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ACTEW CORPORATION

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Mr Richard Mulcahy MLA
Chair
Standing Committee on Public Accounts
ACT Legislative Assembly
GPO Box 1020
CANBERRA ACT 2601

Dear Mr Mulcahy

I refer to our recent correspondence regarding ACTEW's submission to the Public Accounts Committee's Inquiry into the Auditor-General's Report No. 5 of 2006 on Rhodium Asset Solutions Limited (Rhodium). ACTEW welcomes the opportunity to respond to the Report.

The Report raises a number of general and specific matters related to governance principles and practices. Given the significance of these issues, ACTEW sought legal advice from one of Malleson Stephen Jaques' special counsels, Mr Stephen Skehill. Attached is a copy of Mr Skehill's advice which the ACTEW Board has reviewed and accepted.

Following the release of the Report, an analysis of the Auditor-General's recommendations and a review of ACTEW's governance framework was undertaken to determine the appropriateness and adequacy of governance arrangements for the Corporation. As will be apparent, we consider that ACTEW's internal governance arrangements are highly refined and at least adequate to detect and if necessary, address occurrences of the types criticised by the Auditor-General in relation to Rhodium.

The Board is accountable to the Shareholders for the overall strategic direction, management and corporate governance of ACTEW. Responsibility for day to day management and administration of ACTEW is delegated by the Board to the Managing Director and the Executive team. The Managing Director manages ACTEW in accordance with the strategy, directions, plans and policies approved by the Board.

The obligations and requirements of the Corporations Act, the TOC Act and the Company's Constitution set the broad framework for ACTEW's governance arrangements. A corporate governance charter and various policies, procedures, delegations and guidelines underpin these key documents and include, but are not limited to, corporate administration, human resource management, ethical standards,

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risk management, directors' duties and obligations, financial management, and legal and regulatory compliance. These are periodically reviewed and updated as required.

ACTEW's business goals and priorities are outlined in the Statement of Corporate Intent which is provided annually to the Shareholders for information and consideration and tabled in the ACT Legislative Assembly. Quarterly reports on financial and operational matters are provided to the Shareholders and outcomes reported in the Annual Report.

The Board receives regular reports on business and financial performance, licence and regulatory compliance, audit and risk management, health and safety, human resources and capital expenditure. A schedule of regular reporting requirements to the Board is maintained, reviewed and updated annually.

The Board's Audit and Risk Management Committee is governed by the Audit and Risk Management Committee Charter. The Committee meets quarterly and assists the Board fulfil its legal responsibilities and strengthen the objectivity and credibility of financial reporting, management of its business risks, the independence of the audit functions and the effectiveness of internal control systems. The Committee approves the annual internal audit program for ACTEW and an annual meeting planner which details activities and functions for the year. ACTEW's internal audit activities are coordinated by ActewAGL's Audit Services and PricewaterhouseCoopers provides external audit services. Other independent auditors are engaged as appropriate.

ACTEW has a detailed risk register which is comprehensively reviewed annually by ACTEW management, key staff and an external risk management adviser and submitted to the Audit and Risk Management Committee and the Board. Quarterly reviews of the register are also undertaken and a report provided to the Audit and Risk Management Committee and the Board.

ACTEW undergoes an interim and end of year financial audit by the Auditor-General's contracted auditor each year. Issues the audit covers includes:

- Tests and controls of ACTEW's financial systems;
- Full set of financial statements that are compliant with AIFRS;
- Risk of fraud;
- Mapping of trial balance to the financial statements;
- Reconciliation of all balance sheet accounts;
- Analysis of ACTEW's results and explanations on variances;
- Review of minutes of the Board of Directors, Audit and Risk Management Committee and other significant meetings; and
- Workpapers supporting disclosures in the financial statements.

The provision of IT equipment, systems and support is provided by ActewAGL. ActewAGL maintains a corporate procedure for IT security which covers risk analysis, data protection, access controls and disaster recovery planning.

A schedule of financial and administrative delegations and authorisations is maintained. The schedule is reviewed regularly and updated as required to ensure key positions within ACTEW maintain an appropriate level of authority for business and operational purposes. The schedule is provided to all relevant staff.

All credit card charges are authorised and reconciled into the financial system on a monthly basis. Approvals for payment of expenditure for corporate entertainment are in accordance with financial delegations.

ACTEW does not provide promotional products. A small inexpensive supply of corporate branded gifts was retained after the establishment of the ActewAGL Joint Venture for visiting delegations.

ACTEW has procedures for the management of company records. Implementation of the *Territory Records Act 2002* (ACT) (TRA) is continuing with the assistance of an external consultant in consultation with the Territory Records Office and progress has been reported in the ACTEW annual report since commencement of the Act.

ACTEW has a commitment to supporting the local community. For many years we have provided both major and minor sponsorships or provided in-kind donations to a variety of programs, events, charities and organisations. The Sponsorship Program has four established criteria which are taken into account when considering requests for financial assistance. To receive funding an event should:

- Play a role in the support of initiatives and events that benefit the ACT community and surrounding areas;
- Be relevant to ACTEW's broad interests, activities, responsibilities and mandate;
- Position ACTEW as a socially responsible organisation and good corporate citizen; or
- Provide opportunities to form networks and relationships within the business environment and community at large.

The Board approves the annual sponsorship budget and receives quarterly reports on expenditure and commitments. The Program is reported in ACTEW's Annual Report which is subject to scrutiny by the Public Accounts Committee.

Policies and procedures for human resource management, including recruitment and engagement of consultants are maintained. ACTEW's Pay Philosophy, approved by the Board, outlines the company's philosophy in relation to recruitment and remuneration of staff and reflects the reality of the commercial and business operations of the Corporation. Independent external reviews of remuneration paid to staff are undertaken periodically.

The Remuneration Committee, which comprises all members of the ACTEW Board, is governed by the Remuneration Committee Charter. The Committee annually assesses the performance of the Managing Director. The Committee also consults with the Managing Director on the annual review of performance appraisals and remuneration of ACTEW staff. The Managing Director has in place procedures and plans to annually assess the performance of the Executive team and all staff have performance plans which are assessed annually by their supervisor or manager.

ACTEW's Code of Conduct outlines the high standards of honesty, integrity and law abiding behaviour expected of ACTEW personnel. The Code which is reviewed on a regular basis and updated as required, is displayed in ACTEW's Offices and provided to all staff.

The Board approves ACTEW's annual capital expenditure program. Project and contract management is undertaken by our Joint Venture, ActewAGL. New projects are identified through ACTEW's Asset Management Plan, regulatory requirements or ACTEW's Strategic Directions Plan. For each major capital works project the business case is established. The business case addresses the need for the project and its benefits, including business risk management, sustainability and regulatory matters, project rationale and financial analysis based on preliminary estimates of cost. The scope of the project is developed, through options studies, concept design or preliminary design. During scope development, the initial project budget estimates, risks, time frames and delivery methodology are developed and refined.

ACTEW obtains third party verification of costs using experienced consultants and quantity surveyors. Approvals are obtained through Regulators, the ACTEW Board, and for significant projects, ACTEW's Shareholders are consulted and their agreement sought, as required by the TOC Act. Project delivery is through a Project Management Agreement. During project delivery, ACTEW management provides oversight and reports to the ACTEW Board. At completion, the project is financially closed, capitalised and entered into ACTEW's asset register.

In summary, the Auditor General made six recommendations. The information outlined above confirms ACTEW's compliance with good governance practices and principles and with the recommendations and observations made in the Report.

Finally, I hope this is of assistance to the Committee in its inquiry into the Auditor-General's Report into Rhodium.

Yours sincerely

Michael Costello AO
Managing Director

MALLESONS STEPHEN JAQUES

By email

16 October 2006

Mr Jim Service AO
Chairman
ACTEW Corporation Limited
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Dear Mr Service

Auditor-General's Report re Rhodium Asset Solutions Limited

We refer to your request for advice as to any legal issues which may arise from the comments and recommendations set out in the September 2006 Performance Audit Report of the ACT Auditor-General in relation to Rhodium Asset Solutions Limited (**"Rhodium"**) and as to the extent to which those comments and recommendations may be applicable to other ACT Territory Owned Corporations (**"TOCs"**) or, more specifically, to ACTEW Corporation Limited and its related bodies corporate.

1 Summary

1.1 It would involve a fundamental misconception of the law, and could promote a breach of the duties of a TOC's director under the *Corporations Act 2001* (Cth) (**"the Corporations Act"**), if readers were to interpret various comments made by the Auditor-General as requiring TOCs to adopt and not depart from public service norms on matters such as employment terms and conditions, sponsorships, etc.

1.2 It would similarly involve a fundamental misconception of the law to interpret comments made by the Auditor-General as requiring the voting shareholders of a TOC to determine the corporate direction and strategies of a TOC.

1.3 A TOC is a fundamentally different entity to a Government Department or other administrative agencies of the public service, and its directors and management have fundamentally different duties to those of officers engaged under the *Public Sector Management Act 1994* (**"the PSM Act"**). The norms applying to PSM employment and operations have no necessary relevance to those of a TOC.

1.4 The Auditor-General's recommendations in relation to Rhodium are, in their terms, inapplicable to any other TOC.

1.5 Whether any other TOC should take the same or similar remedial action as that recommended by the Auditor-General to be taken by Rhodium necessarily depends

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upon the present state of governance within the individual TOC and there is nothing in the report to indicate that any such action is necessarily required by any other TOC. Nevertheless, it may be appropriate for TOC boards and management to consider whether there are any lessons they might appropriately learn from the events at Rhodium as reported by the Auditor-General.

2 Analysis

2.1 It is appropriate to consider the comments and recommendations made by the Auditor-General separately.

Comments

2.2 The Auditor-General makes in her report a number of comments which could, if misconstrued, have important and adverse legal consequences. These comments essentially fall into two categories:

(a) those concerning the applicability or relevance of public service standards to a TOC and its personnel; and

(b) those concerning the role of voting shareholders in the conduct of the business of a TOC.

2.3 In relation to this first category, reference is made to the following passages of the report:

> At page 34: *It is recognised that as a TOC, Rhodium needs to operate and compete within a commercial environment. For this reason, a TOC is not always required to comply with the standards and rules applied to Government departments. Nevertheless, being a Government business and operating with taxpayers' money, there is community expectation that the Rhodium Board and management should ensure that decisions on public money are exercised with due care and integrity.*
>
> At page 47: *Some costs incurred on the credit cards included payment for meals and expensive wines, hire of movies, mini-bar purchases and accommodation in luxurious hotels, for entertainment, hospitality and travel expenses by Rhodium management and staff. Audit considers that these costs were often not in line with good practices, such as the Public Sector Management Best Practice Notes, and were at times excessive.*
>
> At page 57: *Rhodium, being a TOC, does not have to comply with Government policy in determining its executives' remuneration. The Board has the authority to determine the remuneration of the CEO and other executives. However, it is the expectation of the community that TOCs, which operate with*

taxpayers' moneys, will follow better practice in remunerating their executives and staff, including benchmarking against similar positions in the TOC sector and Government Senior Executives.

At page 62: *The* Public Sector Management Act 1994 *(PSM Act)establishes a foundation for human resource management in the ACT Public Sector. The legislation is supported by Standards and guidelines, which together set a personnel practices framework based on sound management and better practice. As a Territory Owned Corporation, Rhodium is not required to comply with the PSM Act. Nevertheless, as a Corporation funded from public money, the community would expect Rhodium to be guided by the general principles inherent in the PSM Act, and manage its human resources in a manner consistent with good business practice.*

At page 68 *Appointment, transfer, and promotion of public sector employees in the ACT is governed by the PSM Act. The Act does not apply to TOCs, in part because the Government has recognised that TOCs need the flexibility to respond to a competitive and commercial market environment. Nevertheless, the PSM Act outlines basic good practice principles for human resource management that can be applied to public and private sector employment. For example, the principles of merit and procedural fairness are integral to any sound recruitment processes.*

2.4 The potential peril in such passages is that they might be thought by some to suggest that a TOC should adopt and not deviate from standards applicable within the ACT Public Service. Such a view would misconstrue what the Auditor-General has in fact said but, more fundamentally, would also involve a mistake of law.

2.5 A TOC is a very different legal entity to a Government department or other agency subject to the PSM Act. Being formed under the Corporations Act, the directors and management of a TOC owe defined duties to the corporation itself as distinct from its shareholders or other stakeholders. They are bound to perform their functions in what they consider to be the best interests of the corporation rather than any other entity. In contrast, PSM employees owe their duties directly to the Government of the day rather than to any intervening entity such as a TOC. While senior executives subject to the PSM Act are bound to comply with Public Sector Standards, guidelines and policies, TOCs are expressly not so bound and indeed may in particular circumstances be bound to do otherwise.

2.6 Consistent with the Corporations Act, a TOC is statutorily obliged, under section 7 of the *Territory-owned Corporations Act 1990* (**"the TOC Act"**), to pursue certain main objectives which include operating at least as efficiently as any comparable business and to maximising the sustainable return to the Territory on its investment in the corporation.

2.7 So, by way of example, a TOC board is bound to ensure that it engages the services of staff who have all the requisite skills and experience to undertake the particular business of the TOC, under the board, in a way that optimises the prospects of attainment of these commercial objectives. While some such persons may possibly be found within the ranks of the public service or may otherwise be prepared to accept TOC employment on public service terms and conditions, this cannot be assured. Appropriate inquiry may indicate that such persons can only be attracted at higher rates of remuneration or on more favourable terms and conditions. If that is the case, a TOC board that failed to secure the services of the right employees simply because it was not prepared to deviate from public service terms and conditions would fail in its legal duty under the Corporations Act. In such a case, its legal obligation would be to offer such terms and conditions as were reasonably necessary to secure the requisite skills and experience.

2.8 This is not to say that remuneration levels within the public service can never be a relevant consideration for a TOC in setting its employment terms. Where it is competing with public service employers within the same skill set, then they may well be relevant. But where the TOC is competing in a broader market or for skill sets that are not available within the public service (which may frequently be the case for TOC positions that require commercial or other technical skills), public service remuneration levels will not be relevant. And, even if they are of some relevance for a particular position, they may be only one of the various considerations that all need to be factored into a final decision and, at that time, it may not only be appropriate but also legally necessary to depart from public service levels. While public service levels may be referred to by the Auditor-General in this context as a "benchmark", such terminology should not be interpreted to suggest that departure from that benchmark would be somehow necessarily blameworthy.

2.9 The above analysis holds good not only for staff terms and conditions but also for other aspects of a TOC's commercial operations, including some that were considered by the Auditor-General in the context of Rhodium - eg, sponsorships.

2.10 It is important to note that there is nothing in the TOC Act that contradicts this analysis, which derives from the Corporations Act. Indeed, if there were, any such provision would be constitutionally invalid by reason of inconsistency between Commonwealth and Territory law.

2.11 Despite the above, it is open to the shareholders of a corporation to absolve the corporation's directors from compliance with their ordinary duty. They may do so by exercising their Corporations Act rights to pass a resolution at a general meeting of the corporation to direct the board to operate in some particular way. Alternatively, in the case of a TOC, they may either give a direction under section 17 of the TOC Act or exercise their power under section 17A of that Act to advise directors of a Government policy with which they must comply. (However, by directing a TOC in this way, the Government may become liable to make a compensatory payment to the TOC.)

2.12 Before taking such action, because of the public rather than personal capacity in which they hold equity, a TOC's shareholders would have to satisfy themselves that it was in the public interest (ie, of net benefit to the community generally) that a TOC be forced to act in a less than commercial manner. Where the reasons leading to the constitution of the body as a TOC remain valid, it is conceivable that this test could simply not be met.

2.13 More fundamentally, of course, a Government that was not comfortable with the application of commercial standards within a publicly owned corporation could decide to dismantle the TOC's structure and absorb its functions within the public service (as was done with most Totalcare functions) or to sell the TOC (as was proposed with Rhodium itself).

2.14 The second category of comment, concerning the role of voting shareholders in the conduct of the business of a TOC, is reflected in the following comment:

> *Audit considers that the uncertainty of Rhodium's future, and a lack of clear directions from the Shareholders, made it difficult for the Board to provide and commit to appropriate long-term business strategies to drive Rhodium in achieving the best outcome for the shareholders.*

2.15 There is a danger that some readers might infer from this comment that the Government was somehow blameworthy on two scores:

(a) for failing to provide "clear directions" to Rhodium; and

(b) for creating uncertainty about the future ownership of Rhodium.

2.16 On both scores, any such attribution of blame would fundamentally misconstrue the nature of a corporation and the respective roles of shareholders on the one part and directors and officers on the other.

2.17 It is clearly established that it is the directors of a corporation formed under the Corporations Act who are responsible for setting the strategic direction of the corporation, and not its shareholders. While shareholders do have the option to exercise their voting rights at a general meeting in a manner that may influence strategic direction, they have no duty or responsibility to do so. Moreover, unless they have some reasonable basis to believe that directors are not appropriately acquitting their duty, one would not expect shareholders to even contemplate such action. That is, the proactive role lies with the directors and not shareholders.

2.18 This position under the Corporations Act is not affected in any way by the provisions of the TOC Act. In particular, sections 19 and 20 of the TOC Act are completely consistent with it. Those sections require a TOC's directors to draft a statement of corporate intent (which is to include, among other things, the corporation's business and corporate strategies) and to seek the voting shareholders' comments on that. However, it is crucial to appreciate that it is the directors and not the voting shareholders who finally determine the content of the statement. At most, this process gives voting shareholders information upon the basis of which they may contemplate exercise of their voting rights at a general meeting (or under sections 17 or 17A). But it would be completely wrong to suggest that voting shareholders bear any responsibility or duty to determine the direction of the TOC.

2.19 As to the issue of uncertainty, while accepting that it may indeed have been difficult for the Rhodium board to commit to long term strategies while a sale was under consideration, it would be wrong to assume that the Government was somehow blameworthy for bringing about or contributing to that difficulty. Quite clearly it may be appropriate for any shareholder to consider selling their interest in a corporation. While that process of consideration is in train, it may indeed be the duty of the board not to commit to long-term strategies where such could reduce the value of the corporation to current shareholders and impede future shareholders in exercising their ownership rights to optimise their own perception of the best strategic direction for the corporation in their hands. That is, in some circumstances, the legal duty of the board may in fact be to "tread water" rather than commit to a long term strategy.

Recommendations

2.20 The Auditor-General made 6 recommendations in the following terms:

> *1. Rhodium should, as a priority, enhance the control environment and structure by developing and implementing formal policies and procedures, including Chief Executive Financial Instructions.*
>
> *2. Rhodium should*
>
> - *address the inadequacy in financial controls; and*
> - *improve its financial management information and reporting systems.*
>
> *3. Rhodium should ensure staff are fully aware of their responsibilities to contribute to the effective management of business and integrity risks.*
>
> *4. Rhodium should develop and implement a records management policy and guidelines to ensure compliance with the* Territory Records Act 2002.
>
> *5. Rhodium should develop recruitment policies and guidelines and improve record keeping practices to facilitate transparency in recruitment decisions.*

6. *Rhodium should develop, for each major project undertaken:*

- *a comprehensive business case, which describes the rationale, expected benefits and costs for the project, and identifies risks and appropriate strategies to manage those risks; and*

- *a project management plan, which clearly defines the roles and responsibilities of key personnel (and contractors) and incorporates a mechanism to report regularly to the Board on progress and significant developments.*

2.21 As is apparent, each of these recommendations is specific to Rhodium and has, in its terms, no application to any other TOC. The question is thus whether it would be appropriate for the action that is recommended to be taken by Rhodium to also be taken by other TOCs.

2.22 Taking Recommendation 1 as an example, whether other TOCs need to enhance their control environment and structure by developing and implementing formal policies, including Chief Executive Financial Instructions, necessarily depends upon the strength (or weakness) of their existing control arrangements and structures. Clearly, if such are inadequate, they should be strengthened. But equally, if they are already adequate (or better), there may be no need for any action whatsoever.

2.23 Accordingly, it is a matter for factual assessment in the case of each TOC whether any further action of this type is warranted. Under the Corporations Act, it is in the ordinary course a matter for the corporation's board and management to gain an appropriate degree of satisfaction that its control environment and structure is appropriate.

2.24 As between the two, the board's role is to set strategic direction for the corporation and to monitor the performance of the corporation in the pursuit of that direction. Where a board has any reason to suspect that the corporation's management has not put in place a control environment and structure that is adequate, its duty is to act to redress that inadequacy (usually by directing and monitoring action by management). However, even absent such reason to suspect inadequacy, a board still has a duty to make appropriate periodic inquiry to ensure that its ongoing state of satisfaction remains warranted. In the usual case in relation to a matter such as control environment and structure, this would be done by the board audit committee.

2.25 In the ordinary course, it would not be the role of the corporation's shareholders to intervene in a matter such as this which is clearly within the responsibility of the corporation's board and management. It would only be where the corporation's shareholders had reason to believe that its board was not fulfilling its duties that shareholders would be expected to intervene.

2.26 Accordingly, it would be inappropriate to require that all TOCs take the same action as that recommended to be taken by Rhodium. However, it may well be appropriate for the board of each TOC, having regard to the findings of the Rhodium report, to make such inquiries as it considers reasonable to satisfy itself that such action is not required. And it may also be appropriate for the Government, again by reference to the findings of the Rhodium report, to ask each TOC to consider whether any action is warranted. Indeed, this is what the Government has, very properly done, in the letter of 28 September 2006 addressed to ACTEW.

2.27 The same situation applies in respect of each of the other recommendations in the report. That is, whether action of the type recommended for Rhodium is required is a matter for individual consideration and the TOC board should, in the ordinary performance of its Corporations Act duty, periodically make such inquiries as are appropriate in the particular circumstances of the TOC to allow it to form a reasoned judgement about whether remedial action is or is not warranted.

Please do not hesitate to contact us if you have any further queries in relation to the above.

Yours sincerely

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