 In a similar vein, the MBA recommended that the Government should redefine the role of ACS as the central policy making and construction advisory body of the Commonwealth. MBA envisaged that this role would be very similar to the role performed by the New South Wales Government's Construction Policy Steering Committee.⁸

5.9 The comments and suggestions summarised in the previous paragraphs were made in late 1993 and early 1994. In a supplementary submission to the Inquiry which was received in November 1994, DAS admitted that a policy vacuum had been left in some areas. DAS recognised that:

5 Professional Division, Legal Sub-Division, PSU, *Submission*, p. S2096 (Vol. 6 of Submissions).

6 C S Schumacher, *Submission*, p. S250 (Vol. 1 of Submissions).

7 IEA, *Submission*, p. S1886 (Vol. 5 of Submissions).

8 MBA, *Submission*, p. S761 (Vol. 2 of Submissions).

There has been no recognised mechanism for providing policy advice to Government on a range of public works issues or for:

- . facilitating the exchange of information between Commonwealth agencies and other levels of government;*
- . promoting the use of the Government's purchasing power to drive reform of the construction industry;*
- . handling the interface between industry and Government on broad policy issues; or*
- . reporting to Government on the implementation of policies relating to public works.⁹*

5.10 As a result, DAS was establishing an advisory committee on public works matters, which would draw representation from other Commonwealth agencies and industry as well as DAS. It was planned to be part of the Department, and thus independent of the businesses, and to:

- . provide advice to the Minister for Administrative Services;*
- . promote, review and report on the implementation of government policy;*
- . promote best practice approaches; and*
- . provide a focus for submissions on public works matters.¹⁰*

The Committee noted that witnesses to the Inquiry saw it as important that anybody charged with providing independent advice to the Government was positioned within the department, so that it would be unhindered by commercial considerations.¹¹

5.11 DAS also acknowledged that concerns had been raised by submissions to the Inquiry about one of its former **social welfare** roles. In the course of commercialising ACS, the

9 DAS, *Submission*, p. S2308 (Vol. 7 of Submissions).

10 *ibid.*, pp. S2309-10.

11 C S Schumacher, *Submission*, p. S251 (Vol. 1 of Submissions); IEA, *Submission*, p. S1885 (Vol. 5 of Submissions).

decision was taken to disband a specialist unit which provided advice on Aboriginal community development.¹² In response to the concerns expressed by Aboriginal groups, DAS is reviewing its existing strategies and developing new ones for delivering infrastructure and transferring skills to indigenous people.¹³

Conclusion

5.12 The experiences recounted above illustrate the problems that can arise when insufficient attention is given on the introduction of commercialisation to the fate of non-commercial roles. The Committee urges a careful examination of these roles, including consultation with interested parties to determine whether they should be dropped altogether or continued by another agency.

5.13 Recommendation 19

When introducing commercialisation, the Government should:

- (a) *in consultation with interested parties, examine carefully whether the former public interest activities of commercialising agencies should continue; and*
- (b) *make appropriate alternative arrangements when it decides to continue an activity in the public interest.*

Support for Australian Industry

5.14 Government businesses may be in a position to assist the development of Australian industry in a number of ways. Firstly, State and Commonwealth GBEs account for a significant proportion of domestic demand for certain goods and services. Indeed, according to the then Department of Industry,

¹² W F Buckwell, *Submission*, p. S209 (Vol. 1 of Submissions); C Starkis, *Submission*, p. S235 (Vol. 1 of Submissions).

¹³ DAS, *Submission*, p. S2311 (Vol. 7 of Submissions).

Technology and Regional Development (DITARD), GBEs represent the largest and sometimes the only customer for such items as air traffic control systems. Through their purchasing decisions, GBEs are in a position to 'provide a powerful stimulus to the emergence of competitive, innovative Australian firms'.¹⁴ Business units may also find themselves in a similar situation, according to AUSLIG's General Manager.¹⁵

5.15 Secondly, the use of certain products by government businesses may recommend these products to potential customers overseas. DITARD commented in its submission that:

As major purchasers of technology-based products, GBEs can ... also function as reference sites for new products; demonstrated use by a major government agency is often a significant factor in local firms achieving success in world markets.

Some GBEs possess an international reputation for the setting and maintenance of standards, the management of projects and the provision of assistance to overseas agencies. In this context, GBEs often play an important role in supporting Australian companies export bids through certification and recommendation of products that meet the local agencies' standards.¹⁶

5.16 In the third place, GBEs' participation in international forums allows them to identify export opportunities at a very early stage and pass on this information to Australian businesses.¹⁷ Finally, when GBEs are unable to

¹⁴ DITARD, *Submission*, p. S1994 (Vol. 5 of Submissions).

¹⁵ DAS, *Transcript*, p. 476 (Canberra, 31 January 1994).

¹⁶ DITARD, *Submission*, p. S1991 (Vol. 5 of Submissions).

¹⁷ Certain government businesses undertake the public interest activity of representing Australia's interests in international forums. For example, the CAA acts on behalf of the Government at meetings of the International Convention of Aviation Organisations (CAA, *Submission*, p. S511, Vol. 2 of Submissions), and ANL Ltd occupies 'the Australian seat at a number of international forums where worldwide shipping issues are debated and discussed' (ANL, *Transcript*, p. 1754, Sydney, 15 June 1994).

buy what they want on the domestic market and turn to overseas manufacturers, they are in a position to use their leverage to promote contact between the overseas and local suppliers. In this way, Australian firms may be able to access overseas expertise.

5.17 DAS has recently acknowledged the potential of its businesses to expand into South East Asia. It intends, among other objectives, to develop strategic alliances with business and Asian governments. In doing so, it will seek opportunities to work in partnership or joint ventures with the private sector.¹⁸

5.18 In recognition of the contribution that GBEs can make to industry development, the Government put increased pressure on them to support local firms in 1992 with the request that they:

- include industry development objectives in their corporate plans;
- prepare and make public industry development plans; and
- develop industry impact statements before the start of the tender process for contracts over \$30m.¹⁹

5.19 Both the Civil Aviation Authority (CAA) and the Federal Airports Corporation developed industry development plans in 1994. The CAA's plan adds further impetus to the impact on industry development of The Australian Advanced Air Traffic System (TAAATS), which Thomson-CSF is contracted to supply. One of the evaluation criteria for this contract was Australian industry involvement, with respect to which Thomson has undertaken to:

- *maximise Australian activity in the project;*
- *make Australia its regional headquarters and promote substantial Australian exports of air traffic management systems, products and services to the Asia-Pacific region;*

¹⁸ DAS, *Submission*, p. S2312 (Vol. 7 of Submissions).

¹⁹ DITARD, *Submission*, p. S1992 (Vol. 5 of Submissions).

- *develop strong in-country support capabilities for TAAATS hardware and software; and*
- *establish cooperative arrangements with Australian based firms and institutions to undertake R&D into air traffic control products and services.²⁰*

5.20 The CAA's current corporate plan states that the CAA will assist in the development of Australian industry by purchasing technically proven hardware, software and services, certify products and services, and keep Australian industry informed of current and future developments in airways management and technology.²¹ The CAA also involves local business in developing business opportunities related to its core interests.

5.21 DITARD acknowledged that, in some cases, buying locally might be more expensive than sourcing purchases from overseas, and might be seen as being at odds with the commercial orientation of GBEs. However, it could well lead to valuable long term relationships with suppliers and provide gains to the economy as a whole. DITARD concluded that:

... GBEs understanding and interpretation of what it means to be a "commercial" organisation could be broadened. A mechanism to address the conflicts between the short term financial considerations and the longer term strategic interests and broader industry policy objectives of Government needs to be explored.²²

5.22 The Committee notes that the House of Representatives Standing Committee on Industry, Science and Technology is undertaking an inquiry into government purchasing policies. This inquiry will consider, among other matters:

²⁰ CAA, *Civil Aviation Authority Industry Development Plan*, Canberra, June 1994, p. 5.

²¹ *ibid.*, p. 16.

²² DITARD, *Submission*, p. S1994 (Vol. 5 of Submissions).

- the measures adopted by all government entities to develop their supply bases in Australia;
- the Government's efforts to promote the use of Australian made goods and services; and
- the contribution of industry support programs to the use of locally produced goods and services.

5.23 This inquiry can be expected to report on the topic of Australian industry support in much greater detail than is possible here. In the interim, the Committee believes that it would be useful for the Government to reiterate its earlier request to Commonwealth GBEs, and extend it to all government businesses.

5.24 Recommendation 20

The Government should:

- urge its businesses to give careful consideration to the long term advantages of supporting Australian industry;*
- extend to all government businesses its request that, if appropriate, they develop and implement Australian industry development plans; and*
- reiterate its request to government business enterprises that they develop and implement Australian industry development plans.*

The Good Corporate Citizen: Can Commercially Oriented Agencies be Expected to Behave Ethically?

5.25 Can commercially oriented agencies that must return profits to the Government be expected 'to behave with integrity and ethically when it may cost them money'?²³ There are some who believe that it is unrealistic to expect the same high standards of behaviour from government businesses as are

²³ IEA, *Submission*, p. S841 (Vol. 2 of Submissions).

expected from the core public service. Nevertheless, the PSU asserted that:

... it is in the national interest that the Commonwealth commercial agencies be required to behave, as they currently are, with integrity and ethically even if it does cost them money in the short term.²⁴

The Public Interest Advocacy Centre agreed that government businesses should conduct their affairs in an exemplary manner:

GBEs should be expected to carry on business in a way that sets a good example to private sector businesses. Examples include achieving better than required health and safety and environmental standards, equal opportunity provisions, employee rights, workplace industrial democracy, engaging in public and customer consultation, and providing world best practice in service delivery.²⁵

5.26 The ANAO also believed that 'it should go without saying that the public sector should always retain the highest standards of integrity and probity'.²⁶ It saw a role for the public sector in, not only setting a good example, but also keeping the market honest and not letting the market dictate the terms of its involvement.

5.27 The Committee reiterates its view, as expressed in its report on the social responsibilities of statutory authorities and GBEs, that 'the behaviour of government entities should be of the highest standard'.²⁷ These high standards will only be maintained if the accountability requirements applying to government businesses are appropriate, as is discussed in the next chapter.

²⁴ PSU, *Submission*, p. S1276 (Vol. 3 of Submissions).

²⁵ Public Interest Advocacy Centre, *Submission*, p. S2132 (Vol. 6 of Submissions).

²⁶ ANAO, *Transcript*, p. 95 (Canberra, 8 November 1993).

²⁷ Joint Committee of Public Accounts, *Social Responsibilities of Commonwealth Statutory Authorities and Government Business Enterprises*, Report 315, AGPS, Canberra, April 1992, p. xi.

Introduction

6.1 The financial, regulatory and accountability arrangements that apply to a business are significant influences on the way it is managed. If the Government is to obtain the most efficient and effective operation possible for its businesses, it is important that the arrangements put in place are appropriate. This chapter explores the financial arrangements that apply to the Commonwealth's businesses.

6.2 With the introduction of a more commercial approach to the supply of goods and services by the Government, many of the arrangements characteristic of private sector businesses have been adopted. Government businesses are typically required to:

- make a return to the Government on the public's investment in the assets of the business; and
- pay income, State or other taxes, or a levy in lieu of such charges.

The Government may also make clear that it will not guarantee a business should it get into financial difficulties. However, because government businesses differ in a number of ways from private sector businesses, it has proved difficult in some cases to make a direct translation to the public sector of financial arrangements and processes suitable for the private sector.

6.3 This chapter begins with a brief description of the financial policy frameworks that have been established for the operation of government businesses. It then deals with the experience that has been gained in the course of commercialisation's introduction and explores, in particular:

- asset valuation;
- target rates of return;
- dividends;
- pricing; and
- capital structure.

The chapter ends with a discussion of how the financial operations of government businesses are monitored.

6.4 The Committee was assisted in its examination of the financial aspects of government business operations by consultants from Fay Richwhite Merchant Bankers, led by Dr P Dodd. Dr Dodd's team prepared a background paper for the Committee, part of which is reproduced at Appendix VIII. Readers are referred to this paper for additional explanation of the topics covered.

Financial Policy for Commonwealth Government Businesses*Government Business Enterprises*

6.5 The key financial elements of the Government's policy are set out in the Accountability and Ministerial Oversight Arrangements. They comprise the following requirements.

- Ministers are to set a clear mandate and objectives for each government business enterprise (GBE), influence strategic directions proposed by boards with regard to the assessment of shareholder risk, agree financial targets and dividend policy, and approve borrowing limits subject to Loan Council processes.
- Community service obligations (CSOs) are to be specified with an objective for the GBE to meet these at minimum cost, and new CSOs are to be financed from the Budget.

- Financial targets should be set so that GBEs are required to earn commercial returns sufficient to at least justify long-term retention of assets in the business, and to pay commercial dividends from those returns.
- As a minimum, GBEs should earn, over time, a rate of return on assets equivalent to the long-term bond rate plus an appropriate risk premium.
- Target rates of return are to be adjusted for unfunded non-commercial activities, including CSOs.
- The mandate and capital structure of each GBE is to be reviewed at intervals, usually every five years, to ensure that they are consistent with expected performance.
- In addition to annual reports, GBEs will provide six monthly reports (or quarterly if agreed) to the responsible Minister, who will copy it to the Minister for Finance.
- Dividends should be based on a fixed percentage of profit after abnormal items and after tax, with:
 - the benchmark payout ratio being 50%; and
 - attention being given to the effect of the payout on the GBE's operations, capital structure and requirements for capital. Dividends are payable in two instalments, interim and final.¹

6.6 In addition to these general requirements, financial policies for individual GBEs may be prescribed in the GBE's enabling legislation or in documents such as corporate plans.

Business Units

6.7 The financial arrangements for business units are less well formalised and tend to be specific to each department. This situation is less than ideal. However, the Committee understands that the financial arrangements for business units will be covered in some detail in the practical guide to commercialisation which the Department of Finance (Finance) is

¹ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, pp. 1, 2, 5, Attachment A.

preparing. This is a useful initiative and, as recommended in Chapter 2, the guide should be issued as promptly as possible.

Asset Valuation

6.8 The purpose of asset valuation is to provide information to stakeholders in the business, such as shareholders, lenders and management. Assets can be valued by a variety of methodologies, the choice of which depends on the purpose for which the valuation is being carried out. It is important to note that the different valuation methods may produce different values for the same asset. This means that there is no one 'true' value for the asset. Furthermore, the value of assets can change significantly over time. These two points were well illustrated by the valuation of the assets of ANL Ltd at \$158m in December 1993, compared with its valuation for sale as a going concern in mid 1994 at between minus \$75m and minus \$118m.²

6.9 Professor T Parry, the Chairman of the Government Pricing Tribunal of New South Wales, expressed the view in an informal meeting with the Committee, that valuing assets is a very difficult exercise. It is more difficult in the public sector than in the private sector because of the nature of the assets concerned and the lack of active capital market trading to provide timely estimates of market value.

6.10 The Industry Commission has concluded, on the basis of a survey of State and Commonwealth business enterprises, that most of them have undervalued their assets.³ However, in the context of the debate over the privatisation of the Federal Airports Corporation's (FAC) airports, the possibility that some of the airports had been overvalued was raised. Of the 22 airports owned by the FAC, only seven ran at a profit, although almost all of them were cash flow positive. It was suggested that this situation arose from their having been assigned inappropriately high values. For example, the

² The Auditor-General, *Project Audit, ANL, Valuation Issues*, Audit Report No.11, 1994-95, AGPS, Canberra, 1994, p. 12.

³ Industry Commission, *Transcript*, p. 733 (Canberra, 4 February 1994).

Bankstown Airport Chamber of Commerce drew attention to the fact that Cambridge Airport in Tasmania, which had been valued at \$3.8m, sold for \$900 000.⁴ The Australian Aviation Industry Association made a similar general point.⁵

6.11 The value assigned to the assets of a government business is significant in establishing a rate of return target for the business and as a basis for regulating monopoly prices and assessing performance. The Committee believes that the guidelines on asset valuation developed by the Steering Committee on National Performance Monitoring of Government Trading Enterprises (GTEs) will assist in the development of generally accepted accounting principles by the accounting profession.

Target Rates of Return

6.12 The Committee believes it is reasonable that the taxpayer should be compensated for the funds that are tied up in a business and for the consequent exposure to risk that is associated with commercial activities. It is also reasonable that government businesses should be expected to earn a rate of return on assets commensurate with that achieved by firms in the private sector that have similar risk characteristics. The Accountability and Ministerial Oversight Arrangements recognise this principle in stating that GBEs are 'to achieve over time economic rates of return on assets for their commercial operations equivalent to the long term bond rate plus an appropriate margin for risk'.⁶

6.13 In evidence to the Inquiry, the Civil Aviation Authority (CAA) and the FAC both indicated that they had been assigned rate of return targets of 7.5% before interest and tax; the Defence Housing Authority indicated that it had set itself

4 Bankstown Airport Chamber of Commerce, *Transcript*, p. 1658 (Sydney, 20 May 1994).

5 Australian Aviation Industry Association, *Transcript*, p. 1189 (Melbourne, 19 May 1994).

6 *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, p. 2.

a target of 5%.⁷ In a letter to the Committee, the Treasury indicated that it now supported the use of economic rate of return targets, because they allow for changes in both operational performance and asset values, and so give a more meaningful indicator of shareholder returns and risk over time than do cash-based accounting measures.⁸ The CAA indicated that it would be moving to an economic rate of return target of 9% in 1994-95.⁹

6.14 Finance pointed out in a supplementary submission to the Inquiry that:

Financial target setting across the whole range of GBEs raises difficult methodological questions and issues.

- *Methodologies are being further refined and developed and a working group of the Steering Committee on National Performance Monitoring of Government Trading Enterprises (NPM Committee, a Commonwealth/State group) is also considering the issue.*
- *Methodological questions being addressed include determination of the appropriate level of financial target to apply to particular GBEs and means of measuring actual rates of return achieved. Finance and other departments anticipate that, following the completion of this work, consideration will be given to reaching agreement with each GBE on financial targets to be observed by them.*¹⁰

6.15 At a public hearing, the Secretary of Finance expanded on the type of problem being encountered:

... over the last couple of years there has been some work

7 CAA, *Transcript*, p. 1438 (Sydney, 20 May 1994); FAC, *Transcript*, p. 1871 (Canberra, 6 July 1994); Defence Housing Authority, *Transcript*, pp. 833-4 (Canberra, 11 February 1994). The Defence Housing Authority will not pay tax or dividends until 1996.

8 The Treasury to Secretary, JCPA, *Correspondence*, 23 May 1994.

9 CAA, *Transcript*, p. 1438 (Sydney, 20 May 1994).

10 Finance, *Submission*, pp. S2232-3 (Vol. 7 of Submissions).

done by technicians to try and produce an empirical approximation that would allow some guidance to be given about how to calculate an appropriate economic rate of return. You need to be able to take into account what the underlying return on a risk free asset should be, for example, then you should be able to work out what the appropriate adjustment for risk is for this class of business as opposed to others. Conceptually that is a reasonably simple kind of notion to get your hands on. To calculate it in practice, though, the approach that has been adopted to date has been to look at the return on equity and the return on debt separately and to work to produce some notion of a weighted average cost of capital. In the event it has turned out that those measures are not insensitive to the underlying corporate structure in a way which theoretically they should be. So at the level of theoretical nicety there is still some methodological work to be done to try and get better empirical approximations to what is a reasonably simple concept.¹¹

6.16 Rate of return targets are an important element in the incentive structure facing GBE management. This is particularly the case for GBEs that are monopoly suppliers. There are dangers, however, which the Industry Commission alluded to in its 1992-93 annual report. For example, 'narrow and rigid reliance on financial targets can undermine efficiency and create problems for other industries if GBEs inappropriately raise prices and/or reduce the quality of service to meet targets'.¹² Using non-financial performance indicators as well and coupling financial targets with regulation can help to expose these practices. Furthermore, for GBEs that operate in competitive markets, a rigid reliance on financial targets is inappropriate; the focus on financial targets should be secondary to efficient pricing practices.¹³

6.17 The Industry Commission also urged caution when using rate of return results to judge the performance of a GBE; care needs to be taken in the interpretation placed on

11 Finance, *Transcript*, p. 2392 (Canberra, 17 October 1994).

12 Industry Commission, *Annual Report 1992-93*, AGPS, Canberra, p. 171.

13 *ibid.*, p. 179.

the results obtained. If the target rate of return is not met, it may signal the need for a change of management or strategy. On the other hand, it may reflect such factors as the general economic condition in the country or past bad investment decisions.¹⁴

6.18 While the long term financial objective for GBEs is to achieve a commercial rate of return, the Government's policy provides that a lower rate of return may be established as an alternative to budget funding of CSOs. This approach is a practical response to the complexity of estimating costs where the CSO is an integral part of the total operations of the GBE. It does, however, make the assessment of performance more difficult than when CSOs are budget-funded.

6.19 The discussion in this section has concentrated on the arrangements for GBEs. However, the Committee notes that some business units in the Department of Administrative Services (DAS) and the Attorney-General's Department (Attorney-General's) are also expected to eventually make an appropriate return to the Government on the taxpayers' investment in them. Finance informed the Committee that:

*No specific, single rate of return has been set for all business units. The types of financial targets which might be applied to departmental business units may differ from those applying to GBEs.*¹⁵

Using economic rate of return targets, such as those that are being developed for GBEs, may not be appropriate for business units because some of them do not have large holdings of non-current assets or they receive significant revenue from the Budget. In these circumstances, other performance indicators are developed.

14 *ibid.*, p. 177.

15 Finance, *Submission*, p. S2416 (Vol. 7 of Submissions).

Dividends

6.20 Dividends, together with interest payments and taxation, are among the financial distributions made by government businesses to the Government. These payments simulate the market disciplines to which private sector firms are exposed, and put pressure on the businesses to perform efficiently.

6.21 As Finance pointed out in a supplementary submission to the Inquiry, the median dividend distribution in recent years among private sector firms 'has tended to be not less than 50% of profits'.¹⁶ The Government has opted to model its dividend requirements on private sector performance.

*The government has adopted a benchmark dividend payout ratio of 50% of profits after abnormals and after income tax. This ratio reflects information about the preference for dividends in the private sector, recognition that dividend payments allow the Government to routinely exercise judgement about which use of these funds best advances the interests of the community, and recognition that profit retention represents an important source of additional equity capital for wholly owned GBEs.*¹⁷

6.22 The principles used to determine the payment of dividends by GBEs are set out in the Accountability and Ministerial Oversight Arrangements. In broad terms the principles provide that, when drawing up a corporate plan for the next financial year, a dividend policy is to be agreed between the board of a GBE and the responsible Minister, in consultation with the Minister for Finance. Although the dividend payout ratio is normally 50% of profits after abnormals and tax, the principles allow for some variation in the ratio.

The dividend payout in any given year should recognise its effect on a GBE's operations, the GBE's capital structure and its ability to internally finance capital requirements in a commercial fashion in the light of the investment oppor-

¹⁶ *ibid.*, p. S2281.

¹⁷ *ibid.*, p. S2282.

*tunities available to it and any special capital requirements to be met by the GBE, Loan Council borrowing limits, and performance of the GBE.*¹⁸

Dividend payments are made twice a year, and are expected to be consistent with the policy agreed at the start of the year.

6.23 Fully commercialised business units within departments of state are also required to make dividend payments to the Government.¹⁹ In November 1993, DAS indicated that it would pay \$18m in dividends for its business units in 1993-94, comprising the dividend for 1992-93 and a provisional dividend for 1993-94. According to DAS, this figure was reached by discussion and negotiation between DAS and Finance, during which 'the Department of Finance keeps a lot of pressure on us to ensure that those dividends are as high as is reasonable'.²⁰

6.24 There has been concern in some quarters that governments in Australia are reaping excessive profits from their businesses by setting the dividends too high. In its review of dividend payments by Australian GTEs, the Industry Commission pointed out that the dividends paid by the major Commonwealth GBEs were generally lower than those paid by State GTEs. They were also substantially below those paid in the private sector, although they had increased from 18% of earnings after interest and tax in 1989-90 to 43% in 1991-92.²¹

6.25 The Industry Commission concluded that:

Generally, we are finding that GBEs are not declaring excessive dividends or making excessive profits. In fact, we are finding the reverse. We are finding that the dividends are not high enough and that in many cases, because assets have often been undervalued, insufficient attention has

¹⁸ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, Attachment A.

¹⁹ Finance, *Submission*, p. S2416 (Vol. 7 of Submissions).

²⁰ DAS, *Transcript*, p. 283 (Canberra, 8 November 1993).

²¹ Industry Commission, *op. cit.*, pp. 187-90.

been given to the amount of dividends that ought to be paid.²²

6.26 Nevertheless, as the Commission conceded, 'there is the ever-present possibility that short-term considerations such as impending budgetary constraints may lead governments to require excessive dividend payments'.²³ The Committee believes that the introduction of competition to the markets in which GBEs operate, and the implementation of the recommendations of the Hilmer Report will help to prevent the use of GBEs as 'milch cows'.

6.27 Dividend payout ratios for the Commonwealth's major GBEs in the last four financial years are shown in Table 6.1.

Pricing

Overview

6.28 It is important that appropriate price levels and structures are used by government businesses for the goods and services that they provide. Incorrect prices can have a major impact on service demand and capacity requirements. For example, underpricing of services may result in too high a level of consumption of those services which, in turn, may require higher than optimal levels of investment. The result is a misallocation of resources away from the production of higher valued services in favour of the incorrectly priced services. For example, the Second Sydney Airport Coalition argued that the FAC's network pricing policy distorted the costs of providing services at different airports, which might have influenced past investment decisions.²⁴

²² Industry Commission, *Transcript*, p. 733 (Canberra, 4 February 1994).

²³ Industry Commission, *Annual Report 1992-93*, AGPS, Canberra, p. 194.

²⁴ Second Sydney Airport Coalition, *Submission*, p. S1970 (Vol. 5 of Submissions).

Table 6.1 Dividend payout ratios for the major Commonwealth GBEs, 1990-91 to 1993-94

Government Business Enterprises	Dividend payout ratio*			
	1990-91	1991-92	1992-93	1993-94
Benchmark#			50%	50%
Australian Maritime Safety Agency	34.8%	97.4% ^x	50.0%	50%
Australian National Line	18.8%	0%	0%	0%
Australian National Railways Commission	0%	0%	0%	0%
Australia Post	20.2%	36.6%	49.5%	50%
Civil Aviation Authority	50%	59.6%	71.4%	50%
Federal Airports Corporation	18%	14.6%	32.6%	n/a
Telstra Corporation Ltd	26.0%	152.5%	74.5%	43%

* The ratio is expressed in terms of dividend/operating profit after tax and abnormals for the financial year.

As required under the *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993.

x This ratio is unusually high due to a large abnormal item. Adjusting for this, the ratio becomes 38%.

Source: Finance, *Submission*, p. S2417 (Vol. 7 of Submissions).

6.29 In the past, government businesses have tended to set their prices too low to recover the full economic cost of the service provided. Furthermore, the costs of monopoly suppliers were often inflated because of inefficient production, and in some cases these costs passed through into prices which were too high and depressed consumption. This situation characterised the Australian telecommunications and domestic aviation industries in the past.

6.30 Where competition exists, the prices charged by government businesses are under pressure from the market, particularly when there are policies in place to achieve commercial rates of return under conditions of competitive neutrality. In the absence of competition, however, some form of price regulation is necessary; this topic is discussed briefly in a later section of this chapter.

6.31 In the Finance Directions and a number of publications, Finance has provided guidance to agencies on the costing and pricing of commercial activities.²⁵ The Committee understands that additional information will be available on these topics in the practical guide to commercialisation, which is currently in draft form.

6.32 The Prices Surveillance Authority (PSA) too has produced pricing guidelines.²⁶ But, in evidence to the Committee the PSA commented that 'there has been relatively little awareness of the guidelines and indeed little regard for them'.²⁷ This occurred even though the Government had determined that these guidelines should be applied, where appropriate, by Commonwealth authorities, and the Prime Minister had written to the States requesting that the States' authorities adhere to the guidelines. The PSA has recently put out a discussion paper flagging the need to develop a more flexible approach to prices surveillance.²⁸

²⁵ Finance, *Guidelines for Costing of Government Activities*, AGPS, Canberra, July 1991; *Running Costs Handbook*, September 1992.

²⁶ PSA, *Guidelines for Pricing Restraint*, August 1987.

²⁷ PSA, *Transcript*, p. 657 (Canberra, 4 February 1994).

²⁸ PSA, *Discussion Paper on Pricing Guidelines for Efficiency and Fairness*, March 1994.

6.33 In Chapter 4, the Committee noted that the costing of CSOs was a very complex and time consuming activity. Even with less complex costing tasks, problems appear to exist. For example, the Trade Practices Commission (TPC) reported to the Committee that, in the course of investigating anti-competitive conduct, it had found that:

*...[GBEs] have really no idea how to cost. The general feeling was that they were left up in the air by Finance and they have not been given sufficient guidelines.*²⁹

In addition, the TPC had found it 'almost impossible' to ascertain the details of GBEs' costings. It commented that 'we could not work out the costing, and nor could they'.³⁰

Conclusion

6.34 Evidence from the PSA, TPC and the Industry Commission indicates that costing and pricing activities still present government businesses with significant problems. The Committee believes that further guidance should be provided to those government agencies which cost and price the goods and services they provide.

6.35 Recommendation 21

The Department of Finance should coordinate a review of the costing and pricing techniques used by government businesses with a view to providing comprehensive guidance on best practice in the costing and pricing of government produced goods and services.

Introducing Efficient Pricing

6.36 The Committee noted that, when efficient pricing is introduced to government businesses for the first time, it affects both the level and structure of prices and can result in

²⁹ TPC, *Transcript*, p. 748 (Canberra, 4 February 1994).

³⁰ *ibid.*, p. 749.

substantial price increases. This happened for general aviation operators when the FAC was first established, and more recently for the trading community that uses the services of the Australian Quarantine and Inspection Service (AQIS).³¹

6.37 Situations like this require careful management to ensure that customers have time to adjust to the new regime. For example, as the Industry Commission pointed out, it is important that the need to raise prices is counteracted by the improvements in productivity.

*You almost have to have a few things going hand-in-hand ... You have to have a revaluation of assets, appropriate dividend policies and, at the same time, substantial pressure on the GBEs to increase their performance. In that way, you will get a bit of a balance and it will not filter through to the economy as a very substantial increase in the prices of goods and services.*³²

In addition, it would be useful if the need to regulate the price increases that flow from efficient pricing were covered in the advisory material provided to government businesses.

6.38 In the sections that follow, the Committee examines a number of the pricing concerns raised in evidence to the Inquiry. The specific issues are:

- claims of monopoly pricing;
- the practice of cross-subsidisation of prices, particularly in relation to the network pricing policy of the FAC; and
- price regulation and its adjuncts.

Allegations of unfair pricing practices by business units when competing with the private sector are considered in Chapter 8, in the context of a discussion about commercialisation.

31 Archerfield Airport Chamber of Commerce, *Submission*, p. S154 (Vol. 1 of Submissions); General Aviation Association, *Submission*, p. S710 (Vol. 2 of Submissions); Australian Chamber of Shipping, *Submission*, p. S1795 (Vol. 5 of Submissions).

32 Industry Commission, *Transcript*, p. 733 (Canberra, 4 February 1994).

Monopoly Pricing - the Federal Airports Corporation and Civil Aviation Authority

6.39 The Committee heard much complaint about the charging levels and structures of the FAC and CAA, particularly from the general aviation industry. As the FAC observed, its charges and pricing structure had been 'a matter of particular criticism from people making submissions to this inquiry and generally'.³³ The tenor of the criticism is illustrated by a view expressed by the Australian Aviation Industry Association (AAIA):

*The AAIA believes that the FAC and the CAA have not reached their full potential as commercially competitive GBEs because they have both a monopoly position and the power to regulate the recovery of funds from industry. The aviation industry does not have any choice about using the FAC and CAA, and therefore there is little incentive for these GBEs to be efficient or effective.*³⁴

6.40 The FAC pointed out to the Committee that its Act requires that the FAC's charges be reasonably related to cost and not such as to amount to a tax.³⁵ Other considerations are also taken into account when the FAC's charges are set. They include:

- the requirement that the FAC act commercially;
- the expectation that it will conform with accepted international practice and convention;
- the requirement that the FAC meet financial targets specified by the Government; and
- the requirement that the FAC pay tax at a rate of 70-71%.³⁶

6.41 In response to the criticism levelled against it, the FAC pointed out that a comparison with overseas airports

33 FAC, *Transcript*, p. 1873 (Canberra, 6 July 1994).

34 AAIA, *Submission*, p. S459 (Vol. 1 of Submissions).

35 FAC, *Submission*, p. S602 (Vol. 2 of Submissions).

36 *ibid.*, p. S621. The high rate of taxation results from the FAC having been unable to obtain deductions for depreciation on certain aviation assets constructed before 1992.

showed that, not only were the FAC's aeronautical charges among the lowest in the world, but its airports performed better than other airports on other indicators as well.³⁷

*A further measure of how successful the corporation has been ... can be shown by the following facts. The basic airport landing fee has been held steady at \$5.72 per tonne since April 1991. This means a decline in those charges in real terms. On average, the increases in landing fees have been kept below the CPI since 1 January 1987. On average, the corporation's charges have not increased in real terms since commencement, while at the same time more than \$1 billion has been spent on capital works. Finally, it is difficult to understand how accusations of abuse of monopoly position can be sustained when our aeronautical charges recover only 58 per cent of our aeronautical costs.*³⁸

6.42 The FAC also claimed that market forces derived from competition between terminals operated by the FAC, Qantas and Ansett ensured that terminal charges were competitive. Furthermore, comparison of charges for other non-aeronautical activities with off-airport facilities showed that the FAC's charges were fair and reasonable.³⁹

6.43 The PSA did not agree with all aspects of this assessment. For example, its inquiry into the FAC's charges showed that the FAC was earning very high returns from its commercial leases, and had used an inappropriate basis of comparison for its charges.⁴⁰ As discussed in Chapter 7, the Committee also heard much criticism of the FAC's poor record of consultation with the industry in relation to the fixing of its charges.

6.44 The CAA's Act has similar requirements to the FAC's. Its charges must be related to cost and it has a limited capacity to raise funds from taxes, as is discussed in greater detail in

³⁷ *ibid.*, pp. S617-20.

³⁸ FAC, *Transcript*, p. 1873 (Canberra, 6 July 1994).

³⁹ FAC, *Submission*, pp. S644-645 (Vol. 2 of Submissions).

⁴⁰ PSA, *Transcript*, p. 666 (Canberra, 4 February 1994).

Chapter 2. The CAA has experienced very considerable difficulty in developing a basis for charging for its monopoly provision of aviation safety regulation.⁴¹ It made several attempts that were met with fierce opposition from the industry, to establish an appropriate framework for charging. The proposals put to the aviation industry included an aircraft registration levy, annual licence fees and taxation measures.

6.45 The CAA put a new proposal to the industry in mid 1994⁴² that comprised a mix of user charges, licence fees, industry taxation and general taxation, which is shown in Table 6.2. During a meeting with the Committee, the CAA outlined its approach in producing the funding strategy shown in the Table. It consisted of:

- allocating the costs of particular regulatory services to a beneficiary which might be the general public, the travelling public or an industry participant; and
- considering whether there would be financial and safety implications of charging these beneficiaries on the basis of costs allocated. Any charges that appeared to undermine safety or the financial viability of the beneficiary were rejected.

6.46 The Committee understands that the CAA has consulted widely with the industry, reviewed its funding strategy in light of the comments received, and advised the Minister accordingly. The Government has yet to announce a decision on this issue.

⁴¹ This occurred against a background of anger in the aviation industry that the Government had changed its stand on the funding of aviation safety regulation, and had moved to a greater degree of cost recovery than was originally envisaged. In 1984 an Independent Inquiry into Aviation Cost Recovery (the 'Bosch Report') had recommended that the costs of implementing standards be fully cost recovered, but the setting and enforcing of standards be funded by the Government. In 1986 the Government had accepted these recommendations, but changed its stand in 1990.

⁴² CAA, *Funding Strategy: Aviation Safety Regulation*, April 1994.

Table 6.2 Summary of the Civil Aviation Authority's Proposed Funding Strategy

DASR Services	Cost \$m	Beneficiary (\$m)					
		General Public	Travelling Public	Industry Participants			Licence Fees
				Tax	User Charge	Licence Fee	
Safety Regulation Infrastructure	17.4	17.4					
Requested Services	8.4	1.2 ^(a)	4.3	6.8	4.2		
Entry Control and Licensing	8.5 ^(b)						
Compliance Activities	12.3		9.2			3.1 ^(c)	
- Planned surveillance	6.4 ^(d)	3.2	3.2				
- Unplanned surveillance	5.3 ^(e)	2.7			2.6		
- Advice on regulatory regs	0.5	0.5					
- Prosecution and admin action							
Total	58.4	23.8	17.9	6.8	2.6	7.3	
Adjustments							
- Govt contribution limits (e)		(3.7)	3.7		2.5		
- International operators contribution in lieu of fuel tax (f)			(2.5)				
- Govt's remote community subsidy (g)		0.3	(0.3)				
Funding Strategy	58.4	20.4	18.8	6.8	5.1	7.3	
	Revenue \$m	General Taxation	Fuel Tax	A/C Reg Tax	User Charge	Licence Fees	
							Funding Mechanism (\$m)

Source:
Note:

Team Analysis

- (a) industry tax covers costs where safety issues arise
- (b) 50-50 split between beneficiaries
- (c) 25% of planned surveillance; limited by safety
- (d) 50-50 split between beneficiaries
- (e) Government's calculation limits contribution to \$20.1 million
- (f) by international convention, international operators do not pay fuel excise
- (g) part of Government's formula announced in August 1992 statement

Source:

Anderson Consulting, *Aviation Safety Regulation Costing and Pricing: Recommendations for a Funding Strategy*,
CAA/Anderson Consulting, December 1993, p. iv.

6.47 The Committee has drawn some conclusions with respect to monopoly pricing by GBEs.

- The criticism that has been levelled over the years at the FAC and CAA with respect to their charging regimes suggest that a much more considered approach was needed from the outset.
- A valuable way of reducing criticism and complaint is to engage in genuine consultation although, even with extensive consultation such as the CAA's, reaching an acceptable result can be difficult.

Monopoly Pricing - Business Units

6.48 Monopoly pricing by business units was also brought to the Committee's attention. The Chairman of the PSA indicated to the Committee that he had received a number of complaints about the Australian Government Publishing Service (AGPS) and AQIS which he had investigated.⁴³

6.49 AQIS is a monopoly provider of food inspection and quarantine services. It is a regulatory authority, required by law to carry out certain inspections and barrier operations, as well as fulfilling international obligations and treaty requirements. AQIS is a business unit in the Department of Primary Industries and Energy, and fully recovers all user-attributable costs.

6.50 As indicated above, AQIS's charges have increased substantially since full cost recovery was introduced, provoking concern among the trading community that uses its services.⁴⁴ The Australian Chamber of Shipping drew to the Committee's attention a comparison of the costs of inspections

43 PSA, *Transcript*, p. 657 (Canberra, 4 February 1994).

44 Australian Chamber of Shipping, *Submission*, p. S1795 (Vol. 5 of Submissions).

carried out by AQIS and a private sector inspector; the latter was very significantly cheaper.⁴⁵ The Chamber of Shipping called for transparency from AQIS with its pricing.⁴⁶

6.51 In reporting on its inquiry into AGPS's pricing policy for its publications, the PSA drew attention to several features of AGPS's practices that undermined the efficient application of the user pays philosophy, among them:

- insufficient budget supplementation to cover the cost of CSOs;
- non competitive pricing for core publications, for which its clients are tied; and
- cross-subsidisation between different classes of publications.⁴⁷

6.52 The PSA recommended that the AGPS price its publications on a commercial basis unless instructed by the Government to do otherwise. Such instructions should be clearly set out as CSOs and detailed in full. In addition, the AGPS should be subject to regular PSA scrutiny for its tied products or, alternatively, all its clients should be untied.⁴⁸ The Government broadly endorsed the PSA's recommendations, and undertook to introduce a more equitable user-pays pricing formula to eliminate cross-subsidies between publications and improve the delivery of AGPS's CSOs.⁴⁹

6.53 A significant challenge for many commercialising agencies has been the installation of appropriate systems to adequately capture their costs, as well as provide efficient billing and debt management. AGPS, the Legal Practice and AQIS are examples of business units that experienced problems

45 Australian Chamber of Shipping, *Submission*, p. S2044 (Vol. 6 of Submissions).

46 Australian Chamber of Shipping, *Submission*, p. S1796 (Vol. 5 of Submissions).

47 PSA, *Inquiry into the Publications Pricing Policy of the Australian Government Publishing Policy*, December 1992, pp. xiii-xv.

48 *ibid.*, pp. xv-xvi.

49 Joint statement by the Minister for Administrative Services and the Assistant Treasurer, 18 January 1995.

in this respect.⁵⁰ DASFLEET told the Committee that its biggest problem had been changing its financial system and valuing its assets.⁵¹ Sorting out such problems takes time and impinges on financial performance. For example, in his 1992 audit report on AQIS, the Auditor-General concluded that:

- AQIS's charging and cost recovery procedures do not enable it to meet the commercial expectations of Government and industry;
- past cost recovery targets required by Government have not been met; and
- the charges set by AQIS for its services are not based on a comprehensive costing of those services.⁵²

In its review of Auditor-General's reports tabled in March 1994, the Committee commended AQIS on its response to the Auditor-General's recommendations, which were aimed at improving AQIS's performance.⁵³

Cross-Subsidisation

6.54 Cross-subsidisation has been a major issue for the FAC, which cross-subsidises between airports and between the aeronautical and non-aeronautical sides of its business. The FAC defended these practices in terms of cross-subsidy between airports being Government policy, and cross-subsidy between aeronautical and non-aeronautical activities being an internationally accepted practice which is recommended by the International Civil Aviation Organisation.⁵⁴ It also pointed out the benefits of running its airports as a network.

50 Attorney-General's, *Submission*, p. S1151 (Vol. 3 of Submissions); the Auditor-General, *Efficiency Audit, Department of Primary Industries and Energy, Australian Quarantine Inspection Service, Quarantine Division*, Audit Report No. 35 1991-92, AGPS, Canberra, 1992, p. xv; PSA, *Inquiry into the Publications Pricing Policy of the Australian Government Publishing Service*, AGPS, Canberra, 1992, p. 82.

51 DAS, *Transcript*, p. 450 (Canberra, 31 January 1994).

52 The Auditor-General, *op. cit.*, p. ix.

53 Joint Committee of Public Accounts, *Review of Auditor-General's Reports May 1991-September 1992*, Report 330, AGPS, Canberra, March 1994, p. 92.

54 FAC, *Transcript*, p. 1874 (Canberra, 6 July 1994).

The network-based approach enables the achievement of Government policy with the pooling of administration, information, and operational costs and the cost efficiencies of simplified uniform pricing policies.

The network-based approach enables the financing of lumpy investments to be shared among the revenues of network members. Given the capital intensive nature of airports, it is extremely doubtful whether any airport could individually fund major developments as effectively as the FAC can.⁵⁵

6.55 The larger airlines and the PSA have criticised the FAC's approach to charging and recommended that charges be more closely aligned to costs in the interests of efficiency.⁵⁶ (However, smaller, regional operators, such as the Regional Airlines Association of Australia, supported continuing cross-subsidisation.⁵⁷) The PSA questioned whether there was in fact a Government policy of cross-subsidisation for the FAC's airports.⁵⁸ It suggested that, if certain airports needed a subsidy to remain operational, this should have been formally recognised as a CSO for the FAC.⁵⁹ The FAC is now moving towards a charging regime that is more cost and location specific. It reported to the Committee that it had:

... significantly improved the economic efficiency of our pricing and will continue to do so. This improvement has been achieved by a number of reforms, which include more closely matching charges to services provided, the introduction of a general aviation infrastructure tariff and the introduction of peak period pricing at Sydney airport.⁶⁰

55 FAC, *Submission*, p. S620 (Vol. 2 of Submissions).

56 Ansett Australia, *Submission*, p. S451 (Vol. 1 of Submissions); PSA, *Inquiry into the Aeronautical and Non-Aeronautical Charges of the Federal Airports Corporation*, August 1993, pp. xvi-xvii; Singapore Airlines, *Submission*, p. S417 (Vol. 1 of Submissions).

57 AATA, *Transcript*, p. 1200 (Melbourne, 19 May 1994).

58 PSA, *Submission*, pp. S1738-9 (Vol. 4 of Submissions).

59 PSA, *Transcript*, p. 664 (Canberra, 4 February 1994).

60 FAC, *Transcript*, p. 1874 (Canberra, 6 July 1994).

6.56 The Committee noted that, when the Committee was gathering evidence for the Inquiry, the CAA also employed a network pricing policy in setting its charges. This, however, appeared not to be contentious as none of the witnesses to the Inquiry commented adversely on it. The CAA is also moving to more closely relate its charges to its costs.

6.57 The suspicion of cross-subsidisation was mentioned by several competitors of DAS's business units in the context of their complaints about unfair pricing. It was alleged that certain DAS businesses were cross-subsidising their chargeable work from funds received to meet their CSOs and public interest responsibilities. This issue is discussed further in Chapter 8.

6.58 The Committee believes that it is generally inappropriate for government businesses to cross-subsidise between the different elements of the business, particularly if the elements receiving the subsidy can be characterised as a CSO. If certain business elements require a subsidy to remain operational, they should be formally recognised and funded as CSOs.

Monitoring Prices

6.59 There are various formal mechanisms, and some informal consultative mechanisms, in place to monitor and comment upon the prices set by government businesses.

6.60 Under the Accountability and Ministerial Oversight Arrangements, corporate plans must contain information about price control arrangements and service quality targets. The Trade Practices Act applies to GBEs and declarations under the Prices Surveillance Act have placed some GBEs under regular scrutiny. The pricing regimes of the two telecommunications carriers are monitored by AUSTEL.

6.61 The Committee noted, in relation to DAS business units, that the Minister for Administrative Services has a special role in relation to any pricing disputes. Under DAS's *Principles for the Operation of Services to Government*

Agencies, pricing disputes between a DAS business unit and its clients are referred to the Minister if the two parties cannot resolve their differences. The PSA recommended to the Government that, if the tying of AGPS's clients was to be continued, AGPS's prices should be subject to external scrutiny, for example, by the PSA. The PSA has also received a legal opinion in relation to AQIS that its Act covers a body like AQIS.⁶¹

6.62 In addition, the enabling legislation of monopoly GBEs, such as the FAC and the CAA, requires that they consult with their customers. This provides another means by which pricing practices can be exposed to public scrutiny. The mode of operation of the consultative system and an assessment of how effectively it is working is provided in Chapter 7.

6.63 Consultative arrangements have also been set up for business units. For example, Australian Protective Services negotiates its prices and annual budgets with its customers.⁶² DASFLEET, whose customers are tied to it, described the consultative mechanisms with which it is involved. It told the Committee that the Government had:

... established, under the chairmanship of the Department of Finance, a forum which includes Finance and a number of our major customers. The forum reviews our performance and our pricing to make sure that the monopoly position of DASFLEET is not abused. It has also agreed that annually there will be an independent audit of DASFLEET's performance, efficiency and effectiveness.⁶³

6.64 On a more general level, the Report of the National Competition Policy Review (the Hilmer Report) made a number of recommendations that, if implemented, would alter considerably the surveillance regime applying to government businesses.⁶⁴ For example, it recommended that Australian

61 PSA, *Transcript*, pp. 670-1 (Canberra, 4 February 1994).

62 Attorney-General's, *Submission*, p. S2377, (Vol. 7 of Submissions).

63 DAS, *Transcript*, pp. 445-6 (Canberra, 31 January 1994).

64 *National Competition Policy: Report by the Independent Committee of Inquiry*, AGPS, Canberra, August 1993.

governments establish independent pricing bodies on the lines of the New South Wales Government Pricing Tribunal. It also recommended that a national oversight and monitoring regime should operate by declaration of a designated Commonwealth Minister, subject to certain limitations, such as no price control power.

6.65 The Council of Australian Governments agreed to the principles of the competition policy articulated in the Hilmer Report at its meeting in February 1994. The practical aspects of implementing the recommendations are now under consideration and, together with the changes proposed by the PSA to meet changing market circumstances, will have a significant impact on the arrangements now in place for regulating prices.

Capital Structure

Government Business Enterprises

6.66 The capital structure of a business is the mix of debt and equity used to fund it. The debt/equity ratios of the Commonwealth's GBEs range widely, from 0% to 93%, as shown in Table 6.3. In providing the information shown in the Table, Finance commented on some of the factors that have determined each GBE's ratio. Firstly, different considerations applied to the trading and financial institution GBEs.

The capital structures of the GBEs which lend money (CBA [Commonwealth Bank of Australia], AIDC [Australian Industry Development Corporation] and EFIC [Export Finance and Insurance Corporation]), typically differ from those of trading GBEs, as the core revenue of the former is derived from the margin earned above the cost of their liabilities (retail deposits plus borrowings). Hence, banks borrow to lend rather than to purchase assets. Their gearing ratios will therefore differ markedly from trading companies with the ratio being much higher. The capital structures of insurance companies (EFIC and HLIC [Housing Loans Insurance Corporation]) will also differ from trading companies as their revenue arises from their premium income while their liabilities are mostly related to

*claims or provisions for claims, rather than borrowings. Hence it would not be necessary to maintain a standard capital structure which has, as its central precept, the ability to repay borrowings rather than provisioning against risks.*⁶⁵

6.67 Secondly, the GBEs' capital structure reflected their historical development.

*The debt/equity ratio of each of the Commonwealth's GBEs reflects the capital structure provided by the Government at the time of the establishment of the GBE and subsequent events, in particular financial results from operations, dividend policies applied to the GBE, borrowings and decisions taken to restructure the capital base of the GBE and to the provision of additional equity.*⁶⁶

6.68 The Accountability and Ministerial Oversight Arrangements indicate that GBEs' capital structures should be reviewed every five years.⁶⁷ Such reviews take account of the need to fund future investments and maintain a stable capital structure. In addition, as GBEs are increasingly exposed to competition, it is also important that a GBE's capital structure is revised so as to remove any competitive disadvantage. Finance reported that it was for this reason that the Government decided in 1991 to convert \$2b of its loans to Telstra to equity over a period of five years.⁶⁸

6.69 A similar situation was brought to the Committee's attention by the Australian National Railways Commission (AN). Its debt/equity ratio of 75% was markedly higher than the less than 50% that characterised the ratios of comparable companies listed on the Stock Exchange. AN pointed out that:

AN has to price services to compete with this sector with a non commercial gearing ratio. A poor gearing ratio will

⁶⁵ Finance, *Submission*, p. S2277 (Vol. 7 of Submissions).

⁶⁶ Finance, *Submission*, p. S2272 (Vol. 7 of Submissions).

⁶⁷ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, p. 2.

⁶⁸ Finance, *Submission*, p. S2276 (Vol. 7 of Submissions).

Table 6.3 Gearing Ratios of Government Business Enterprises*

Government Business Enterprises	1989-90	1990-91	1991-92	1992-93	1993-94
Trading GBEs					
Australian Defence Industries Limited	0%	1%	0%	16%	19%
Australian Maritime Safety Authority	n/a	24%	26%	25%	24%
Australian National Line Limited ***	42%	49%	37%	32%	n/a**
Australian National	72%	71%	88%	90%	73%
AeroSpace Technologies of Australia Limited	19%	24%	26%	27%	31%
Australian Technology Group	n/a	n/a	n/a	0%	0%
Australia Post	n/a	4%	4%	4%	23%
Civil Aviation Authority	45%	54%	33%	31%	24%
Commonwealth Funds Management	n/a	n/a	40%	41%	0%
Defence Housing Authority	25%	30%	42%	30%	28%
Federal Airports Corporation	33%	33%	36%	39%	40%
National Rail	n/a	n/a	1%	1%	0%
QANTAS	73%	76%	74%	64%	58%
Snowy Mountains Hydro-electric Authority	99%	98%	25%	26%	27%
Telstra Corporation	n/a	n/a	47%	42%	35%
The Pipeline Authority	100%	100%	100%	100%	n/a
Financial Institution GBEs					
Australian Industry Development Corporation	91%	92%	94%	93%	93%
Commonwealth Bank of Australia	93%	93%	91%	91%	91%
Export Finance & Insurance Corporation	90%	92%	93%	94%	91%
Housing Loans Insurance Corporation	0%	0%	0%	0%	0%

NOTES:

* Gearing Ratio is defined as Total Interest Bearing Debt (Total Interest Bearing Debt Plus Total Equity)

** 'n/a' - not available or not applicable

*** If ratio is adjusted to remove future income tax benefits and unrealised exchange losses and to include non-cancellable operating leases, as per the consultants' (Price Waterhouse/Salomon Brothers) report on ANL the following ratios are obtained:

Year	1989-90	1990-91	1991-92	1992-93	1993-94
Gearing Ratio	13%	41%	63%	59%	n/a

Source: Finance, Submission, p. S2279 (Vol. 7 of Submissions).

force AN to charge prices for services higher than our competitors, causing it to be non-competitive or resulting in an inefficient allocation of resources ...

Providing AN with an appropriate capital structure suitable to its new role has been recognised by Government as an issue which must be resolved and will be addressed in mid 1995. AN has submitted that such a review must result in providing AN with a capital structure which is comparable with its competitors in the private sector, particularly as AN is expected to earn commercial returns similar to publicly listed corporations to justify the Government's continued investment in AN's assets.⁶⁹

In 1993-94, the Government decided to increase its equity in AN.

6.70 However, Finance made the point in one of its submissions to the Inquiry that:

Debt/equity ratios vary significantly in the private sector amongst firms in the same industry; hence it is difficult to establish in any deterministic sense, by reference to the private sector, what is an appropriate level of debt for a GBE.

There are arguments for and against GBEs having high debt/equity ratios. High levels of debt provide a more certain return to lenders/investors and generally cause boards to adopt more conservative approaches to expansion. On the other hand high levels of debt reduce reported profits and can increase the exposure of the profitability of the enterprise to economic fluctuations.

Taken as a group, GBEs now borrow mainly from the private sector, whereas in previous periods they have borrowed significant amounts from the Commonwealth. Returns to the Commonwealth from its investment in GBEs now mainly take the form of dividends rather than interest on borrowings. Hence dividends and interest are no

69 AN, Submission, p. S2026 (Vol. 5 of Submissions).

longer alternatives from the point of view of the return to the Commonwealth Budget.

... Judgements about the appropriate capital structure for a GBE are made on a case-by-case basis and take into account all relevant financial and operational factors and the portfolio preferences of the Government as the investor.⁷⁰

6.71 In addition to the considerations discussed above, the suitability of a GBE's capital structure can also be judged in relation to the criteria used by international credit rating agencies to assess business performance.

Business Units

6.72 Business units in departments of state are not able to borrow in their own right because they do not have an existence separate from the Commonwealth. Those business units which are considered to be fully commercialised are assigned a notional capital structure, so that they are operating under the same conditions as their private sector competitors.⁷¹

Monitoring Financial Arrangements

Government Business Enterprises

6.73 As described earlier in this chapter, the Accountability and Ministerial Oversight Arrangements require GBE boards to prepare annual corporate plans (including business plans, financial targets and projections), to provide annual performance reports and, in addition, to provide six monthly reports (or quarterly if agreed) to the responsible Minister. The reports detail progress against, or changes to, the corporate plan and include financial statements. The Arrangements

⁷⁰ Finance, *Submission*, p. S2243 (Vol. 7 of Submissions).

⁷¹ Finance, *Submission*, pp. S1427, S1429 (Vol. 4 of Submissions).

state that the responsible Minister shall provide copies of such reports to the Minister for Finance.

6.74 In a submission to the Inquiry, Finance indicated that these arrangements are designed to provide:

... the opportunity for analysis of risk so that the Government may be alerted to cases in which a GBE is placing the Government's shareholding at undue risk, or at an increasing level of risk, or where they are creating an unacceptable level of contingent liabilities on the entity.⁷²

6.75 The Committee believes that these arrangements are appropriate and notes that the Commonwealth Authorities and Companies Bill provides for similar reporting requirements on the financial performance of GBEs.

6.76 The Committee also endorses those elements of the Bill which require Commonwealth authorities and companies to keep the responsible Minister informed of significant events and transactions, and more generally to keep the responsible Minister and the Minister for Finance informed of the operations of the company.⁷³

Business Units

6.77 There is less central monitoring of the financial arrangements for business units than there is for GBEs. Some departments have negotiated monitoring regimes which see the provision of regular reports to Finance, others appear to have purely internal arrangements.

6.78 The Committee notes, for example, that DAS business units routinely provide copies of their business plans and interim reports to Finance for scrutiny. Evidence presented to

⁷² Finance, *Submission*, p. S2245 (Vol. 7 of Submissions).

⁷³ See Clauses 15, 16, 39 and 40 of the Commonwealth Authorities and Companies Bill 1994 and, for the Committee's comments on these clauses, see Joint Committee of Public Accounts, *An Advisory Report on the Financial Management and Accountability Bill 1994, the Commonwealth Authorities and Companies Bill 1994 and the Auditor-General Bill 1994*, Report 331, AGPS, Canberra, September 1994, pp. 39-42.

the Committee indicates that not all departments have such routines. Yet the value of a central agency examining the plans and projections of business units was highlighted by an incident involving AUSCRIPT, one of the business units within the Attorney-General's portfolio.

6.79 Finance reported to the Committee that, in December 1992, it had advised portfolio departments that 'the Minister for Finance and the Attorney-General should be consulted in advance on any proposals to establish or vary a direct Commonwealth interest in a company'.⁷⁴ In spite of this direction, Attorney-General's failed to consult Finance about the setting up of a joint venture company involving AUSCRIPT and a Singaporean company. The company was incorporated in Singapore in March 1993, but Finance was not notified of the company's incorporation until December 1993. Copies of documentation relating to the company were not forwarded to Finance until March 1994. Finance was therefore unable to undertake a comprehensive risk assessment of the proposed joint venture before it was established. In a submission to the Inquiry dated 17 November 1994, Finance indicated that it was still 'not yet satisfied that the Commonwealth has not been exposed to undue risk through AUSCRIPT's joint venture (AUSCRIPT (Asia) Pte Ltd) with a Singaporean company'.⁷⁵ It appears to the Committee that, if regular reports had been made to Finance, this type of situation would not have arisen.

6.80 AUSCRIPT's joint venture with its Singaporean partner is a small, low risk concern. It does, however, raise an important issue in so far as the Government expects its own agencies to maximise any opportunities available to them to export their skills and services. The number of joint ventures undertaken by departments can therefore be expected to increase in coming years. The problems that may arise from overseas joint ventures by departments of state was explained by Finance with respect to AUSCRIPT.

⁷⁴ Finance, *Submission*, p. S2246 (Vol. 7 of Submissions).

⁷⁵ *ibid.*, p. S2289.

*As AUSCRIPT is effectively a branch of the Attorney-General's Department, it has no legal existence separate from the Commonwealth. AUSCRIPT's shareholding in the Singaporean joint venture may therefore be exposing the Commonwealth to financial liabilities as well as political risks given that the company is an independent, foreign managed entity. Furthermore, it is unclear to what extent the limited liability corporate structure of the joint venture will protect the Commonwealth from financial damage. Under some foreign jurisdictions, we understand that AUSCRIPT (Asia) Pte Ltd could be considered to be operating commercially as an arm of the Australian Government and this could expose the Commonwealth to legal action.*⁷⁶

Finance concluded that:

Public sector agencies involved in overseas joint ventures need [to] show more than usual caution because, in the event of losses, legal disputes with parties, etc, the very fact of their being government agencies may result in political or even diplomatic sensitivities. ...

*Commonwealth entities need to be satisfied that any overseas activities will not compromise their core responsibilities, that they can limit any potential Commonwealth liability and can meet any claims or losses that might eventuate.*⁷⁷

6.81 While there is a particular need for care with overseas joint ventures, care also needs to be exercised with joint ventures within Australia. This is particularly the case as such undertakings become more common as a means of delivering public services and bringing innovations developed in either sector to the market. Several departments are involved in such ventures for example, the Departments of

⁷⁶ *ibid.*, p. S2289.

⁷⁷ *ibid.*, pp. S2283-4.

Social Security and Employment, Education and Training.⁷⁸ The recent experience of organisations, such as CSIRO, with expensive litigation associated with commercialisation of their products draws attention to the difficulties that may arise.

6.82 The Committee notes that, although the Commonwealth Authorities and Companies Bill contains clauses that would:

- require Commonwealth authorities and their subsidiaries to notify their portfolio Ministers of proposals to participate in, among other things, joint partnerships and joint ventures (s.15); and
- allow the Minister for Finance to require the directors of a Commonwealth authority to provide information (s.16),

there is no comparable requirement in the Financial Management and Accountability Bill to cover departmental joint ventures.

6.83 The history of the AUSCRIPT joint venture is in stark contrast to the good practice developed by DAS. To help prevent problems from occurring with joint ventures, the Committee believes that all departments operating business units should adopt the practice of referring the business plans of those units to Finance for comment.

6.84 Recommendation 22

All departments of state which operate business units should, on a regular basis, submit the business plans of those business units or other commercial activities to the Department of Finance for comment.

⁷⁸ For example, Department of Social Security, *Submission*, p. S1555, (Vol. 4 of Submissions); N Hooper, 'PS exports its know-how', *Business Review Weekly*, 16 (42), 31 October 1994, p. 24.

Conclusion

6.85 From its review of the financial arrangements that apply to the Government's businesses, the Committee concludes that much work has been done to provide an appropriate framework. Nonetheless, there are still sizeable gaps that need urgent attention. The Committee notes that efforts are continuing in several areas:

- to establish appropriate methods of asset valuation and institute their use for government businesses;
- to further develop the methodology for setting target rates of return; and
- to implement the new arrangements for monitoring pricing, particularly by monopoly businesses.

6.86 A core document setting out the broad parameters for the operation of GBEs has been in existence for some years. The arrangements for the Government's business units in departments of state have yet to be formalised across portfolios to the same extent. Finance has started the process of producing the necessary guidelines at both policy and practical levels. The Committee has urged that this process be finished as soon as possible. It should include the requirement that the business plans of business units are monitored by Finance.

6.87 Pricing is a topic on which guidance is available but is either insufficient or not adequately used. Ways of providing more information in an appropriate form and encouraging its use need to be found.

Introduction

7.1 The Commonwealth's commercialised activities are covered by the overall framework of accountability that applies to all activities undertaken by Commonwealth bodies. In its submission, Finance describes this framework thus:

... Ministers are accountable to Parliament for the activities that are undertaken within their portfolios. Commonwealth bodies are obliged to provide Ministers with sufficient information to enable them to account to Parliament for the performance of the programs for which they are responsible.¹

7.2 This view of the accountability of government agencies represents the traditional, hierarchical mechanisms of the Westminster system, in which accountability is seen to be directed upwards. A wider view of accountability accommodates 'a much more open and multidimensional process, with sideways and downwards as well as upwards components'.² This wider accountability involves the clients of government agencies and external review bodies such as the courts, administrative appeals tribunals and the Ombudsman. As a group of senior public servants pointed out in a recent publication, the traditional, hierarchical relationships between ministers and the agencies for which they are responsible, have been complemented by other mechanisms.³ This chapter covers both the more traditional accountability mechanisms and the newer ones.

1 Finance, *Submission*, p. S1437 (Vol. 4 of Submissions).

2 R Wettenhall, 'Corporatised bodies old and new: is parliament missing out?', *Papers on Parliament*, no. 21, Dec. 1993, p. 73.

3 Management Advisory Board & Management Improvement Advisory Committee, *Accountability in the Commonwealth Public Sector* (No. 11), AGPS, Canberra, June 1993, p. 4.

Accountability to the Parliament for Business Units

Introduction

7.3 As parts of departments of state, business units are generally subject to the same accountability requirements as the departments of which they are part. Business units are subject to the same level of ministerial oversight as other programs within a department, to the same annual reporting requirements, and to the same level of parliamentary scrutiny. Specifically, business units are subject to:

- scrutiny by Senate Estimates and other parliamentary committees;
- audit by the Auditor-General;
- review by the Ombudsman;
- Freedom of Information legislation;
- oversight by the Department of Finance (Finance); and
- Cabinet and other government reviews of operations and policies.

Business units may also be investigated by the Trade Practices Commission and the Prices Surveillance Authority (PSA).⁴

7.4 However, the financial arrangements which have been put in place to allow business units to operate commercially have given rise to some special accountability arrangements.

Trust Accounts and Accountability

7.5 One distinguishing feature of business units is that they operate from Group 2 Trust Accounts rather than from the Consolidated Revenue Fund, as do departments of state. Trust Accounts are a mechanism that allows business units to operate outside the system set up to administer budget appropriations.

4 Department of Administrative Services, *Submission*, p. S342 (Vol. 1 of Submissions).

7.6 In evidence to the Committee, Finance has argued that the establishment of Group 2 Trust Accounts, while allowing business units more flexibility in their financial operations, does not undermine, but rather enhances, the accountability of their operations. This is because:

- the establishment of Trust Accounts must be fully justified to the Minister for Finance;
- the scope and purpose of Trust Accounts must be carefully defined; and
- a financial framework must be established that includes financial and performance reporting, asset management and funding arrangements.⁵

For example, the reasons that the Department of Administrative Services (DAS) has established its Business Services Trust Account are enumerated in both the purpose clause for the Account and in the memorandum of understanding with Finance, which also outlines the financial framework for that Account.⁶

7.7 The Financial Management and Accountability legislation that is currently before Parliament will replace the existing Trust Accounts for commercial entities with components of the Commercial Activities Fund. These components will operate in much the same way as the existing Trust Accounts, except that the determinations by which they are established will be disallowable instruments.

Guidance on Accountability Issues

7.8 The Committee notes that Finance's discussion paper on the policy framework for commercialisation covers the following accountability issues:

- the business's relationship with its Minister, including what matters he or she might be involved with, as one of the owners' representatives;

⁵ Finance, *Submission*, pp. S1437-8 (Vol. 4 of Submissions).

⁶ DAS, *Submission*, pp. S366-71 (Vol. 1 of Submissions).

- the Minister for Finance's involvement as the Commonwealth's banker and financier in setting dividend policies and expected returns on investment, and monitoring commercial viability and borrowings; and
- the need to tailor accountability arrangements to match the risk characterising the commercialised activity or the flexibility of the funding arrangements.

The Committee understands that the practical guide to commercialisation, which Finance is preparing, will also deal with these issues.

7.9 To provide specific guidance to its business units DAS has drawn up its own accountability framework. The framework was derived from the policy guidelines for statutory authorities and government business enterprises (GBEs) which existed at the time. These guidelines were modified to reflect DAS's status as a department of state, and strike 'a balance between the Minister's formal accountability to the Parliament for all DAS operations and the needs of DAS business managers for extensive devolution of authority'.⁷ Thus, the Minister reviews and endorses annually the strategies and performance targets of the business units, and receives regular reports against these plans. The Minister for Finance also approves the units' annual business plans, and receives quarterly and annual financial reports on them.⁸

7.10 Another important element in the accountability of DAS business units is that each business operates in accordance with a charter which has received Cabinet approval.⁹ These charters contain a clear statement of the objectives of each business and provide a basis for monitoring the performance of each business. A clear statement of business objectives is not only an essential prerequisite for business success, but is also an essential part of an effective accountability regime.

⁷ DAS, *Submission*, p. S364 (Vol. 1 of Submissions).

⁸ *ibid.*; Finance, *Submission*, p. S1438 (Vol. 4 of Submissions).

⁹ DAS, *Submission*, p. S364 (Vol. 1 of Submissions).

Agency Views

7.11 Finance claims that commercialised activities are exposed to 'a greater degree of accountability for performance than applies to the public service generally', provided:

- the commercialised activities are subject to the disciplines of the market;
- they are fully costed on an accrual basis;
- corporate and business plans are submitted to Ministers for approval; and
- expenditure on budget-funded public interest activities is explicitly identified.¹⁰

7.12 DAS agrees that its 'commercialised activities are now more accountable than they were prior to commercialisation', as does the Attorney-General's Department (Attorney-General's).¹¹ They point to:

- the transparency of asset management resulting from user charging, freedom of choice, accrual based accounting and the use of Group 2 Trust Accounts; and
- the clear identification and analysis of community service obligations (CSOs) that has accompanied the introduction of commercialisation.

7.13 The Secretary of Finance did, however, admit that 'maybe a trust account is a less transparent form [of accountability] for the Parliament'.¹² The Trust Accounts stand to become more transparent to the Parliament than they have been with the passage of the Financial Management and Accountability Bill. The Bill will make these business units' Trust Accounts into components of the Commercial Activities Fund, the establishment of which will be disallowable by the Parliament.

10 Finance, *Submission*, p. S1438 (Vol. 4 of Submissions). Finance is considering introducing the requirement that three-year rolling business plans be produced for commercialised activities (Finance, *Submission*, p. S2416 (Vol. 7 of Submissions)).

11 Attorney-General's, *Submission*, p. S1148 (Vol. 3 of Submissions); DAS, *Submission*, p. S342 (Vol. 1 of Submissions).

12 Finance, *Transcript*, p. 61 (Canberra, 8 November 1993).

7.14 Furthermore, DAS has argued that its businesses are subject to greater scrutiny than their private sector counterparts and other areas within the public sector. Private sector firms, for example, can generally apply greater degrees of commercial confidentiality to their operations and outcomes, while public service departments operating under the traditional cash based accounting systems are not required in all cases to account for the full costs of their operations.¹³

Conclusion

7.15 It appears to the Committee from its examination of the accountability mechanisms applying to DAS business units that the arrangements in place are adequate and effective. However, there was sparse information available to the Committee about the arrangements for other business units. The Committee understands that Finance's practical guide to commercialisation will cover this topic. It is unfortunate that this guide was not available at an earlier stage. Recommendation (paragraph 2.72) puts pressure on Finance to issue the guide as soon as possible.

7.16 There are some concerns, however, that the enhanced accountability required of business units has its drawbacks. Attorney-General's was concerned that:

*... [the] duplication of exposure (i.e. through Program Performance Statements and Senate Estimates, as well as through the Annual Report and Financial Statements) places Government commercial activities at a disadvantage compared to private sector counterparts who are not subjected to the same level of public scrutiny.*¹⁴

7.17 The Committee appreciates the nature of the concerns expressed by Attorney-General's, but believes that it would be inappropriate to reduce the accountability obligations for business units.

13 DAS, *Submission*, p. S343 (Vol. 1 of Submissions).

14 Attorney-General's, *Submission*, p. S1150 (Vol. 3 of Submissions).

Accountability through the Minister to the Parliament for Government Business Enterprises

Introduction

7.18 An important theme in the reform of GBEs has been clarifying the responsibilities of GBE management, boards and the relevant Minister. The objective has been to give GBE boards responsibility for the financial performance of the business while retaining ministerial control at the strategic level. Broadly, the Government's intention has been to involve itself in business, not as a day to day manager, but as an active and interested shareholder.

7.19 At the same time as allowing GBE boards more flexibility in their operations, the Government has sought to make clear that a definite and clear chain of accountability exists. The Government's Management Advisory Board (MAB) and Management Improvement Advisory Committee (MIAC) has described the claim in the following terms:

- . *staff in GBEs are accountable to management, and ultimately to the board through the chief executive officer (CEO);*
- . *the CEO, as the individual in charge of day-to-day management, is accountable to the board;*
- . *individual board members (including the CEO), and the board itself, are accountable to the relevant portfolio minister for achievement of the corporate plan and financial targets; and*
- . *the minister, on behalf of the Government, is accountable to Parliament for the performance of GBEs within his or her portfolio.¹⁵*

¹⁵ MAB & MIAC op. cit., p. 18.

7.20 The following sections consider in more detail the general accountability framework for GBEs, and highlight some issues requiring further attention.

General Accountability Framework

7.21 The accountability arrangements for GBEs are currently defined in the Accountability and Ministerial Oversight Arrangements, in the annual reporting guidelines for statutory authorities, and in the enabling legislation, articles of association or memoranda of understanding for specific GBEs.

7.22 The main features of the Accountability and Ministerial Oversight Arrangements, were summarised by Finance as follows.

- The responsible Minister sets a clear mandate and objectives for each GBE and leaves the day-to-day management of the GBE to the board.
- Boards develop business strategies and consult the responsible Minister as appropriate before implementing the strategies.
- GBEs produce annual corporate plans, which cover three to five years ahead, and consult the responsible Minister before finalising each plan.
- GBEs provide interim reports regularly (at least every six months and for some GBEs every three months) on progress against the corporate plan.
- GBEs are to work towards a financial target, including a dividend policy usually agreed in the corporate planning process.
- The responsible Minister is to consult the Minister for Finance on GBE corporate plans and interim reports and on all other major matters affecting GBE accountability and performance.¹⁶

7.23 The accountability arrangements specified in enabling legislation or memoranda of understanding typically require

¹⁶ Finance, *Submission*, p. S1439 (Vol. 4 of Submissions).

GBE boards to make publicly available details of any directions issued by the Minister and to provide information about performance targets and achievements.

7.24 Another reporting and accountability mechanism is provided by the Steering Committee on Performance Monitoring of Government Trading Enterprises. This body, which was set up after the Special Premiers' Conference in July 1991, collects information on the basis of which GBE owners can assess GBE performance and plan for their future. Similarly, Finance provides an annual, confidential report to Cabinet on the financial performance of all GBEs.

7.25 The Commonwealth Authorities and Companies (CAC) Bill 1994, which is currently before Parliament, draws together into a single set of reporting and accountability requirements the current requirements that are scattered through numerous enabling Acts, company memoranda and articles. Many of the clauses in the Bill impose on the executive officers of non-incorporated GBEs similar requirements to those imposed on companies incorporated under Corporations Law.

The Corporate Plan

7.26 The corporate plan is the main plank of accountability of a GBE board to the portfolio Minister. While it is not a formal contract, it is a legal requirement dating from the 1987 reforms, that has been written into enabling legislation, memoranda and articles of association or shareholders' agreements.¹⁷ The Accountability and Ministerial Oversight Arrangements issued in 1993 specify the contents of the plan.¹⁸ The information provided in the plan is updated at least annually and should include:

¹⁷ Finance, *Submission*, p. S2237 (Vol. 7 of Submissions).

¹⁸ *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises*, May 1993, pp. 3-4. Sections 17 and 41 of the CAC Bill 1994, which is currently before the Parliament, contain almost identical requirements, and will replace existing requirements in the enabling legislation of existing GBEs.

- objectives, including ministerially agreed financial targets;
- assumptions about the business environment;
- business strategies;
- investment and financing programs, including strategies for managing financial exposure;
- financial projections;
- dividend policy;
- non-financial performance information;
- CSO details and costs, including strategies for managing costs;
- review of performance against past plans and targets;
- analysis of critical factors most likely to affect achievement of targets, or expose the GBE or its shareholder to significant risk;
- pricing/service quality controls in the case of monopoly provided services; and
- major human resources and industrial relations strategies.

Boards are also responsible for keeping Ministers informed on an ongoing basis of significant changes in the areas listed above.

7.27 The corporate plan is confidential to Ministers and their advisers and portfolio departments although, in some cases such as Australia Post and the Federal Airports Corporation (FAC), some details are contained in the annual report.

Annual Reports

7.28 The main publicly available information about GBE performance is contained in their annual reports which their Ministers table in Parliament. In the 1987 guidelines for statutory authorities and GBEs, these annual reports were described as the 'centrepiece' of accountability for these bodies.¹⁹

¹⁹ Minister for Finance, *Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises*, AGPS, Canberra, October 1987, p. 10.

7.29 Annual reporting by statutory corporations is subject to guidelines that were issued in 1982. In addition, if the corporations are incorporated as companies, they are bound by the requirements imposed by Corporations Law as well. As ANL Ltd told the Committee:

*Our accountability, primarily, is to the Companies Act. We operate totally under the Companies Act and all of the requirements of the public companies sections of the Companies Act in terms of reporting, style of reporting, nature of reporting, timeliness of reporting.*²⁰

Government Business Enterprises' Views of the Accountability Arrangements

7.30 Both private and public sector organisations commented on the accountability regime that has been established for GBEs. For example, Australia Post told the Committee that the system of accountability checks that applies to it is adequate and working effectively.²¹

7.31 The Civil Aviation Authority (CAA), in its submission to the Inquiry, welcomed the promulgation of the Accountability and Ministerial Oversight Arrangements for 'the additional guidance they provide to the Board and management of the Authority'.²² The guidelines were described as 'appropriate' in an academic review of Australian governments' accountability regimes,²³ and the Public Sector Union (PSU), as it then was, judged that they had some welcome features.²⁴ The Australian National Audit Office (ANAO) described the guidelines as providing 'some important initiatives in relation to the monitoring of government business enterprises'.²⁵

20 ANL, *Transcript*, p. 1744 (Sydney, 15 June 1994).

21 Australia Post, *Transcript*, p. 2283 (Canberra, 18 August 1994).

22 CAA, *Submission*, p. S542 (Vol. 2 of Submissions).

23 E Harman, 'Accountability and challenges for Australian governments', *Australian Journal of Political Science*, Vol. 29(1), March 1994, p. 8.

24 PSU, *Submission*, p. S1272 (Vol. 3 of Submissions).

25 ANAO, *Transcript*, p. 109 (Canberra, 8 November 1994).

7.32 The FAC compared the accountability regime to which it is subject with that applying to a private sector business (Table 7.1). It commented that, 'whilst acknowledging that accountability is desirable, the FAC notes that the burden of existing accountability mechanisms is significant'.²⁶ They are certainly more onerous than those applying to the private sector. During discussions with the Committee, the Director of Corporate Services from the Australian National Railways Commission (AN) indicated that AN regarded the accountability and oversight arrangements as appropriate for a government exercising its role as a shareholder of the business. He did, however, express concern that the accountability arrangements applying to government businesses such as AN should not be more onerous than those applying to publicly listed companies.²⁷ He believed that requirements imposed by Corporations Law and listing under the Stock Exchange are appropriate prudential controls.

Clients' Views of Accountability Arrangements for Government Business Enterprises

7.33 Mr J V Kimpton, the Manager of Aviation Policy for Ansett acknowledged that 'the Government as equity provider and lender, and other lenders, should be provided with sufficient information by the CAA and FAC to assess the state of their investments'. Mr Kimpton commented further that 'there is no suggestion that these formal requirements are inadequate; supplemented, as they no doubt are, from time to time with informal updates and briefings'.²⁸

26 FAC, *Submission*, p. S656 (Vol. 2 of Submissions).

27 See also AN, *Submission*, pp. S2025A-26 (Vol. 5 of Submissions).

28 Ansett, *Submission*, p. S456 (Vol. 1 of Submissions).