



# Independent Governance Review

Report for the  
Reserve Bank of Australia  
Special Committee

MARCH 2012

## TABLE OF CONTENTS

<b>Section 1 - Executive Summary</b> .....	<b>3</b>
1.1 What we were asked to do.....	3
1.2 What we did.....	3
1.3 What we found.....	3
1.4 What we recommend .....	4
<b>Section 2 – The Scope of the Review</b> .....	<b>5</b>
<b>Section 3 - What we did</b> .....	<b>6</b>
3.1 Review of relevant documents.....	6
3.2 Interviews of relevant persons.....	6
3.3 Research into governance practices at the relevant times.....	6
3.4 Updates to the Special Committee.....	7
3.5 Caveat.....	7
<b>Section 4 – Background - Bank governance and note printing (1996 – now)</b> 8	<b>8</b>
4.1 The Reserve Bank Governance Framework.....	8
4.2 Unique aspects of the current Bank governance framework .....	9
4.3 Note printing within the Reserve Bank .....	10
<b>Section 5 – Corporate Governance Standards 1996 – current</b> .....	<b>11</b>
5.1 Public Sector Governance.....	11
5.2 Private Sector Governance.....	14
5.3 Private Sector Subsidiary Governance .....	15
5.4 Conclusion .....	19
<b>Section 6 - NPA Governance Framework</b> .....	<b>20</b>
6.1 Corporatisation .....	20
6.2 NPA Governance Framework post-Corporatisation .....	21
<b>Section 7.0 - Secrecy Governance Framework</b> .....	<b>31</b>
7.1 Background to the Joint Venture .....	31
7.2 Secrecy Governance Framework.....	31
<b>Section 8 – Our Findings</b> .....	<b>36</b>
8.1 Our assessment .....	36
8.2 Other possible actions .....	39
<b>Section 9 – Our Conclusions and Suggestions for improvement</b> .....	<b>42</b>
9.1 Overall Conclusion .....	42
9.2 Suggestions for improvement.....	42

## **APPENDICES**

Appendix 1 - The Role of the Reserve Bank Board .....	43
Appendix 2 – Reserve Bank documents reviewed .....	45
Appendix 3 – Persons interviewed.....	46
Appendix 4 – Public Sector Guidelines/Reference Material.....	47
Appendix 5 – Private Sector Corporate Governance Codes .....	48
Appendix 6 - Other relevant governance references .....	51
Appendix 7 – NPA Board Composition 1996 - current.....	52
Appendix 8 - Securrency Board composition 1996 - current.....	53
Appendix 9 - Our Qualifications as an Expert .....	54

## Section I - Executive Summary

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### I.1 What we were asked to do

On 1 July 2011, the Reserve Bank of Australia (**the Bank**) announced that Note Printing Australia Limited (**NPA**), a wholly owned subsidiary of the Reserve Bank, and Securrency International Pty Ltd (**Securrency**) had both been charged with offences relating to alleged payments contrary to provisions of the Australian Criminal Code.

In August 2011, the Board of the Bank established a special committee (**Special Committee**) to consider the appropriateness of the governance structures put in place by the Bank, as shareholder, in respect of NPA, originally a branch of the Bank but established as a separate company in 1998, and Securrency, a 50-50 joint venture between the Bank and Innovia Films BVBA (previously UCB Films PLC) from 1996, as against the governance standards for subsidiaries and/or associated companies at the relevant time.

In September 2011, Cameron Ralph Pty Ltd (**Cameron Ralph**) was retained by the Special Committee, on behalf of the Reserve Bank Board, to conduct an Independent Governance Review (**Review**), in relation to the following two issues for the period 1996 to the present in respect of Securrency, and 1998 to the present in respect of NPA:

1. the appropriateness of the Reserve Bank's oversight over NPA and Securrency;  
and
2. any areas for improvement in respect of the current oversight.

### I.2 What we did

We reviewed primary documents held by the Bank relating to NPA and Securrency, and interviewed current and past officers of the Bank. We researched the corporate governance literature of the time when NPA and Securrency were set up as such, up to present. We had full co-operation in every respect from everyone we sought to meet and in obtaining the documents we needed.

### I.3 What we found

The Bank gave due consideration as to the governance arrangements for the two companies, and put in place processes for their oversight and reporting which were broadly consistent with usual practice at the time. The Bank appointed people whom it was entitled to believe could direct the affairs of the companies with due care, diligence and skill. The Bank received regular reports both at management and board level, and responded to those reports in a considered and deliberate way.

There is evidence of the Bank taking appropriate action where the entities appeared not to be performing in line with the Bank's expectations and/or standards.

Clearly, with the benefit of hindsight, there could have been more oversight applied to the activities of the companies, which *may* have detected earlier the alleged illegal payments. But that does not mean that the Bank's oversight at the time was inappropriate.

## **1.4 What we recommend**

Any major changes to the governance framework currently in place will no doubt prove difficult until the current litigation with the entities becomes clearer. In the longer term, a clear strategy for each of the entities should be developed, before attempting to establish the most appropriate governance arrangements.

For example, if NPA is to focus primarily on producing the Bank's notes, and other domestic business, it would be appropriate for its Board to be comprised wholly of Bank executives.

On the other hand, if NPA is to continue to be a commercially focused entity, looking for global opportunities, then it may be of value to appoint independent directors with particular skills and experience in the respective industries, including appointing an independent chairman. The necessary link to the Bank as parent can be maintained by other means, including by direct bank representation on the Boards.

In light of the likelihood that the litigation may continue for some time, implementation of any agreed strategy with respect to either company may similarly be delayed. During that period, consideration should be given, from time to time, as to whether tighter controls over strategy, plans, targets and outcomes for both companies should be put in place. Section 8.2 sets out a range of actions which may still be relevant going forward. We suggest you consider these.

## **Section 2 – The Scope of the Review**

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On 1 July 2011, the Reserve Bank of Australia (the Bank) announced that Note Printing Australia Limited (NPA) and Securrency International Pty Ltd (Securrency) had both been charged with offences relating to alleged payments contrary to provisions of the Australian Criminal Code. The alleged offences related to dates from 1999 to 2004.

NPA is a company wholly owned by the Reserve Bank, responsible for running the printing works where Australia's banknotes are printed. Securrency is a separate company that is a 50-50 joint venture between the Reserve Bank and Innovia Films BVBA (and previously UCB Films PLC), and produces the polymer substrate on which Australia's banknotes are printed.

In August 2011, the Board of the Bank established a Special Committee comprising Ms Catherine Tanna, a RBA Board member (appointed in 2011), and Mr Terry Williamson, an external member of the Bank's Audit Committee (appointed in 2010) to consider the appropriateness of the governance structures put in place by the Bank, as shareholder, in respect of NPA, as a wholly owned subsidiary since 1998, and previously a division or branch of the Bank, and in respect of Securrency since 1996, as against the governance standards for subsidiaries and associated companies at the relevant time.

In September 2011, Cameron Ralph was retained by the Special Committee, on behalf of the Reserve Bank Board, to conduct an Independent Governance Review in relation to the following two issues for the period 1996 to the present in respect of Securrency, and 1998 to the present in respect of NPA:

1. the appropriateness of the Reserve Bank's oversight over NPA and Securrency;  
and
2. any areas for improvement in respect of the current oversight.

The following areas were expressly excluded from the scope of the Review having regard to the Australian Federal Police investigation and the current prosecutions of the two companies:

1. the conduct of the Boards of NPA and Securrency;
2. the conduct of any former or current employee or Board member of NPA or Securrency; and
3. the controls or governance systems in place at Securrency and NPA.

We were not asked, nor have we undertaken, any review of current actions being taken against any persons and companies under the Criminal Code, and we make no comment or findings on those matters. We have not examined any material relating to those allegations as such, other than to address the supervision issue which is our focus.

## **Section 3 - What we did**

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The following outlines the steps we undertook in order to complete this Review:

### **3.1 Review of relevant documents**

We reviewed relevant sections of the Reserve Bank Act 1959, which are extracted at Appendix 1.

We reviewed a comprehensive set of primary documents relating to the relationship between the Bank and the two companies for the period 1996 to the present in respect of Securrency, and 1998 to the present in respect of NPA (the relevant period). Appendix 2 contains an overview of these documents.

Minutes of the RBA Board and its Audit Committee were redacted so as to remove material not related to NPA or Securrency. We did nevertheless view complete RBA Bank Board papers for a small number of meetings, in order to observe the overall context in which the RBA Board saw material related to these entities.

We were provided with full cooperation in relation to provision of documents and confirm that we believe we were provided with sufficient information for the purpose of conducting this Review and preparing this Report.

### **3.2 Interviews of relevant persons**

Based on our document review, we identified a number of current & former Bank staff, directors, and committee members whom we believed could have relevant historic knowledge of the oversight of the companies, as well as knowledge of the more recent governance arrangements for the entities.

We prepared a standard interview guide covering a full range of issues to be discussed, and tailored each of these to the specific involvement of each particular individual.

The Bank and the Special Committee provided full cooperation in arranging interviews with these persons.

In all cases, the persons whom we had identified agreed to meet with us and we had full cooperation from them during our interview. As could be reasonably expected, because of the passage of time since 1996 and 1998 respectively, the degree of recall of the individuals varied.

Having said that, we believe we have been able to establish a reasonably accurate understanding of the way in which the governance of the companies was conducted, i.e. we have sufficient information from which to draw our conclusions.

A list of the persons we interviewed is in Appendix 3.

### **3.3 Research into governance practices at the relevant times**

We reviewed a wide range of national and international governance codes and guidelines for the private and public sectors, as well as a range of writings on corporate governance,

in order to establish common practice for the governance of public sector enterprises, focusing on the arrangements for oversight of a subsidiary or associated company, during the relevant time periods.

We also drew upon our own personal experiences as directors prior to, and after that time.

A list of the codes, guidelines, and articles we reviewed are in Appendices 4, 5, and 6.

### **3.4 Updates to the Special Committee**

We held regular meetings with the Special Committee, which included updates on the progress and timing of the review, discussion of any additional information or assistance we required. We had full cooperation from the Special Committee.

We provided the preliminary draft of this report to the Special Committee for three main reasons: first, for confirmation of factual accuracy; second, to ensure that the report could not be construed as canvassing the matters which are the subject of police investigation or court proceedings in an inappropriate way; and third, to allow consideration of whether procedural fairness required any person mentioned or referred to in the report to be given the opportunity to comment on it.

### **3.5 Caveat**

This review was not a comprehensive audit of all of the Reserve Bank's activities in regard to these entities, nor does it attempt to provide a detailed documentation of how those systems worked. Neither is this report an evaluation of the performance of any of the individuals involved.

This is an assurance review that examined the Bank's systems and actions with respect to these companies, against a reasonable framework for appropriateness and effectiveness.



## Section 4 – Background - Bank governance and note printing (1996 – now)

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### 4.1 The Reserve Bank Governance Framework<sup>1</sup>

The Reserve Bank is the independent central bank with responsibility for monetary, financial system and payments system policies. It is not a company incorporated under the Corporations Act, but is established under its own Act of Parliament - the Reserve Bank Act 1959 (the Act).

Unusually, the Reserve Bank has two boards. These are the Reserve Bank Board, which has responsibility for monetary policy and financial stability, and the Payments System Board, which has responsibility for matters relating to the payments system. We do not discuss the Payments System Board in this Report.

The Reserve Bank Board comprises nine members: three ex officio members – the Governor (who is Chairman), the Deputy Governor (who is Deputy Chairman) and the Secretary to the Treasury – and six non-executive members, who are appointed by the Treasurer. The Governor and Deputy Governor are appointed for terms of up to seven years, and are eligible for reappointment. The non-executive members are appointed for terms of up to five years, and are eligible for reappointment.

The ‘mandate’ or ‘charter’ of the Reserve Bank Board is contained in section 10(2) of the Act:

‘...the Reserve Bank Board has power to determine the policy of the Bank in relation to any matter, other than its payments system policy, and to take such action as is necessary to ensure that effect is given by the Bank to the policy so determined.

It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank under this Act and any other Act, other than the Payment Systems (Regulation) Act 1998 and the Payment Systems and Netting Act 1998, are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:

- (a) the stability of the currency of Australia;
- (b) the maintenance of full employment in Australia; and
- (c) the economic prosperity and welfare of the people of Australia.’

It is clear from our examination of the papers, and our interviewees confirmed, that the main focus of the Reserve Bank Board’s activities (including the majority of the time spent at meetings each month) is monetary policy. This discussion occurs against the background of papers prepared by Reserve Bank staff about developments in the domestic

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<sup>1</sup> This section of the report draws heavily from (and in some places directly quotes from) extracts of material on the website of the Reserve Bank of Australia, accessed on 1 December 2011.

and foreign economies, and in financial markets. These papers are supplemented by staff presentations at each Board meeting.

The Reserve Bank Board has an Audit Committee, which generally meets four times each year. It is (consistent with current Commonwealth guidelines) chaired by a non-executive member of the Reserve Bank Board, and its members comprise a second non-executive member of the Reserve Bank Board, and two independent members. Its objectives are to ensure a high-quality, independent and effective audit process and assist the Governor and the Board in fulfilling their obligations relating to financial reporting, compliance, internal control and risk assessment, employee conflicts of interest, business ethics and prevention of fraud.

## 4.2 Unique aspects of the current Bank governance framework

Unusually, and perhaps uniquely, Section 12(2) of the Act (set out below) gives the management of the Bank to the Governor, who is effectively the Chairman and Chief Executive.

### “12 Management of the Bank

- (1) There shall be a Governor of the Bank and a Deputy Governor of the Bank, who shall be appointed and hold office as provided by Part III.
- (2) Subject to sections 10 and 10B<sup>2</sup>, the Bank shall be managed by the Governor.
- (3) The Deputy Governor shall perform such duties as the Governor directs and, in the event of a vacancy in the office of Governor, the Deputy Governor shall perform the duties of the Governor and shall have and may exercise the powers and functions of the Governor.”

As can be seen from this provision, the statutory role of the Reserve Bank Board under the Act is limited to determining monetary and banking policy. The Board does not take typical corporate-style board decisions, such as hire/fire the CEO, or approval of budgets. Neither does the RBA Board have any oversight of the RBA Officers' Superannuation Fund (which has its own board).

Notwithstanding the statutory position as described above, the RBA Board members must also meet the general obligations of directors of Commonwealth authorities, as set out in the Commonwealth Authorities and Companies Act 1997 (**CAC Act**).

In practice, the RBA Board does, and did, exercise some oversight of the Bank, including receiving regular reports with respect to NPA and to a lesser extent (as was appropriate) Securrency - as will be shown below. Our observation is that over time, the degree of involvement of the RBA Board in oversight of the operations of the Bank has varied – evolving to some degree in parallel to developments in corporate governance generally, but also reflecting the preferences of the individuals in key positions at the time. For example, the establishment of a Remuneration Committee is a recent development.

Another example of the evolving nature is the composition of the Bank's Audit Committee. When it was first established, it comprised only Bank executives.

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<sup>2</sup> Section 10 is set out relevantly above, and Section 10B relates to the Payments System Board

Subsequently an external member was added, as well as an external Bank Director. The arrangements have further evolved, with the committee now being chaired by an external Bank Director, as required under current Commonwealth guidelines.

### 4.3 Note printing within the Reserve Bank

The Bank has been the body responsible for Australia's bank notes since it was set up under the Act. Until 1990, that activity was carried out in a part of the RBA called the Note Printing Branch (**NPB**), which was located physically apart from the rest of the Bank, at various locations around Victoria and ultimately at Craigieburn, a suburb of Melbourne.

The Branch had had a history of being a difficult commercial operation for the Bank – it was regarded by some as a manufacturing plant, inefficient, dominated by industrial relations issues, and not functionally or culturally consistent with the rest of the Bank. It had, since its inception, operated with a fair degree of autonomy.

There were two points of oversight of the Branch – the Assistant Governor, Currency, who was in effect the customer of the Branch, and the Assistant Governor, Corporate Services who was, in effect the "owner". Only very occasionally, matters of import (such as counterfeiting levels) were raised at the weekly senior Executive Committee.

In 1989, management consultants, McKinsey & Co recommended that Note Printing be set up as a separate division, with its own Charter and Board. McKinsey observed that NPB had substantial excess capacity, and that changes to printing technology continued to reduce work volume. The Branch had an expensive cost structure and asset base, at the same time as new technology, especially polymer notes, provided an opportunity for additional external volume. Their recommendation was that NPB should operate as a self-sufficient business enterprise providing competitive bank note and security printing with the RBA as its main customer. It needed fundamental organisational change to reduce its staff from just under 500 to around 270 people, and a new relationship between Head Office (**HO**), meaning the RBA itself) and NPB. We quote from the last conclusion in full:

*“The existing relationship between HO and NPB is based on managerial and administrative ties. Many decisions, appraisals and reviews are dependent on input from HO where, it can be argued, there are insufficient commercial skills to help NPB in a competitive market environment. Therefore, if NPB is to operate as a Business Enterprise, its relationship with HO should change. NPB should report on a quarterly basis to a subsidiary or advisory board, including private sector business representatives, which should set direction and monitor performance. It is crucial that the subsidiary or advisory board provides an environment conducive to the development of production management and marketing skills at NPB, but at the same time acknowledges NPB's role as part of the RBA. Relationships with HO staff should be confined to negotiating and resolving customer/supplier issues, and to managing the few major issues common to both organisations, such as superannuation and housing loan schemes.” (Emphasis added.)*

These matters were clearly taken into account during the process of corporatisation of the Branch dealt with below at Section 6.

## Section 5 – Corporate Governance Standards: 1996 – current

In order to assess whether the governance arrangements established for the oversight of the companies were appropriate, we examined a range of materials in order to ascertain the common practices and governance standards for the public sector, the private sector, and for subsidiaries (and associated companies) in particular, at the relevant times. We describe these below, but the conclusion can be stated at the outset.

The materials we examined set down hardly any guidance relating to supervision of this kind. Directors of holding companies have the ordinary duties of care, skill and diligence, and must apply themselves to the supervision of activities conducted through subsidiaries and associated entities, but the way in which they do so has not been the subject of detailed consideration in the governance literature.<sup>3</sup>

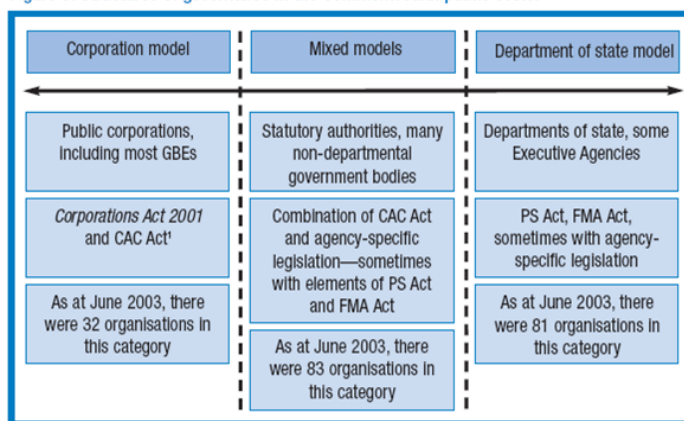
Such literature can be helpful in terms of general guidance, by suggesting indirectly, by analogy, how supervision could be undertaken. We seek to identify such assistance in what follows.

### 5.1 Public Sector Governance

During the period covered by the Review, public sector governance was undergoing a number of important changes.

Whilst the Financial Management Act (FMA) and Commonwealth Authorities and Corporations Act (CAC Act) of 1997 were in force, a complex landscape of governance structures continued to operate across the Commonwealth public sector.

Figure 3: Structures of governance in the Commonwealth public sector



Source: Department of Finance and Administration, *List of Bodies Subject to the CAC Act 1997* (as at June 2003) and *List of Agencies Subject to the FMA Act 1997* (June 2003).

Note: (1) Several GBEs are subject only to the CAC Act

<sup>3</sup> One possible explanation is suggested in Strikwerda, J. 2003. "An entrepreneurial model of corporate governance: devolving powers to subsidiary boards". *Corporate Governance*, 3(2): 38-57, that in the United States, corporations prefer to be incorporated in Delaware in one single entity. Hence US authors on governance are presumably less likely to address this issue.

In 1997, the Commonwealth issued *Guidelines for the Governance Arrangements for Commonwealth Government Business Enterprises*<sup>4</sup> (GBEs). These set out a series of principles, which primarily went to the relationship between and respective responsibilities of the Shareholder Minister and the GBE's Board. These were to apply to all wholly owned GBEs and their subsidiaries. Partly owned GBE's were to aim to apply the guidelines via their Memorandum & Articles, and/or their shareholder agreements. The Guidelines covered the areas of: Reporting, Board of Directors, Financial Governance, including risk management, and other matters such as workplace relations and superannuation. These Guidelines were reviewed in 2011, and a number of changes made.

The companies with which this Review is concerned, were not covered by these Guidelines, which only applied to seven GBEs, all extremely large organisations, unlike the companies in this Review. Further, the Guidelines included no discussion on the oversight of subsidiaries.

In addition to the relevant legislation, better practice guides were developed for CAC and FMA Boards, and set out in a Discussion Paper (1999) and a series of guides published by the ANAO in 2003<sup>5</sup>. None refers specifically to the supervision of subsidiaries.

During those years (1997 onwards), State Governments were also issuing various guidelines and principles, with the aim of applying a more systematic and rigorous approach to governance in the various forms of State-owned Corporations.

These guides set out a number of best practice principles, albeit they are clearly envisaged to be applicable to Boards which are responsible for the oversight of the organisation itself, not any subsidiary with a separate board.

These guides also acknowledged the need to avoid being prescriptive in the application of these principles:

“The importance of the principles will, however, vary between different organisations, depending on individual organisational circumstances. Other approaches may equally or perhaps even better achieve the goal of a fully accountable governance structure. Furthermore, where there are significant changes in circumstances, CAC bodies will need to innovate and adapt their corporate governance practices in order to effectively respond to new challenges and opportunities. Importantly, the Board should not feel that it has discharged its corporate governance responsibilities just by putting in place a particular set of structures and formal processes. They must also periodically review these structures and related processes to ensure that they are achieving good corporate governance in practice.”<sup>6</sup>

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<sup>4</sup> Commonwealth Government; *Guidelines for the Governance Arrangements for Commonwealth Government Business Enterprises*. June 1997

<sup>5</sup> See Appendix 4 for references to the documents referred to in this section

<sup>6</sup> Australian National Audit Office; *Corporate Governance in Commonwealth Authorities and Companies – Discussion Paper*, May 2003.

In addition to guidance from various governments, the Australian Institute of Company Directors also issued guidance for governance in the public sector – “*Check list for Directors of Government Boards*” was issued in 1994. They do not deal with subsidiaries.

Whilst the following principles were not developed with internal subsidiaries in mind, the *Directors’ Checklist* as set out in the ANAO Corporate Governance Principles and Better Practices paper (1999), can be used to examine the governance framework established for NPA and Securrency. Some of the relevant principles in that checklist are paraphrased below:

1. A Board Charter. Definition of the Board’s role and powers clearly defined. A framework of strategic control including formal procedural and financial delegations.
2. Board Composition – new members appropriately briefed, subject to regular re-nomination, made on the basis of skill requirements of the board. Sufficient independent members. An independent Chairman. Sufficient mix of financial, operational, and compliance skills.
3. Appropriate arrangement to ensure access to relevant information and regular briefings.
4. Policies on corporate governance, code of conduct.
5. A clear long term strategy consistent with the entities governing legislation.
6. Annual measurable objectives and budget set out in an annual plan.
7. A process to regularly review the effectiveness of the Board and Directors.
8. An Audit Committee with charter, members with requisite skill, oversight of a formal risk management programme.
9. Effective arrangements to ensure compliance with all applicable statues and regulations and other relevant statements, guidelines, and statements of sound administrative and financial management practice.

In June 2003, the report of the Review of the Corporate Governance of Statutory Authorities and Office Holders (known as the ‘Uhrig Review’) was released. This review had examined the structures for good governance with the aim of developing a range of templates and principles that could be extended to all statutory authorities. The report aimed to be broadly applicable for a range of government enterprises, and it soon was implemented across a large number of entities.

The Report highlighted the need for both efficiency and independence, when it came to governing entities that were to undertake functions outside of a government department. Below, we quote the principles set out in the review:

- “Owners, or their representatives need to establish, clearly, an understanding of success for the activity, including their expectations of performance.
- Governance should be present and the arrangements should be appropriate for the entity given the nature of ownership and its functions.
- To be successful, power must be: in existence, delegated, limited and exercised.

- There should be clarity of roles within the governance arrangements of organisations to ensure that efforts are directed towards success and that responsibilities are performed in an efficient manner.
- With responsibility there needs to be accountability.
- For a board of directors to be effective, it must have the full power to act, including the ability to appoint, supervise, and remove senior management as well as approve strategy.”

The Uhrig Report also set out their guidance on achieving high performance from governance boards. This guidance set out what they considered to be ‘better practice’ in a number of areas:

- “Board size should be developed taking into consideration factors such as an entity’s size, complexity, risk of operations and the needs of the board
- Committees are a useful mechanism for the board to enhance its effectiveness through further detailed oversight and supervision of the management of risks that are critical to the success of the entity. Committees should be used only for this purpose.
- In getting the best from boards, appropriately experienced directors are critical to good governance.
- Maximum board service periods allow for a structured rotation of directors.
- All boards should have orientation programs and directors should have the opportunity for ongoing professional development.
- Annual assessments of the board need to occur to ensure government gets the best from the board.”

## 5.2 Private Sector Governance

For over a decade now, standards of governance for listed (and other) private sector companies have been codified around the world, in a series of Principles, Guidelines and Codes, which are typically issued by stock exchanges, institutional investors, or governments.

We set out a list of the most widely followed in Appendix 5, including whether they make any mention of governance of subsidiaries.

The corporate governance principles underpinning all of these codes are quite similar. They include:

- Clarity around the role of board and management
- Effective board composition, including independence
- Responsible decision making
- Integrity of financial reporting
- Timely disclosure
- Respect the rights of shareholders
- Recognise and manage risk

- Review and encourage enhanced board and management performance
- Remunerate fairly and responsibly
- Recognise legitimate interests of stakeholders

These codes provide little guidance specifically on the governance of subsidiaries.

We also examined the course notes for the Company Directors' Course conducted in the 1990s by the Australian Institute of Company Directors. The oldest set which could be located by the Institute in their historical collection was from 1997. No explicit reference to how directors of parent companies should approach the oversight of subsidiaries or associated companies was found.

## 5.3 Private Sector Subsidiary Governance

### 5.3.1 Overview

Despite the fact that the largest multinational corporations are virtually dependent on their global, often legally independent and separately managed subsidiaries, the governance of these entities has not been a major focus of the governance debate over the past two decades.

Aside from the specific provisions of the Law, regulation of subsidiaries as such is almost non-existent, e.g. there are no stock exchange rules, no industry codes, and of course, no "external" shareholders scrutinising the subsidiary's results and/or management.

Kiel, Hendry and Nicholson's 2006 paper<sup>7</sup> entitled 'Corporate governance options for the local subsidiaries of multinational enterprises' provides a useful review of the existing literature on subsidiary governance from 1980 to 2003.

It was not until a number of problems with how subsidiaries were used to obfuscate financial performance or conceal risk to the parent, (e.g. in the cases of Enron, Worldcom, and Parmalat), that interest in the governance of subsidiaries began to increase. Most of the literature since then focuses on the governance of subsidiaries of Multi-national Enterprises.

"Good governance depends on the relationship between the management of the subsidiary and that of the group as a whole. .... No regulation could probably have prevented the recent catastrophes at Enron, Ahold and Parmalat; and, by the same token, you will never fully know what is going on at your subsidiaries. However, it is important to strive for complete information and complete control as far as possible."<sup>8</sup>

Around the mid 2000's, noticeable interest arises in relation to the governance of subsidiaries, and complex organisations begin to put in place structures specifically to deal with the governance of subsidiaries.

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<sup>7</sup> Kiel, Geoff C. and Hendry, Kevin and Nicholson, Gavin J. (2006) Corporate governance options for the local subsidiaries of multinational enterprises. *Corporate Governance: An International Review* 14(6):pp. 568-576.

<sup>8</sup> Financial Times Limited, 'Herding your subsidiaries towards good governance', By Ulrich Steger and Jochen Brellocks, Published: April 6 2006



### 5.3.2 Models of subsidiary governance

A leading European business school, IMD, established a Global Corporate Governance Research Initiative research project in 2003 that examined subsidiary governance of European multinationals.

It found three primary models<sup>9</sup> of governance for subsidiaries:

- “1. The subsidiary maintains a (supervisory) board that is active in subsidiary management. This model is often found in joint ventures and subsidiaries with multiple and minority shareholders.
2. The subsidiary has a board, but its role is formal in nature – best described as a “rubberstamp board”. Such boards are often mandated by law and deal with official issues only, for example legally required reporting.
3. The subsidiary is wholly owned by its parent and there is no dedicated board at all, is found in the largest number of cases. It is a “no frills” option that emerges by default to keep organisations as lean and efficient as possible.”

Kiel, Hendry, and Nicholson in their paper<sup>10</sup> referred to above proposed four possible governance frameworks for subsidiary corporations, each of which has advantages & disadvantages:

- “Model 1 – Direct Control - The subsidiary’s corporate governance functions are undertaken solely by the parent corporation. The parent management structure governs the company. The subsidiary’s legal board, comprised entirely of local managers, is a compliance board with no formal responsibilities outside those required under law (for example, conducting the annual general meeting and attesting to legal matters such as the annual corporate reporting to regulators). The parent retains all decision making.”
- “Model 2 – Dual Reporting – The subsidiary’s corporate governance is split between a local board and the parent corporation. As a result, the subsidiary CEO has a dual reporting line to the local board and most often to the parent management structure. The local board also has a communication line to the parent governance or management structure. The local board’s roles are contingent upon the parent’s requirements and delegations. It will typically play a stronger role in the governance roles that benefit from greater local knowledge and contacts. These roles include networking, stakeholder communication, compliance and policy making. It may also have a role in strategy and monitoring. Similarly, the parent’s role in the subsidiary’s governance depends on the roles it requires of the local board.”
- “Model 3 – Advisory Board - The advisory board contains local people who are not formally registered as directors, but who are given specific roles and responsibilities which mirror some of the roles of formal boards. The subsidiary’s corporate governance role is undertaken solely by the parent corporation’s management and is usually in compliance to local legal

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<sup>9</sup> Steger and Brellochs, April 6 2006. op.cit.

<sup>10</sup> Kiel, Geoff C. and Hendry, Kevin and Nicholson, Gavin J. 2006. op.cit.

requirements. The subsidiary CEO reports to parent management. The advisory board has no decision-making power (unless specifically delegated by the parent corporation). “

- “Model 4 – Local Board - The subsidiary’s corporate governance is undertaken entirely by a local board. This SB is legally constituted and directors have the resulting legal duties. The SB has full control of the subsidiary and performs all four board roles. Under this model in its purest form, the parent corporation’s role in subsidiary corporate governance is purely that of a shareholder. As the shareholder, the parent appoints the SB (consistent with its constitution) and may have some personnel on the SB. The SB then has full autonomy for governing the subsidiary’s operations and is accountable for its performance and the subsidiary’s performance to the shareholder (subject to any financial controls used by the parent). “

In 2003, Prof. Dr. Strikwerda<sup>11</sup> discussed the typical “decisions delegated to the boards of subsidiaries”. He noted: “Specific arrangements differ from company to company, depending on a variety of parameters: the size of the company, the nature of the business, the local legal system, the history of the corporation, the risk profile and the experience and the personality of the directors.” He described the typical delegated decisions as including:

- Product innovation and product policy
- Pricing and market positioning
- Sales, distribution and marketing
- Product development and process development
- Manufacturing and procurement
- Hiring staff (remuneration which depends on local system of industrial relations) but not first level management of the subsidiary
- Investments in equipment and some other assets (but not real estate).”

And the following powers are usually reserved for the board of the parent company:

- "Setting the business scope of subsidiaries, product divisions, etc.
- Accounting standards, rules for consolidation
- Financing operations, changes in share capital and international cash management
- Corporate resources: patents and trademarks
- Ownership of real estate
- Official reporting, annual reports, fiscal reports, government relations, relations with shareholders and capital markets
- Changes in the legal system
- Guarantees to third parties, pledges on assets

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<sup>11</sup> Strikwerda, J. 2003. op.cit.

- Cash management
- Acquisitions and divestments, mergers and alliances
- Management development policies
- Appointing the top management of subsidiaries
- Major restructuring and large volume lay-offs”.

### 5.3.3 Governance of joint ventures

A search of literature for guidance on the governance of joint ventures indicates a much greater focus on how to set up and manage joint ventures for success. There is extensive literature focusing on the logic for creating the venture, finding a partner, negotiating terms, or the ongoing management of the business. Beamish and Lupton provide a useful overview of the literature on joint ventures from the 1990’s & 2000’s in their 2009 article “Managing Joint Ventures”<sup>12</sup>, in which they highlight that ‘most JV governance research has focused on high-level factors such as ownership structure and division of control’.

Further evidence of the lack of detailed thinking around governance of joint ventures is set out in a 2005 McKinsey Quarterly article<sup>13</sup>, in which the authors state “Corporate governance has become a top priority for executives of public companies. Yet too few of them have raised the bar for governing joint ventures.....Where standards exist at all, they are informal and vary quite widely.”

The article goes on to highlight the challenges and risks surrounding the governance of joint ventures, as well as the obvious difference in the model of governance typically employed (as compared to the governance of a typical public company).

Finally, a number of suggestions made in the article are set out below for improving governance – though the authors acknowledge that “Few, if any joint ventures now follow such guidelines”:

- Appointing at least one outside director
- Designate a lead director or strong chairperson, to ensure at least one member of the board is the ‘equal’ of the CEO
- Review and reward the board members’ performance
- External audit
- Oversight the JV performance as intensely as one would their own business
- Give the JV CEO the authority to run the business without meddling from the shareholder directors

Finally, it wasn’t until 2009, that CALPERS (California Public Employees’ Retirement System), the institutional investor well known for their strong approach to governance, issued their ‘Global Principles of Accountable Corporate Governance: Joint Venture Governance Guidelines’.

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<sup>12</sup> Beamish, Paul and Lupton, Nathaniel; ‘Managing Joint Ventures’ Academy of Management, 2009

<sup>13</sup> Bamford, J. and Ernst, D., “Governing Joint Ventures”; McKinsey Quarterly March 2005

## 5.4 Conclusion

In considering the usefulness of the preceding material, one should consider the relevance of these models to the particular situation of the entities under review.

First, whilst the entities' businesses (or at least, that of Securency) eventually spanned the globe, their operations were mostly located in the same country as the parent and in premises it owned (rather than being physically remote). Secondly, the parent remained a major customer, giving it special insight into the operations of the entities. Thirdly, the Audit Committee arrangements in particular (see Section 6.2.7 below) gave the Bank an unusual window through which to observe the entities, or at least NPA in particular.

Whilst the model adopted for NPA was probably closest to the Kiel, Hendry, Nicholson 'Model 4 – Local Board', for the reasons outlined above, this model does not appear to offer more than a useful starting point for assessing the arrangements of NPA.

In the case of Securency, the governance framework was not dissimilar to the model most commonly adopted by joint ventures at the time – being that each shareholder placed a small number of their current executives on the JV board, with the JV Board itself operating more like an Executive Committee, than a traditional board.

## **Section 6 - NPA Governance Framework**

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The following section sets out the history of the governance arrangements for Note Printing Australia.

### **6.1 Corporatisation**

The Note Printing Branch within the Bank is described in Section 4 above, including some of the ways in which the Branch was not seen (internally) either operationally or culturally as part of the Bank.

In 1990, under advice from McKinsey and Co, the Bank took what had been a branch of the Bank, and 'informally corporatised' what was now called NPA, with the aim of fostering more commercial behaviour and achieving export sales (in addition to meeting Australia's own currency note requirements). No separate legal entity was created at that time, but a separate board was established for the first time, led by the then Deputy Governor John Phillips as Chairman, an external Board member of the Bank, Jack Davenport, and an experienced business executive, Mark Bethwaite, as non-executive Directors.

The membership of the NPA Board changed in late 1992 and early 1993, with the then recently appointed Deputy Governor Graeme Thompson becoming Chairman; Mr Bethwaite continued in office, and Richard Warburton, then an RBA Board member, replaced Mr Davenport in 1996. Mr Warburton was an experienced former senior executive who also had experience in the printing industry. Managing Director, Mr Larkin was also a Board member until 1998.

During this time, there was also external pressure for change in the corporate arrangements. Between 1991 to 1995, a major Federal Government review of National Competition Policy (the Hilmer Review) was undertaken, with one of the key recommendations being that Government entities that were engaged in significant business activities and which were, in effect, commercial monopolies, should be subject to 'competitive neutrality' requirements. This supported the popular notion of 'corporatising' government businesses.

In September 1997, the Bank Board resolved to formally corporatise NPA in the legal sense of that term. The proposal prepared for the Bank Board's consideration outlined a 3-year strategy that included the pursuit of export sales and included detailed legal analysis of the issues and the implications of the change.

In January 1998, an interim report on the corporatisation provided a 5-year forecast which admitted to "considerable optimism in these projections". The forecast export revenues were "more a statement of marketing ambition" rather than based on any confidence in identifiable possible orders. The Bank was also informed at that time that Federal Cabinet had agreed that the Bank's commercial activities – including note printing – should be corporatised as wholly owned subsidiaries, provided it was feasible and cost effective to do so.

In July 1998, NPA was finally corporatised in a legal sense, with the establishment of the separate company. The board of NPA remained the same, a new CEO was appointed, and the commercial relationship between the Bank and NPA was formalised in a series of agreements.

The early years under corporatisation looked like a success. Cost control and a number of export contracts produced a profit ahead of budget and a dividend was paid. In February 1997, NPA was awarded the inaugural 'Prime Ministers Award for Innovation in the Public Sector (International Export category)'. Leading up to the end of 1999, a contract with New Zealand, and the extra notes printed as a precaution against possible disruptions caused by Y2K, produced reasonable profits. This masked the fact that NPA was ultimately to struggle to find a long term sustainable business.

In September 2000, three years after corporatisation, NPA produced a report for the RBA Board entitled: "Results and prospects". The NPA Chairman presented the moderate success to-date and the subdued outlook for the future, including prospects for a loss in following year, and only small profits in the subsequent 2 years as a result of declining demand from RBA and slowing of export sales. "Clearly the low RBA demand makes export sales all the more important to NPA's viability."

By February 2001, only 20 countries had used polymer notes (mostly for commemorative printings); only 3 countries (other than Australia) had moved, or intended to move, all their notes to polymer; and competitors were starting to move into the polymer space.<sup>14</sup>

These conditions and the losses in 2002 and 2003 made it clear that exports were not going to be the panacea for NPA.

## **6.2 NPA Governance Framework post-Corporatisation**

The following section outlines the key features of the governance framework for NPA after informal corporatisation in 1990, up until the time of this Report.

The Company was established with a Charter and Memorandum and Articles of Association, now called a Constitution. These documents set out the objects of the company and the basic aspects of its governance.

### **6.2.1 The Subsidiary Charter**

Prior to being corporatised, the branch had operated under a simple, brief Charter. This practice continued after formal corporatisation in 1998, with the 1990 Charter continuing.

This one page Charter set out NPA's prime functions as:

- "the efficient and cost-effective production of Australian currency notes of high quality and design content, incorporating effective security features;
- the production and sale of currency notes to other issuing authorities;
- the production and sale of other security instruments and products which are compatible with its role as a high security currency note producer;
- the development of markets for its output, in Australia and overseas;

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<sup>14</sup> Indeed, our learning from this review is that note printing is a difficult and competitive business. All countries which are large enough to do so, seem to have their own note printing businesses for reasons of national security and pride. Most large western (and many other countries) own their own note printers, and excess capacity creates an incentive to generate revenue by additional sales - even if these are loss-making.

- research and development related to the efficient production of currency notes and other compatible products;
- the exploitation, in Australia's interests, of the results of that research and development.”

The Charter delegated the following to the NPA Board:

- “responsibility, subject to any resolutions of the Board of the Bank, for the overall conduct of NPA;
- due regard also to the provisions of the Reserve Bank Act, other relevant legislation and Australian Government policies where appropriate;
- prepare audited financial accounts for NPA, establish budgets for the financial, production and staffing aspects of the operation, and agree benchmarks against which the efficiency of the operations may be assessed;
- shall report to the Board of the Reserve Bank half-yearly and at other times where appropriate on the operations and results of NPA;
- the appointment, remuneration , and other terms and conditions of service of the General Manager.”

Beyond this, the Board of NPA was free to establish its own governance arrangements and this Charter remained in place, unchanged until 2007.

In April 2007, in response to ongoing issues with NPA, the Bank Board approved a substantive revision to the Charter, setting out more detail around NPA's primary and secondary functions, as well as highlighting more detail around the NPA Board's role and responsibilities. The 2007 amendments also noted that further polymer development, R&D, and exploitation should happen in cooperation with Security.

In 2008, the Bank Board discussed and approved a further revision to the Charter - removing NPA's function of developing markets for polymer and R&D, and exploitation of that R&D.

The 2008 Charter then read:

“Note Printing Australia shall have as its prime function:

- the efficient and cost-effective production of Australian banknotes of high quality and security, in accordance with the specifications and requirements of the RBA.
- NPA may undertake as its secondary functions:
  - the production of bank notes for other issuing authorities; and
  - the development, production and sale of passports, other security instruments and products (other than banknotes) that are compatible both with its primary role as a banknote printer and also with being a subsidiary of the RBA.
- NPA is required to adopt sound commercial practices across its operations and maintain the highest standards of risk management consistent with its role as a banknote printer.

The NPA Board:

- is responsible for the strategy and operations of NPA in accordance with NPA's charter and for the overall conduct of NPA on a sound commercial basis;
- shall adopt and oversee the implementation of policies of NPA, including in relation to risk management and NPA's security and control environment, and shall appoint the RBA Audit Committee to monitor and review NPA's risk management and control framework and to report to the NPA and RBA Boards on its effectiveness;
- in the conduct of NPA's affairs, shall have regard to the reputation of the RBA as Australia's central bank and the need to maintain this reputation;
- shall have regard to the provisions of the Reserve Bank Act 1959, where relevant to the charter of NPA, other legislation relevant to the RBA and NPA as its subsidiary, and Australian Government policies as appropriate;
- in addition to its duties and obligations at law, shall have regard to any direction of the RBA;
- shall report to the Board of the RBA yearly and at other times as appropriate on the operations and results of NPA; and
- shall be responsible for the appointment, remuneration, and other terms and conditions of employment of the Chief Executive.

The Chief Executive shall manage NPA in accordance with its charter, the Chief Executives duties and obligations at law, and in accordance with terms and conditions established by the NPA Board.”

### **6.2.2 The role and authority of the NPA Board**

Under the Charter, it appears clear that all operational decision-making was delegated to the NPA Board, but subject to some restrictions, and reporting requirements to the Bank. This approach was consistent with the Bank having populated the NPA Board with its trusted colleagues, and with the principles set out in the Hilmer Review and the other public sector guidelines at the time.

The Bank retained decision-making in relation to requests for additional capital, and from time to time, considered strategic matters, such as whether the entities were best retained in house or sold. NPA was also to have regard to any direction of the RBA; we have seen no evidence that any direction was ever given. The Constitution of NPA was amended in late 2000 (when the Law was changed to permit such an amendment), to permit the Directors to act (subject to conditions) in the interests of the parent, the RBA.

### **6.2.3 Board Composition & Tenure**

The selection and appointment process for the NPA Board members was carried out by senior Bank Executives and reported to the RBA Board.

The rationale for the composition appears to have included:



1. Appointment of a bank staff member (initially Mr Phillips, followed over the years by Mr Thompson, Mr Austin, Mr Campbell and Dr Rankin) with extensive experience in the Bank and with the entities in order to ensure Bank oversight, control, and injection of Bank culture.
2. The Chairman of the company was either a current or former RBA senior staff member.
3. A conscious decision was made not to appoint the Bank executive who was the 'note issue customer,' in order to avoid perceived conflicts.
4. Appointment of one or two external directors, to provide commercial expertise and experience, which the Bank acknowledged it lacked.
5. Appointment of one sitting external Bank Director, to provide a linkage to the RBA Board. (Mr Warburton was identified for his manufacturing and exporting experience, but also happened to have printing experience.)

However, this appointment rationale was not strictly applied. The changes to the NPA Board over the time period appear to be a result of the 'comings and goings' of various Bank staff and Directors, as opposed to a conscious succession plan. This resulted in the connections between the NPA Board and the RBA staff and Board changing over time. (See Appendix 7 which sets out the composition of the NPA Board over time). For example:

- Both Mr Thompson and Mr Warburton had roles with the Bank when they were appointed to the NPA Board – thereby establishing links with the Bank and the RBA Board.
- Both Mr Thompson and Mr Warburton remained on the Board of NPA after they ceased to be RBA officers, resulting in the overlap between the boards of the RBA and NPA being lost at that point.
- Even before then, Mr Davenport had remained on the Board of NPA after he ceased to be a director of the RBA, "in recognition of his excellent contribution and for continuity".
- Mr Austin was appointed to the NPA Board in 1999, and remained a Director of NPA after his retirement from the Bank in 2001. He remained a Director of NPA until 2009.
- Direct linkage to the Bank executive was restored in 2004, when Mr Campbell, then Assistant Governor (Corporate Services) joined the NPA Board
- In 2007, the intention had been to appoint a current RBA director to the Board of NPA, and one was chosen and agreed. Events in July/August 2007 seem to have led to that not proceeding.

It was not until 2008 that the RBA Board revisited this rationale, and moved to a NPA Board comprised entirely of Bank executives, including the staff member (Dr Rankin) who was, in effect, the customer of NPA.

The result of this chain of events was that whilst the individuals on the NPA Board remained relatively stable, the linkage with the Bank itself varied over time. In fact, including the period pre-corporatisation, a number of the individuals served for quite long

tenures (Mr Bethwaite 17 years; Mr Thompson 14 years; Mr Warburton 12 years; Mr Austin 10 years).

Appointment for a specific period of time commenced with Mr Austin's departure from the Bank in 2001. Mr Thompson was renewed for a specified term in 2003, and Messrs. Warburton and Bethwaite as from 2005. Uniform fixed term appointments were introduced in 2005.

#### **6.2.4 History of the Chairmanship**

A conscious decision at "corporatisation" in 1990 was made to appoint a Deputy Governor as the Chairman of NPA, on the basis that a bank staff member should provide continuity as well as a linkage to the Bank.

As mentioned earlier, that was Mr Phillips initially, and then Mr Thompson as from 1993. Mr Thompson continued as Chairman after he left the Bank in July 1998 to become Chief Executive of the Australian Prudential Regulation Authority (APRA). The other NPA board members asked that their view that continuity in the position of chairman was "most desirable, at least until the end of 1998, and possibly beyond", be conveyed to the RBA Board.

In 2003, after he left the APRA role, he remained as chair of NPA (and Securrency) and, at the request of the Bank, took on a much more active role.

His letter of renewal, in addition to fixing a term, asked him to take a particular interest in audit, control and other governance matters at NPA, to spend 5 days a month on NPA and to visit Craigieburn monthly – to drive the resolution of various outstanding Audit Committee recommendations – see below.

The Chairmanship of NPA therefore remained stable from 1993 until 2007. Although Mr Thompson no longer had a role with the Bank itself after 1998, his lack of formal connection with the Bank was perceived by some of those we interviewed as being offset by the depth of his knowledge of the Bank and the business gained over many years, and by the presence on the NPA Board of others who were current or more recent senior officers of the Bank such as Mr Austin and Mr Campbell.

After Mr Thompson's departure, there were three Chairmen over the next four years, as a result of the changing circumstances of the individual bank staff.

Over the years, there does not appear to have been any consideration of appointing an independent external chairman.

#### **6.2.5 Board Training, Development, and Performance Evaluation**

Initially there did not appear to be any support or training/development for the Bank staff that were appointed as Directors to the NPA Board. Some of them had already had director experience in the capacity of being a Trustee of the RBA Officers' Superannuation Fund, so there was general awareness of the duties and obligations of being a Director.

Later during the Review period, a number of bank representatives on the NPA Board undertook and completed the AICD Company Directors Course. It was, no doubt,

assumed that the external Directors were already well experienced, and did not require support.

Both the ASX Corporate Governance Council Guidelines and the ANAO Better Practice Guides were issued for the first time in 2003, and both recommended that Boards and Directors undertake regular performance evaluation. Nevertheless, none occurred during the relevant period.

### **6.2.6 Bank input to NPA strategy, policy, and risk appetite**

During the period under review, there appears to have been only sporadic involvement by the RBA Board in decision-making regarding the companies:

- In 1997, at the point of corporatisation, a future strategy paper was presented to the RBA Board, suggesting they give the plan a 3 year trial, and then review the strategy;
- January 1998, a five-year business plan & forecast, with admittedly 'optimistic' projections was presented to the RBA Board;
- Sept 1999 capital injection based on an updated business plan forecasting significant growth;
- March 2001, a consideration of whether the Bank should be involved in producing notes at all;
- September 2001, the RBA Board considered the difficult outlook for the company, but decided it was too early to change course.
- Further discussions about the future of the company in meetings held during 2002, 2003, and in 2004, because of outstanding issues around production and operational control problems, the Bank puts the drive for additional export customers on hold.
- In both 2007 and 2008 the RBA Board approved amendments to the NPA Charter; and
- In 2008, the RBA Board considered a paper which examined options for future of NPA.

### **6.2.7 Ongoing Monitoring of results & compliance**

There were a number of mechanisms for the monitoring of NPA as set out in its Charter, including:

**(i) Formal Reporting** – The Bank Board continued to receive the regular 6-monthly reporting from NPA which it had received prior to corporatisation. Typically this report (between 5-10 pages in length) was prepared and presented in person to the RBA Board by the NPA Chairman, and included:

- a qualitative overview of financial outcomes, production/sales/research, management issues, business outlook;
- a simple balance sheet and profit and loss statement;
- a brief table showing budget versus actual for sales, profits, note deliveries, average spoilage, sales per employee, profit per employee, deliveries per employee and number of employees, as well as a

comparison of those items versus the actuals from the comparable period one year earlier; and

- reports on export contracts achieved.

The Bank Board also gained insight into NPA via receipt of the RBA Audit Committee minutes (see section below on Audit Committee).

A three year review was presented to the RBA Board in September 2000, noting NPA's moderate success to-date and its prospects as being heavily dependent on export sales.

The subsidiary board did not meet, as a whole, with the RBA Board (we do not suggest that this was necessary or desirable). Typically, the Chairman of the NPA Board represented the subsidiary at RBA Board meetings during which the six-monthly report was discussed. Interviewees estimate that this six-monthly discussion was typically less than half an hour, and usually at the end of the Bank's half day meeting. On only a couple of rare occasions, did the NPA CEO attend these meetings with the NPA Chairman.

From time to time, RBA senior staff members also received copies of the minutes of the subsidiary board meetings.

**(ii) Informal Reporting** – The close links between senior Bank staff and the chairman and management of NPA were designed to ensure informal reporting on the business of NPA.

In 1999 Mr Austin (Assistant Governor, Corporate Services) had prime responsibility for the financial aspects of the Bank's shareholding in Securrency and NPA, and he was appointed to their Boards. After his retirement in March 2001, he visited both NPA and Securrency several times a year and was in the habit of forwarding reports about NPA and Securrency by e-mail to colleagues at the Bank, up until around 2003.

In November 2002, Frank Campbell took over the monitoring role, which included receiving monthly NPA Board papers and speaking informally to Mr Austin or Mr Thompson. He would also regularly brief the Governor and Deputy Governor on progress and issues around NPA.

From 1999 to 2002, there was also very occasional informal briefing at Bank Board meetings by Mr Warburton, the RBA Board member who also sat on the NPA Board, but that stopped when Mr Warburton left the RBA Board in 2002. There was limited interaction by the Bank Board with the management of NPA. During the period of review, there were only a handful of visits to the facilities at Craigieburn, either by the senior bank executives or the Bank Board itself. These would have been brief opportunities to see the operations and to meet the CEO.

Over the period, the Bank as customer of NPA was dissatisfied from time to time with the quality of the notes, but this was seen as normal tension between a 'captive client' and their supplier.

Interviewees report the Bank received only minor feedback about the company from a handful of external customers of NPA (such as other Central Banks), which was typically positive in nature.

**(iii) Audit Committee** – Prior to legal corporatisation, the RBA Audit Committee and Internal Audit provided audit oversight of NPA as part of its normal role.

In February 1999, the NPA Board asked the RBA if they could fulfil their objective of having an Audit Committee, by having the RBA Audit committee act as their committee. Whilst this appears to be unusual – a subsidiary with its own board, using the parent’s audit committee as its own - it did provide the benefit to NPA of an existing structure with committee members of senior rank and expertise, as well as providing for the Bank, potential for direct insight into the subsidiary’s operations.

It was considered a strength (by some of those we interviewed) that the Bank’s Audit Committee and Internal Audit department were involved, albeit primarily focused on financial controls, as well as operational issues around IT and security around the notes, as opposed to risk management more broadly, which was seen as the responsibility of the NPA Board under their Charter. (The Audit Committee asked for and did receive copies of NPA’s Risk Management Plan).

The RBA Audit Committee Chairmanship changed from time to time during the period (Stephen Grenville (1996-2001); Glenn Stevens (2001-2007); Ric Battellino (2007 -2008); Jillian Broadbent (2008-current)). None of them brought specific audit qualifications, albeit George Bennett joined the committee in 1998, and was a senior, qualified and experienced auditor.

During the period (starting in 1997 and continuing through 2003 and through 2006), various internal audit reports raised concerns about issues such as accounting procedures, IT, security at the plant, spoilage of bank notes and so on – but not the use of overseas agents. The Audit Committee engaged with the NPA Chair and CEO both in writing and face-to-face on numerous occasions on these matters, but their resolution did take longer than the Committee regarded as acceptable.

Copies of all internal audit reports went to the NPA Board, as well as to the Bank’s Audit Committee. Additionally, the NPA Board was given the opportunity to provide input into the development of the internal audit plan.

The Audit Committee did not meet with the entire NPA Board, but rather engaged with the Chairman and occasionally the CEO.

In due course (2010), NPA established its own Audit Committee.

**(iv) External Audit** – The Australian National Audit Office (ANAO) was the auditor for NPA (as required by the CAC Act). The ANAO outsourced the actual work to a large accounting firm and relied on the Bank’s Internal Audit Department to undertake much of the audit testing. The focus of the audit was primarily on producing the consolidated accounts for the Bank.

### **6.2.8 The Bank's response to issues at NPA, including with respect to agents**

Over the years, there is evidence of the Bank taking action to deal with issues with its branch (and subsequently subsidiary).

As early as the late 1990's the Audit Committee expressed concerns about the lack of controls and the commercial culture in operation at NPA. There was repeated interaction between the Audit Committee, the Bank Board and staff, and the NPA management to press for rectification. For example:

- In 2001, senior Bank staff made regular visits to the entities;
- In 2003, Mr Thompson was asked to take a more active, hands-on role with the company;
- During 2003 and 2004, the Bank supplied assistance to NPA's IT and security areas;
- In March 2004, a memorandum to the Governor argued the case for strengthening the oversight of NPA. A number of actions were implemented:
  - The drive for exports was put on hold until production and controls issues could be resolved;
  - the appointment of an Assistant Governor (Mr Campbell) to the Board of NPA;
  - a requirement for more regular and comprehensive reporting from NPA; and
  - direct communication with the newly appointed CEO as to the Bank's expectations.
- In response to the 2005 media coverage of the AVB scandal, early in 2006, the RBA Board requested and received a paper on the subsidiary's guidelines on agents and their use, and later in the year noted that the NPA Board approved a revised policy.
- By late 2006, the RBA Board expressed concern about the length of time that outstanding issues (identified by the Audit Committee – see below) were taking, and requested updates about their status.
- In mid 2007, the Audit Committee reviewed an internal audit report on the use of overseas agents.

In response, NPA established a sub-committee of the NPA Board, consisting of Mr Bennett (member, Audit Committee) as chair, Mr Warburton (NPA Director), and Mr Campbell (Assistant Governor, and NPA Director). In August 2007 the RBA Board discussed the status of the sub-committee investigation, and received a briefing on the draft report of the independent legal advisers.

- By late 2007, a memo for the RBA Board acknowledged that “The aim of establishing a more arms-length relationship between the Bank and NPA has had mixed results.....there has been a long history of concern, including that expressed by the Audit Committee and RBA Board, that the laxity of control

environment at NPA has been at serious odds with the careful risk-management culture of the Bank and that these cultural deficiencies potentially expose the Bank to serious reputational and financial risk....concrete steps need to be taken to improve the performance of NPA or at least take measures to lessen the reputational risk to the RBA...". They considered undertaking a full, externally conducted review of the company but, after discussion, this was ultimately undertaken internally.

- At about that time, the Bank also made a number of changes to the governance framework:
  - renewed the composition of the Board of NPA by appointing current senior staff of the bank selected for their skills in operations, finance, and risk management;
  - appointed one of them as Chairman;
  - changed the NPA Chief Executive Officer;
  - revised the NPA Charter; and
  - improved reporting to the RBA Board.
- Subsequently NPA established its own Audit Committee (2010) with their minutes distributed to the RBA Audit Committee.

We will not go further into the actions subsequently taken to address these issues, other than to note that in the RBA's press release of 1 July 2011, the Bank noted that:

“over the past several years much has been done to tighten controls and strengthen governance so as to avoid any re-occurrence of the alleged behaviour:

- Those charged with offences are no longer with the companies;
- The use of sales agents has ceased;
- Policies and procedures at both companies have been thoroughly overhauled; and
- The Reserve Bank added executive resources in the banknotes area and moved to draw all its appointees to the boards of both companies from the Bank's executive or the Reserve Bank Board.”

## **Section 7.0 - Securrency Governance Framework**

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The following section sets out the history of the governance arrangements for Securrency Pty Ltd.

### **7.1 Background to the Joint Venture**

Securrency was established in 1996 as a separate Joint Venture, when the Bank was approached by its substrate supplier, UCB Films PLC, to join with them in exploiting the polymer which the Bank had developed.

The Bank acknowledged it did not have the commercial skills to run such an enterprise, and they took comfort from the fact that they had a commercial partner who was prepared to contribute capital, and which could bring that expertise to the venture.

Whilst the venture started out positively, by 2002 and 2003, the venture was losing money.

In 2004, UCB's interest in Securrency was sold to Innovia Films.

In 2005, the company had returned to profitability and a \$35 million expansion was approved, based on a strong forecasted profit. In 2006, the company experienced rapid growth – well above budget – and this continued into 2007.

### **7.2 Securrency Governance Framework**

#### **7.2.1 Memorandum & Articles / Joint Venture Agreement**

The Memorandum and Articles of Association of 1996 set out the purpose of the company:

- "(1) the purchase of films for the production of substrates and other security products, and other complementary products such as overcoatings for banknotes, for resale both domestically and overseas;
- (2) the manufacture of, and research and development in relation to, opacified substrate, security documents, and complementary products;
- (3) the exploitation through licensing to the shareholders of the opacification background intellectual property; and
- (4) any and all acts, things, business and activities which contribute thereto."

The Memorandum and Articles also set out the typical powers and duties of the directors (albeit it required them to act unanimously, and a quorum was an even number of each of the shareholders' appointees). The directors were also empowered to elect the Chairman.

The JV agreement echoed the purpose of the venture as outlined in the Memorandum & Articles.



### **7.2.2 The role of the Board, delegations**

The Joint Venture agreement set out a number of specific aspects of the role of the Securrency Board:

- Directors were not paid for their services.<sup>15</sup>
- All decisions of the Board to be unanimous
- Decisions reserved to the Board included: declaring dividends, merging, sale of assets, fundamental changes in the scope or character of the business; redemption or repurchase of equities; execution, renewal, amendment or termination of any licence between the JV and a shareholder; determination of any development work; approval of yearly budget and investment programme; approval of any valuation rules, and accounting principles.
- Prior written board approval was also required for hire/fire senior staff; contracts over 1 year duration or in excess of amount set by Board; sublicensing any JV rights; sale of fixed assets in excess of limits; borrowing/lending; acquisition of real estate, buildings, etc.; establish subsidiary or branch; selection of bank; mortgage property or grant security; introduction or discontinuation of product lines, research, marketing or financial activities; general personnel policies; significant transactions.

### **7.2.3 Board Composition & Tenure**

The composition of the Securrency Board was set out in the Joint Venture Agreement.

At the start of the JV, there was virtually only a very small company operating alongside NPA, therefore the thinking was that there should be some 'common directors', and the Board only needed to be the minimum size. The Joint Venture Agreement called for a 50-50 board consisting of 4 Directors in total. In 1999, the Securrency Chief Executive was added to the Board as a non-voting member.

By 2000, the Bank wanted to add a currently serving Bank executive to the Board, so the Board was expanded to 3+3 (plus the Chief Executive).

As with NPA, the selection and appointment process for the RBA's representatives on the Securrency Board was typically done by senior Bank Executives and reported to the RBA Board.

In 2008, the RBA Board expressed their view that it was time to review the composition of the Board of Securrency, in particular to add some significant commercial, listed company experience, and to re-establish a direct linkage to Bank staff, by appointing Dr Rankin, the Assistant Governor, Currency as Chairman, and appointing John Akehurst (one of the existing RBA Board Directors). Both were appointed in 2008.

A history of the Bank's appointees to the Board of Securrency is set out in Appendix 8.

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<sup>15</sup> Note that Mr Thompson and Mr Austin were eventually paid a fee from 2005 onwards – well after both of them had ceased being employees of the Bank.

#### 7.2.4 History of the Chairmanship

Securency's Articles of Association called for the Directors to select the Chairman. Mr Thompson was appointed as the initial Chairman, and then from 2004, by agreement between the shareholders, he continued in the Chair, including after he left the Bank in 1998.

The Chairmanship of Securency therefore remained stable from inception of the Joint Venture until Mr Thompson stepped down in 2008. The Bank then re-established the direct connection between the Securency Board and the Bank, by appointing the Assistant Governor, Currency (Dr Rankin) as the Chairman.

Given the small size of the Securency Board and the nature of the entity (a Joint Venture), there does not appear to have been any consideration of appointing an independent – either as a non-executive Director or as the Chairman. This was and is not unusual practice in joint ventures.

#### 7.2.5 Board Training, Development & Performance Evaluation

Similarly to NPA, there was no focus on training or support for the Directors – the UCB-appointed directors were all current UCB executives and presumably knew the business well.

Both the ASX Corporate Governance Council Guidelines and the ANAO Better Practice Guides were issued for the first time in 2003, and both recommended that Boards and Directors undertake regular performance evaluation. Nevertheless none occurred during the relevant period.

#### 7.2.6 Ongoing monitoring of results and compliance

**(i) Formal Reporting** - In early 1999, the RBA Audit Committee reviewed a paper on Securency accounting & auditing, in which the RBA Audit Department highlighted the need for formal communication processes between Securency and the RBA, as essential for overall control arrangements. The paper set out suggestions:

- Receive and review the Securency Board minutes;
- Request (ad hoc or continuing) from Securency their important papers, plans, reports on the business operation;
- Receive Securency Audit Committee minutes;
- Maintain dialogue with Securency auditors (BDO),
- Receive half yearly Securency financial reports.

A footnote on that page reveals the Bank's consideration of its information needs: "From a business perspective, the Bank is in somewhat 'uncharted waters' with its 50% investment in Securency, in terms of what information it is reasonable to seek directly from the company. The appropriate 'protocols' will need to be considered. This will dictate whether the Bank receives the Securency Board minutes directly from the Chairman/Company Secretary (ideally) or from one of the Bank-nominated directors".

Ultimately, the Bank received half yearly reports, as well as copies of the Securency board papers.

Because the Bank Audit Committee was not involved in the audit of Securrency, responsibility for monitoring the Bank's shareholding in Securrency (including its performance) was seen as falling to the Assistant Governor, Corporate Services (Mr Austin), whose role included the watching brief on the two entities.

The RBA Board received information about Securrency in the half yearly report which was presented by the NPA/Securrency Chairman at the RBA Board meetings.

On a number of occasions, the RBA Board, queried whether the Bank should continue in the JV, and what options there might be to take the business forward.

By late 2001, new arrangements were put in place, with the Chairman of Securrency requested to provide more regular reports on operational matters, and monthly financial reports.

**(ii) Informal Reporting** - Whilst Mr Austin sat on the Securrency Board as an employee of the Bank, he provided updates via informal memos to the Deputy Governor, in addition to the NPA Board minutes. He ceased this practice sometime after he left the employ of the Bank.

The RBA Board never met with the Securrency Board. On one or two occasions the Governor hosted a meeting with the directors representing UCB/Innovia. There was no direct line of sight from the senior Bank staff or Board into the management of Securrency, albeit the Assistant Governor (Corporate Services) did have a watching brief over Securrency.

**(iii) Audit Committee** - On establishment, the Securrency Board was deemed too small to have a separate Audit Committee or for the company to have its own internal audit function. Later, the Bank's internal audit department provided services to Securrency. However, unlike NPA, Internal Audit's reports were given directly to the Securrency Board, not to the RBA's Audit Committee.

In 1999, the Bank's Audit Committee minutes show the Committee agreeing to receiving six monthly figures from Securrency. It recognised that the investment in Securrency was not large in terms of the Bank's balance sheet, but the Committee saw it as part of its watching brief.

By 2001, the Audit Committee minutes reflect the Committee's view of its role in relation to the JV, as focusing on the financial consolidation of the JV, as opposed to dealing with the entity's performance issues.

**(iv) External Audit** - Annual external audits were done of Securrency by BDO Nelson Parkhill (1999-2005) and Deloitte (2006-onwards) after BDO merged with Deloitte.

### **7.2.7 The Bank's response to issues at Securrency, including with respect to agents**

Between 2002 and 2003, in response to the Bank's and the external auditor's concerns about Securrency's ongoing financial viability, a number of reviews were undertaken (by the Bank's Audit Department).

In early 2006, in response to the Bank Board's concerns arising out of the AWB publicity, the RBA Board asked for and received copies of Securrency's policy in relation to the use

of Agents. Subsequent to that, after consideration by Securrency's Board, the policy was revised.

When in mid-2007, a sub-committee of the NPA Board was established (as described earlier), to examine compliance with business standards and Australian Law in relation to the use of agents, an audit of Securrency was commissioned at the request of the Securrency Chairman. The Bank Board was informed that the Securrency review had found that (in comparison to the findings of a similar review of NPA) 'Securrency's processes and practices were more tightly controlled'.

In 2008, (as noted earlier), the RBA Board expressed their view that it was time to review the composition of the Board of Securrency, in particular to add some significant commercial experience, and to re-establish a direct linkage to Bank staff. It did so by appointing RBA Non-executive Director, Mr Akehurst, as a non-executive director and Dr Rankin, the Assistant Governor, Currency as Chairman.

Whilst some consideration was given in 2007 to a possible sale of Securrency, a firm decision to explore the disposal of the Bank's interest was made in 2010. This decision plus subsequent events have impacted on the rationale and practicalities around making changes to the underlying structure of the Securrency Board – however, this should not prevent considering whether other changes to the governance framework, such as tighter controls over strategy, plans, targets, and outcomes, are required from time to time.

The words from the Bank's press release quoted at Section 6.2.8 above with respect to NPA applied also to Securrency.

## Section 8 – Our Findings

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It is difficult to avoid using hindsight in drawing conclusions in these unusual circumstances. Nevertheless we must seek to assess the appropriateness of the oversight arrangements having regard to what was known and ought reasonably to have been known at the time, and against the standards of the time.

In setting out our assessment of the governance arrangements that the Bank established, we considered the following questions:

- Were the arrangements consistent with good practice as accepted at the time?
- Were the arrangements appropriate for the nature of the businesses, including the nature of the industry they operated in, and the level of market competition?
- Were the arrangements appropriate considering the size and importance of the entities vis à vis the parent?
- Were the arrangements appropriate given the stage of life of the entities?
- Were the arrangements consistent with the risk appetite of the parent?
- Were the arrangements consistent with reasonable cost/benefit of the various structures and processes?

### 8.1 Our assessment

We found that the corporatised structures chosen by the Bank were reasonable and reflected the practices of the time. As explained above, the Bank was required by a combination of the issues around the mis-fit between note printing and the predominant policy focus of the Bank, plus the competitive neutrality guidelines and the Cabinet decision, to put the note printing business into a separate structure.

We found that the governance arrangements put in place at the time NPA and Securrency were established (1998 and 1996 respectively) were sound and consistent with good practice at the time. They were not substantively different from those implicitly recommended both by public and private sector guidelines, and were certainly in line with the size/significance which the entities were at the time.

We found that the level of scrutiny that the Bank envisaged in establishing its oversight was also reasonable at the time. Both entities were non-material, in a financial sense, to the balance sheet and profit and loss of the Bank, which would ordinarily suggest that a lighter touch of supervision was all that was needed. There were further grounds for believing that the entities did not require especially close scrutiny. They were not 'start ups' in that NPA had been operating for some time and had a track record, and Securrency was using a modern, but proven technology. The Report of the Corporatisation Task Force included forecasts for potential export revenue which appeared to make the business challenge of the subsidiaries an easy one. This would have also set the scene for a 'light-touch, autonomous' approach to the governance arrangements, even allowing for the recognition at the time that those forecasts were rather optimistic. Nevertheless the continuing positive results of the entities in the late 1990s would have also given comfort (albeit it was understood that this was largely because of the very large pre-Y2K orders).

With the benefit of hindsight, it is evident that the full array of risks were not initially recognised, however it was clear to us that the Bank understood that the entities were vital to one of the Bank's core functions (e.g. the provision of sufficient, secure notes) and important from a reputational point of view. We also note that the conceptions of risk management were much less developed at the time in question.

However, the Bank did not simply "set and forget" – they understood the need for active oversight - they gave the entities the attention proportionate to their importance from their point of view. In doing so, they utilised four main tools:

- the Charter setting out the role and responsibility of NPA and its Board, (and in the case of Securrency, the Joint Venture agreement);
- The power of appointment to the Boards;
- Use of its own Audit Committee acting for NPA, and providing some oversight of Securrency; and
- Regular reporting to both the RBA Board and senior executives to monitor the companies.

We discuss each in turn.

- i. Board Charter / Joint Venture Agreement - The NPA Charter, written originally in 1990 when the first corporatisation occurred, provided strategic direction for the Company, as well as outlined the duties and powers of the Board. It was a sufficient, but not detailed document. The Charter required the Company to act in accordance with directions of the RBA as parent, and the Constitution was in due course changed to ensure that there was no corporate law reason why they would not do so. The Charter was reviewed in 2007 and 2008, in response to ongoing concerns about the company's focus.

The strategy and Board functions for Securrency were set out in the legal documents constituting the Company. These were not reviewed during the relevant period.

Ideally, these constituent documents for both should have been reviewed earlier and/or provided more guidance to the Boards - best practice today suggests that boards and committees review their charters at regular intervals, perhaps even annually.

- ii. Board Composition - An important element was the composition of the respective boards. The entity boards were comprised on an understanding that there needed to be a mixture of people with an affiliation to the Bank (either current or past) and with commercial expertise. The RBA did consider the composition of the NPA Board from time to time, albeit this was more in response to changes in the situation of the entities and/or individuals involved, rather than a structured succession plan. For example, when deficiencies at the companies were identified, they were addressed, as in the agreement with the Chairman for him to spend more time on and at the companies as from 2003, and the move to more internal staff appointments to the NPA Board as from 2004, as well as the changes made as from August 2007.

There was also a rationale for their selection of Chairman – the Bank had an express desire to keep tight oversight of the entities by one of its trusted senior

(former) colleagues. This appears to have over-ridden consideration of bringing in a chairman with experience in managing a commercial board – the reasoning being that the Chairman provided the necessary link to the Bank as customer, the Bank’s culture and control environment, whilst the CEOs of the entities should provide the necessary commercial expertise.

Even when Mr Thompson’s formal connection with the Bank was severed, this breakage in the linkage with the Bank was seen as being offset by the depth of his knowledge of the Bank and the businesses gained over many years, and by the presence on the Board of others who were current or more recent senior officers of the Bank.

- iii. Audit Committee - The use of the Bank Audit Committee, for such a small subsidiary as NPA, with a small board, was sensible, and the Committee proved to be diligent and useful in identifying areas of concern. It also provided through its minutes and the overlap of its membership with the Bank Board, a window through which the RBA Board had some visibility of the affairs of NPA. The Audit Committee also was able to draw upon the Bank’s Internal Audit department to assess the efficacy of NPA’s administrative and financial management practices.

Having said that, the use of an Audit Committee external to the Company resulted in some difficulty in obtaining timely responses to areas of concern, as well as a lack of insight into all operational areas. This ultimately proved to be a weakness.

In the case of Securrency, there was no Audit Committee, and this might be seen, once the operations of that business reached a reasonable size, as a relative weakness of the governance arrangements.

- iv. Reporting - In addition to all the formal and informal reporting through and to management, the Bank Board itself received a report on NPA and Securrency every 6 months, with the Chairman attending in person to deliver it, and answering questions. This is comparatively unusual in our experience – more like what one might expect from a divisional head than from the chair of a subsidiary with its own board.

It is fair to say that the reporting was fairly basic, and that the Bank Board, at least, did not spend much time or focus on the entities. The Bank staff member with the ‘watching brief’ did spend significantly more time on oversight of the entities, and did receive more detailed information.

It should not be overlooked that the RBA was also the entities’ major customer. It can be argued that the accountability that usually comes from one’s customers (complaints to directors of a parent company from unhappy clients of the subsidiary), did not work effectively in this case – because the Bank as customer had the same difficulties having its concerns addressed as the Audit Committee was having.

All of these arrangements were reasonably consistent with practice at the time, considering the small size of the entities relative to the parent.

Nevertheless, there were some additional actions which would not have been unusual to have applied, given the nature of the businesses and the low risk appetite of the Bank.

We set out some of these actions in the following section.

## 8.2 Other possible actions

We asked ourselves whether there were other actions that the Bank could have or should have reasonably done in relation to the oversight of these entities.

Below we set out some additional actions that could have been considered, albeit we are not confident that these would have provided any guarantee against events of the kind alleged in the charges. These may well be matters for the future.

### 8.2.1 Regularly review the entities' adoption of evolving best practice

Commencing as early as 1995, good governance standards started to be promulgated in the private sector. By the late 1990's these sorts of standards were also being adopted in the government sector for their commercial-like enterprises.

By 2003, when the ASX Corporate Governance Council adopted the first set of Principles and Recommendations, and Standards Australia produced their first governance standard (AS8000-8004), it was commonly accepted that best practice entailed adopting these guidelines (or adapting them to your situation). Also in that year, the 'Uhrig Report' (see Section 5.1 Public Sector Governance) set out a range of 'better practice' guidance for statutory authorities.

As these guidelines were progressively released and adopted generally, it might have been productive for the Bank to use the event of their issue as a prompt to consider their applicability to the entities, and where appropriate require the entities to adopt these practices.

### 8.2.2 Exert greater control over the entities

Under the terms of their Charter and Joint Venture Agreement respectively, the Boards of NPA and Securrency had high degrees of autonomy.

Whilst the small size of the subsidiaries might have justified a 'light touch' governance framework, the expansionary nature of the entities, once combined with the ongoing history of internal audit issues (as shown in successive Internal Audit reports from 1996) might have given cause to make the framework somewhat more extensive than otherwise.

The Bank could have considered exerting greater accountability, perhaps through control of approval of strategy, business plans, Key Performance Indicators, as well as senior management appointments and compensation arrangements.

At a minimum, if a parent company does not want or cannot exert direct control over a subsidiary, then it must ensure a strong flow of information, as well as setting strong oversight via codes of conduct, employment contracts/bonuses linked to compliance, etc. The Bank could have required much more frequent and detailed reporting, as well as a direct line of sight into the management of the entities.

Over a number of years, the RBA Board queried the strategic rationale behind maintaining ownership of these entities. In response to those queries, it might have been productive (and not unusual practice) to have commissioned an external review of the entities, say after the first 5 years, to assess objectively whether the entities were achieving their original aims.



### **8.2.3 Respond to identified issues more actively / on a more timely basis**

Anecdotal evidence provided by interviewees indicates that during the relevant period, the interest from the RBA Board in the subsidiary's operations remained minimal, and mostly focused on note quality issues (i.e. from the customer perspective), as opposed to the subsidiary's operations or profitability. The Bank Board spent only small amounts of time on the reporting from the subsidiary, and there was little engagement by the Directors (that is, of course, until specific issues arose, e.g. AWB, Audit Committee concerns, 2007 review). However, RBA Audit Committee minutes (which included matters concerning NPA) were provided to the Bank Board and occasionally, these triggered questions.

Using the Bank's Audit Committee had a number of positives – it drew on existing processes, expertise, and kept a direct line of sight from the Bank into NPA. However, it does appear to have set up a sometimes unhelpful tension, despite attempts by the Audit Committee not to interfere with the NPA Board's areas of responsibility. Even when the Bank became aware of issues (mostly related to quality control and security of the note printing), getting them resolved via the subsidiary boards was cumbersome.

When action to rectify issues identified by the Audit Committee did not seem to be taken promptly, perhaps an NPA Director should have been invited to sit 'in attendance' during those portions of the Audit Committee meetings which focused on NPA, which may have assisted to get desired response and action.

### **8.2.4 Revisit the governance arrangements as the entities evolved**

It could be argued that, as the businesses evolved and developed into export businesses (as opposed to note printing *for Australia*), the governance structures and processes should have been more thoroughly reviewed to ensure that they remained adequate for the risk profile of the entities. The risks of doing business in the parts of the world to which the companies were attracted were and are well known.

The Bank did pay attention to ensuring a more appropriate mix of skills and experience on the NPA and Securrency boards, but (probably with the benefit of hindsight) it can be seen that more could have been done. They *could* have had a formal program of renewal and refreshment, and could have considered putting additional commercially experienced people on the boards, including possibly in the Chairmanship, as the entity evolved. (As mentioned earlier, we accept the logic behind continuing with the chairmanship by a bank staff member, at least for some period after he ceased to be a current employee.) They could have established fixed term appointments from the start (this would have provided trigger points for reviewing the performance and appropriateness of the boards' composition).

The Bank could have considered whether to give the internal directors, in particular, more guidance and support. Bank staff, who were inexperienced as Directors of commercial entities, could have been provided with training (as now happens - with Bank staff now regularly attending the AICD Company Directors Course). We do not think that was usual or expected in the 1990s or into the next decade, albeit it is now common for executives who are appointed to sit on subsidiary boards.

The Bank could have maintained a direct linkage between the Bank Board and the subsidiary boards. This might have provided a more direct and informal means of insight into the risks at the subsidiaries (albeit the bank was in receipt of both formal reporting from the entities, and informal reporting from the Directors).

By the mid-2000's board performance evaluation had become more common. An independent review of the subsidiary boards' effectiveness would have been useful, we believe, but note our own professional bias to that opinion.

## **Section 9 – Conclusions and Suggestions for improvement**

### **9.1 Overall Conclusion**

In his conclusion to the Report into the collapse of HIH, Justice Neville Owen states:

“For me, the key to good corporate governance lies in substance, not form. It is about the way the directors of a company create and develop a model to fit the circumstances of that company and then test it periodically for its practical effectiveness.”<sup>16</sup>

The Bank gave reasonable consideration as to the governance arrangements for the two companies, and put in place processes for their oversight and reporting which were broadly consistent with usual practice at the time. The Bank appointed people whom it was entitled to believe could direct the affairs of the companies with due care, diligence and skill. The Bank received regular reports both at management and board level, and responded to those reports in a considered and deliberate way.

There is evidence of the Bank taking appropriate action where the entities appeared not to be performing in line with the Bank’s expectations and/or standards.

Clearly, with the benefit of hindsight, there could have been more oversight applied to the activities of the two companies, which may have detected earlier the alleged illegal payments, but that does not mean that the Bank's oversight at the time was inappropriate.

### **9.2 Suggestions for improvement**

Any major changes to the governance framework currently in place will no doubt prove difficult until the current litigation with the entities becomes clearer.

In the longer term, a clear strategy for each of the entities should be developed, before attempting to establish the most appropriate governance arrangements.

For example, if NPA is to focus primarily on producing the Bank’s notes, and other domestic business, it would be appropriate for the Board to be comprised wholly of Bank executives.

On the other hand, if NPA is to continue to be a commercially focused entity, looking for global opportunities, then it may be of value to appoint independent directors with particular skills and experience in the respective industries, including appointing an independent chairman. The necessary link to the Bank as parent can be maintained by other means, including by direct bank representation on the Boards.

In light of the likelihood that the litigation may continue for some time, implementation of any agreed strategy with respect to either company may similarly be delayed. During that period, consideration should be given, from time to time, as to whether tighter controls over strategy, plans, targets and outcomes for both companies should be put in place. Section 8.2 sets out a range of actions which may still be relevant going forward. We suggest you consider these.

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<sup>16</sup> Report of the Inquiry into the collapse of HIH, Final Report - Corporate Governance Chapter 07/12/2007

## **Appendix I - The Role of the Reserve Bank Board**

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The following extracts from the Reserve Bank Act 1959 (as amended up to Act No 46 of 2011), set out the establishment of the RBA Board, the role of the Board, as well as the arrangements for the management of the Bank.

### **“8A The Boards of the Bank**

- (1) The Bank has 2 Boards:
  - (a) the Reserve Bank Board; and
  - (b) the Payments System Board.
- (2) The Reserve Bank Board is responsible for the Bank’s monetary and banking policy, and the Bank’s policy on all other matters, except for its payments system policy (see section 10).
- (3) The Payments System Board is responsible for the Bank’s payments system policy (see section 10B).
- (4) Disagreements between the Boards are to be resolved in accordance with section 10C.
- (5) For how the *Commonwealth Authorities and Companies Act 1997* applies in relation to the 2 Boards, see subsections 7A(2) and (3).

### **9 Establishment of Reserve Bank Board**

There shall be a Reserve Bank Board, which shall be constituted as provided by Part III.

### **10 Functions of Reserve Bank Board**

- (1) Subject to this Part, the Reserve Bank Board has power to determine the policy of the Bank in relation to any matter, other than its payments system policy, and to take such action as is necessary to ensure that effect is given by the Bank to the policy so determined.
- (2) It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank under this Act and any other Act, other than the *Payment Systems (Regulation) Act 1998*, the *Payment Systems and Netting Act 1998* and Part 7.3 of the *Corporations Act 2001*, are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:
  - (a) the stability of the currency of Australia;
  - (b) the maintenance of full employment in Australia; and
  - (c) the economic prosperity and welfare of the people of Australia.

### **12 Management of the Bank**

- (1) There shall be a Governor of the Bank and a Deputy Governor of the Bank, who shall be appointed and hold office as provided by Part III.
- (2) Subject to sections 10 and 10B, the Bank shall be managed by the Governor.

- (3) The Deputy Governor shall perform such duties as the Governor directs and, in the event of a vacancy in the office of Governor, the Deputy Governor shall perform the duties of the Governor and shall have and may exercise the powers and functions of the Governor.”

## **Appendix 2 – Reserve Bank documents reviewed**

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We reviewed a comprehensive set of primary documents relating to the relationship between the Bank and the two companies for the period 1996 to the present in respect of Securrency, and 1998 to the present in respect of NPA (the relevant period).

The documents we reviewed fell under the following categories:

1. Reserve Bank Annual Reports
2. Examples of RBA Board papers
3. Various governance documents of NPA, including 1990 Charter, 2007 Charter, 2008 Charter, 1996 Constitution, 2000 Constitution
4. Various governance documents of Securrency Pty Ltd, including Memorandum and Articles of Association, Joint Venture Agreements dated 19 Jan 1996, and Re-organisation Agreement dated 3 July 1998 between RBA, UCB Films plc and Securrency;
5. NPA and Securrency Financial Reports 1998 - 2009
6. Papers and Minutes of the RBA Board, Audit Committee, and Executive Committee (redacted to only include material relevant to NPA and Securrency)
7. Various internal audit reports
8. Various external audit and other reports
9. Various internal RBA memorandums, file notes, and correspondence
10. Various background documents (e.g. McKinsey Report on Corporatisation, etc.)

## Appendix 3 – Persons interviewed

We interviewed the following persons (listed in alphabetical order):

Individual	Position	Dates of involvement
John Akehurst	Board Member, Reserve Bank Director, Securrency	2007 – current 2008 - current
Les Austin	Asst Governor, Financial Institutions Asst Governor, Corporate Services Director, NPAL <sup>17</sup> Director, Securrency	1993 - 1998 1998 - 2001 1999 - 2009 1999 - 2011
Ric Battellino	Deputy Governor Member, Audit Committee (including Chairman 2007-2008)	2007 - 2012 2007 - 2012
George Bennett	External Member, Audit Committee	1998 - 2010
Jillian Broadbent AO	Board Member, Reserve Bank Member, Audit Committee Chairman, Audit Committee	1998 - current 1998 - current 2008 - current
Frank Campbell	Asst Governor, Corporate Services Director, NPAL Chairman, NPAL	2001 - current 2004 – 2008 2007-2008
Dr Stephen Grenville AO	Deputy Governor Chairman, Audit Committee	1996 – 2001 1996 - 2001
Dr John Laker AO	Asst Governor, Corporate Services Asst Governor, Financial System	1994 - 1998 1998 - 2001
Ian Macfarlane AC	Deputy Governor Governor Member, Audit Committee	1992 - 1996 1996 – 2006 1992 - 1996
Dr Robert Rankin	Asst Governor, Business Services Chairman, NPAL Securrency Interim Managing Director Chairman, Securrency	2004 - 2008 2008 – 2010 2009 - 2010 2008 - current
Glenn Stevens	Deputy Governor Chairman, Audit Committee Governor	2001 - 2006 2001 - 2007 2006 - current
Graeme Thompson	Deputy Governor Chairman, NPA & NPAL Chairman, Securrency	1993 - 1998 1993 - 2007 1996 - 2008
Richard Warburton AO	Board Member, Reserve Bank Director, NPA and NPAL	1992 - 2002 1996 - 2008

<sup>17</sup> For strict accuracy on this page only, we are using the abbreviation 'NPA' for Note Printing Australia - the entity during 'informal corporatisation' and 'NPAL' for Note Printing Australia Limited, the entity after 'formal corporatisation'.

## **Appendix 4 – Public Sector Guidelines/Reference Material**

We reviewed the following materials which set out guidance for the governance of public sector entities.

1. Commonwealth Government; Commonwealth Government Business Enterprise Guidelines: Governance Arrangements for Commonwealth Government Business Enterprises. June 1997
2. Commonwealth Government, Australian National Audit Office; Corporate Governance in Commonwealth Authorities and Companies – Discussion Paper; 1999
3. Commonwealth Government, ANAO; *Better Practice Public Sector Governance, and various Governance Guidance Papers*. 2003 (and previous guides published in 1997 and 1999) – provided guidance to those public sector organisations covered by FMA Act 1997 and CAC Act 1997.
4. Commonwealth of Australia; Review of the Corporate Governance of Statutory Authorities and Office Holders (known as the ‘Uhrig Review’), June 2003
5. Commonwealth Government, Department of Finance and Regulation; Review of Review of the Corporate Governance of Statutory Authorities and Office Holders (known as the ‘Uhrig Review Commonwealth Government Business Enterprises Governance and Oversight Guidelines – Discussion Paper’). June 2011
6. Audit Office of NSW, *Performance Audit Report: Public Sector Corporate Governance: Corporate Governance - Volume One: in Principle* 1997
7. Audit Office of NSW, (1997) *Performance Audit Report: Public Sector Corporate Governance Corporate Governance - Volume Two: in Practice*
8. Audit Office of NSW; Guide to better practice for public sector governing and advisory boards (1998)
9. NSW Premier’s Department; *Conduct Guidelines for Members of NSW Govt Boards and committees*, November 2001 (includes section on Reporting Suspected Corrupt Conduct!)
10. NSW Auditor General, *The Changing Agenda for Public Sector Governance*, speech to CSA Annual Public Sector Governance Forum, Sept 2005
11. Government of Tasmania, Department of Treasury and Finance; Guidelines for Tasmanian Government Businesses: Subsidiary Companies and Joint Ventures; October 2008
12. Government of South Australia, Dept of Planning and Local Government; *Subsidiaries – Ministerial Approval Guidance Paper No 3* 2009
13. Queensland Government; Government Owned Corporation Subsidiaries – Key Shareholder Requirements for Constitutions. 2006



## Appendix 5 – Private Sector Corporate Governance Codes

We reviewed the following Corporate Governance Codes and Principles:

Australia	Issuer/Date	Mention of Subsidiaries
Corporate Governance Principles and Recommendations	ASX Corporate Governance Council (2003; 2010)	In referring to the application of the Principles to listed responsible entities, the difficulty in implementing the Independent Chairperson recommendation in wholly owned subsidiaries is highlighted
The Blue Book - Guidelines on Corporate Governance for Fund Managers and Corporations	Financial Services Council (formerly Investment and Financial Services Association) (1995, 2002, 2004)	nil
Australian Standard: AS 8000	Standards Australia 2003	nil
National Governance Protocols for Universities	Aug 2002	nil
Strictly Boardroom.	Hilmer, (1993 and 1998)	Nil
UK		
The UK Corporate Governance Code	(2010)	nil
A review of corporate governance in UK banks and other financial industry entities	The Walker Review 2009	Suggests that subsidiaries of foreign banks operating in the UK should adopt these recommendations
Combined Code on Corporate Governance	Financial Reporting Council (2000; 2008),	nil
Role and effectiveness of non-executive directors	Higgs Report (2003)	In order to address the perceived need for previous board experience, an option which some companies have found useful is to bring onto the boards of subsidiary companies talented individuals from wider and more diverse backgrounds, to give them exposure to the operation of a board as a possible stepping-stone to the board of a listed company

<b>UK</b>	<b>Issuer/Author/Date</b>	<b>Mention of Subsidiaries?</b>
Committee on Corporate Governance : Final Report	Hampel report (1998)	nil
Financial Aspects of Corporate Governance (includes Code of best practice)	Cadbury report (1992)	Mentions a board should be responsible for decision for acquisition/disposal of subsidiaries
<b>USA</b>		
Principles of Corporate Governance	Business Roundtable (2002, 2005, 2010)	nil
Global Principles of Accountable Corporate Governance	Calpers (2010)	The compensation committee should vigorously oversee all aspects of executive compensation for a group composed of the CEO and other highly paid executives, as required by law, and any other highly paid employees, including executives of subsidiaries, special purpose entities and other affiliates
Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies	National Association of Corporate Directors (NACD)(2008)	nil
NYSE corporate governance principles	New York Stock Exchange (2002; 2003)	Nil
Commission on Public Trust and Private Enterprise	The Conference Board (2003)	Nil
The Good Governance Standard for Public Service	Independent Commission for good Governance in Public Services, 2004	Nil
Report of the NYSE Commission on Corporate Governance	NYSE 2010	nil

Others <sup>18</sup>	Issuer/Author/Date	Mention of Subsidiaries?
King Reports (1994, 2002 and 2009).	South Africa Code	The Companies Act audit requirement should be re-considered for dormant and inactive wholly owned subsidiaries
Where Were The Directors? Guidelines for Improved Corporate Governance in Canada ('The Dey Report')	Report of the Toronto Stock Exchange Committee on Corporate Governance in Canada (1994, reprinted 2000)	Nil
OECD Principles of Corporate Governance	OECD, 2004	Compliance programmes should also extend where possible to subsidiaries.

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<sup>18</sup> For various European codes, visit the [European Corporate Governance Institute](#) website.

## **Appendix 6 - Other relevant governance references**

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Below is a listing of governance references made in the report, as well as other articles of relevant interest.

1. Australian Institute of Company Directors, “Company Directors Course’ reading materials, 1997-1998.
2. Baxt R and Lane T., “Developments in Relations to Corporate Groups and the Responsibilities of Directors – Some insights and New Directions”, (1998)16 *Company and Securities Law Journal* 628
3. Strikwerda, J. 2003. "An entrepreneurial model of corporate governance: devolving powers to subsidiary boards". *Corporate Governance*, 3(2): 38-57.
4. Grantham R, “The governance of government owned corporations”, (2005)23 *Company and Securities Law Journal* 181
5. Bamford, James and Ernst, David; “Governing Joint Ventures”, *McKinsey Quarterly*, March 2005.
6. Kiel, Geoff C. and Hendry, Kevin and Nicholson, Gavin J. (2006) Corporate governance options for the local subsidiaries of multinational enterprises. *Corporate Governance: An International Review* 14(6):pp. 568-576.
7. Financial Times Limited, ‘Herding your subsidiaries towards good governance’, By Ulrich Steger and Jochen Brellochs, Published: April 6 2006

## Appendix 7 – NPA Board Composition 1996 - current

The following table sets out the composition of the NPA Board post corporatisation, and highlights the critical changes during that time.

Year	Individual	'Position held' (NB A change of an individual's position is noted in italics/bold)
1996-1998	G Thompson M Bethwaite R Warburton R Larkin	RBA Deputy Governor, as Chairman External, non-executive director RBA Board Member Managing Director, Note Printing Australia
1998-1999	G Thompson M Bethwaite R Warburton	<b>External, non-executive Chairman</b> External, non-executive director RBA Board Member
1999 - 2001	G Thompson M Bethwaite R Warburton L Austin	External, non-executive Chairman External, non-executive director RBA Board Member Assistant Governor, Corporate Services
2001 - 2002	G Thompson M Bethwaite R Warburton L Austin	External, non-executive Chairman External, non-executive director RBA Board Member <b>External, non-executive director</b>
2002 - 2003	G Thompson M Bethwaite R Warburton L Austin	External, non-executive Chairman External, non-executive director <b>External, non-executive director</b> External, non-executive director
2004 - 2007	G Thompson M Bethwaite R Warburton L Austin F Campbell	External, non-executive Chairman External, non-executive director External, non-executive director External, non-executive director Assistant Governor, Corporate Services
2008	F Campbell R Rankin R Warburton L Austin	<b>Assistant Governor, Corporate Services - Chairman</b> <b>Assistant Governor, Currency - Chairman</b> External, non-executive Director External, non-executive Director
2008 - 2009	R Rankin L Austin D Ross K Hall	<b>Assistant Governor, Currency – Chairman</b> External, non-executive director RBA Chief Financial Officer Assistant Governor, Banking & Payments
2009 - 2010	R Rankin D Ross K Hall L Boulton	Assistant Director, Currency – Chairman RBA Chief Financial Officer Assistant Governor, Banking & Payments RBA Head of Risk Management
2011	M Bullock D Ross K Hall L Boulton M McPhee	<b>Assistant Governor, Currency – Chairman</b> RBA Chief Financial Officer Assistant Governor, Banking & Payments RBA Head of Banking RBA Head of Risk Management

## Appendix 8 - Securrency Board composition 1996 - current

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The following table sets out the RBA's appointees to the Securrency Board, and highlights the critical changes during that time.

Year	Individual	Position held
1996 - 1998	G Thompson R Larkin M Bethwaite	RBA Deputy Governor – Chairman CEO of NPA Briefly while Acting CEO, NPA
1999 – 2000	G Thompson L Austin J Leckenby	<b>External, non-executive Chairman</b> Asst Governor, Corporate Services CEO of NPA
2001-2004	G Thompson L Austin J Leckenby	External non-executive Chairman <b>Non-executive Director</b> CEO of NPA
2004- 2007	G Thompson L Austin C Ogilvy	External non-executive Chairman Non-executive Director CEO of NPA
2008 - 2010	R Rankin L Austin J Akehurst D Ross	Asst Governor, Currency Non-executive Director RBA Board Member RBA Chief Financial Officer
2011	R Rankin J Akehurst D Ross	<b>RBA Chief European Representative</b> RBA Board Member RBA Chief Financial Officer

## **Appendix 9 - Our Qualifications as an Expert**

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Cameron Ralph is one of Australia's longest established specialist governance advisory firms. It was established in 2002, and for nearly nine years has provided governance advisory services and independent board performance assessments to some of Australia's leading commercial firms, government bodies and not-for-profit institutions.

Cameron Ralph has no conflicts of interest in relation to this engagement.

The principals who undertook the Review (Mr Cameron and Ms Ralph) have many years experience as company directors in the public and private sectors, dating back to 1982 and 1988 respectively. Prior to establishing Cameron Ralph, they were senior members of the Australian Securities and Investments Commission, and have accordingly a strong background in public sector governance. More detailed biographies are below:

### **Alan Cameron AO, B.A., LL.M. (Syd), FAICD - Chairman**

- 20 years corporate legal experience;
- Former Chairman of the Australian Securities and Investments Commission;
- Chairman of ASX Compliance Pty Limited
- Chairman, National e-Conveyancing Development Limited
- Chairman, Hastings Funds Management Limited, and Westpac's insurance subsidiaries
- Deputy Chancellor of the University of Sydney
- Facilitator, Australian Institute of Company Directors 'Mastering the Boardroom' and Essential Director Update programs.

### **Lynn Ralph, B.A, M.B.A, FAICD, FFin – Joint Managing Director**

- 15 years funds management experience
- Former Deputy Chairman, Australian Securities and Investments Commission (1993-97)
- Former CEO, Financial Services Council (1998-2002)
- Company Director since 1988. Former directorships held include Financial Industry Complaints Service Pty Ltd; NRMA Limited; Chairman, Centennial Park and Moore Park Trust; Chairman, AMP Foundation
- Current Directorships include: Commissioner, Private Health Insurance Administration Council; Chairman, BT Funds Group; Director Sydney Swans; Bangarra Dance Theatre; Securities Exchanges Guarantee Corporation; and Sydney Institute
- Facilitator, Australian Institute of Company Directors 'Company Directors Course'
- Member of the Institute of Chartered Accountants of Australia's National Quality Review Committee