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Policy and Guidelines Paper

**Commercial Policy:  
CEO Appointment Guidelines for  
Government Businesses**

## 1. Preface

The CEO Appointment Guidelines for Government Businesses (Guidelines) is a component of the NSW Government's Commercial Policy Framework.

The Commercial Policy Framework is a suite of policies that aims to replicate within NSW Government businesses the appropriate disciplines and incentives that lead private sector businesses towards efficient commercial practices.

This edition of the Guidelines replaces and supersedes the previous CEO Contract Guidelines for Government Businesses (TPP06-1). They provide advice on key aspects of the employment of chief executive officers and managing directors of State Owned Corporations and other government businesses not subject to the Government Sector Employment Act 2013 (NSW). The Guidelines reflect best practice corporate governance standards and describe how they might be applied in the context of Government ownership.

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### Note

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This publication can be accessed from the Treasury's website [www.treasury.nsw.gov.au/](http://www.treasury.nsw.gov.au/).

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### 3. Executive Summary

The CEO Appointment Guidelines for Government Businesses provide advice on the appointment of chief executive officers and managing directors (CEOs) of government businesses where the *Government Sector Employment Act 2013* (NSW) (GSE Act) does not apply. The guidelines reflect private sector best practice and relevant employment principles applying in the public sector.

The Guidelines are not prescriptive because the circumstances faced by individual government businesses are not standardised and a wide range of variations exist. It is important, however, that boards consider all sections of these Guidelines carefully and assess how they might be applied in line with directors' obligations to help achieve optimal corporate performance.

While these Guidelines offer advice for Government businesses in areas where they are not subject to the GSE Act, they are also intended to be consistent with the GSE Act's objective of modernising the NSW public sector. Nevertheless, the Guidelines also recognise the independence of government businesses.

Appendix 1 provides a high level checklist of the requirements and advice set out in these Guidelines.

The Guidelines are forward-looking. It is not intended that existing CEO contracts and associated employment arrangements should be modified to reflect any of the advice contained in these Guidelines.

There are precise requirements, summarised in Appendix 3, for approval or consultation with shareholders according to each business's enabling legislation or founding documentation regarding:

- the appointment of a CEO
- the removal of a CEO
- CEO remuneration
- other terms and conditions of a CEO's employment.

With regard to recruitment and the terms of appointment, the Guidelines outline procedures that will typically be relevant for government businesses in the context of:

- attracting a strong and diverse range of applicants
- conducting probity checks
- identifying conflicts of interest
- reaching a contractual agreement
- setting appropriate remuneration policies (including performance pay if appropriate).

Procedures for reappointment and/or termination are also outlined.

The Guidelines recognise that a remuneration package for a CEO of a government business should be market-based. It should be sufficient to attract, retain and motivate a senior executive of the quality required for the role. At the same time, businesses should avoid compromising their commercial interests by paying more than is necessary for this purpose. Government businesses should also take account of community expectations about the remuneration policies applied in the public sector.

In addition, the application of the NSW Public Sector Wages Policy 2011 (Wages Policy) to SOCs limits increases in employee related expenses to 2.5 per cent per annum with any additional increase to be funded by employee related cost savings, including for executives and CEOs.

Any decision to introduce or modify performance payments is a matter for the board and the shareholders subject to the situation of the individual business. Guidance is provided on some of the critical matters to be considered in designing and implementing effective incentive plans as well as how performance agreements and appraisals should be approached. The Guidelines recommend that boards make additional disclosures about executive remuneration in their annual reports to align more closely with standard practice of listed companies and allow government businesses to mitigate risks associated with community expectations and sensitivities.

## 4. Background

These Guidelines provide advice relating to the appointment of CEOs of government businesses in situations where the GSE Act does not apply. The Guidelines have been developed to reflect private sector best practice and relevant employment principles that apply in the public sector. They recognise that government businesses should achieve the best possible commercial outcomes by adopting efficient and effective policies and procedures, and by operating in a manner consistent with community expectations about government businesses.

These Guidelines are not prescriptive because a wide range of variations in circumstances face individual government businesses. It is important, however, that boards consider all sections of these Guidelines carefully and assess how they might be applied in line with directors' fundamental obligations to help achieve optimal corporate performance.

Any departures from the standards outlined in these Guidelines should be explained in businesses' communications with shareholder and/or portfolio ministers, the Treasurer, and their agents including NSW Treasury.

### 4.1 Application of the Guidelines

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These Guidelines aim to assist governing boards of government businesses and commercially focused government entities where the:

- CEO is not employed under the GSE Act
- board is responsible for appointing the CEO, or recommending the appointment
- board has responsibility for performance agreements and performance appraisals of the CEO and other senior executives.

The government businesses and commercially focused government entities that fall into this category include but are not limited to:

- State Owned Corporations ('SOCs')
- Government entities within the Total State Sector Accounts classified as public financial corporations
- Corporations Act 2001 companies where the Treasurer is a designated shareholder.

These Guidelines are forward-looking. It is not intended that existing CEO contracts and associated employment arrangements should be modified to reflect any of the advice contained in these Guidelines.

This document will collectively refer to:

- government businesses and commercially focused government entities as government businesses
- the Treasurer, voting shareholders and portfolio ministers as shareholders
- commercial governing boards as boards.

## 4.2 Relationship to the GSE Act 2013

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While these Guidelines offer advice for government businesses in areas where they are not subject to the GSE Act, they are also intended to be consistent with the objective of the GSE Act - modernising the NSW public sector.

Nevertheless, the Guidelines also recognise the rights and independence of government businesses outside the GSE Act in setting conditions of employment, including remuneration levels, in competitive environments.

It is important to remember that there are certain provisions of the GSE Act that apply to all employees of entities in the government sector. This includes the provisions of Part 5 of the GSE Act which apply across the government sector including SOCs, such as Workforce diversity.

## 4.3 Relationship to Wages Policy

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The Wages Policy, as defined in the GSE Act, applies to the government sector including Public Service agencies, Departments, Executive agencies, SOCs as well as their subsidiaries and independent statutory bodies, including persons identified in the GSE Act.

The application of the Wages Policy limits increases in employee related expenses (including for executives and CEOs) to 2.5 per cent per annum with any additional increase to be funded by employee related cost savings.

## 5. Terms of employment

### 5.1 Appointment

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There are precise requirements for approval or consultation with shareholders regarding the appointment of a CEO according to the enabling legislation or founding documentation for each business. **Appendix 3** includes information on relevant provisions in the founding legislation for particular government businesses.<sup>1</sup>

The following key principles should guide consideration of conditions of employment applying to the CEO and other senior executives of a government business:

- consistency in arrangements for similar entities in the same industry
- recognition of the varying circumstances of individual government businesses
- clarity in roles and responsibilities
- transparency in the relationship between the board and key management personnel (including the CEO).

A CEO appointment should be for a fixed term. Best practice in the private sector suggests that an initial appointment should be for a 4 or 5 year term with no upper limit on maximum tenure. Naturally this tenure is subject to the performance of the CEO and the evolving needs of the business. Given the varying industry conditions and differences in operational circumstances faced by government businesses, boards should adopt term and tenure arrangements suited to their particular situation while being mindful of private sector best practice.<sup>2</sup>

Boards are urged to consult at an early stage with shareholders on the precise terms being proposed for an appointment or a reappointment of a CEO.

### 5.2 Recruitment

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In line with best practice in the private sector and in other Australian government jurisdictions, the CEO recruitment process should commence at least six months prior to the expiry of the incumbent's contract.

**A detailed position description should be prepared. At the minimum, it should describe:**

- duties and responsibilities
- skills required
- mandatory and desirable selection criteria
- standard terms and conditions of employment.

In preparing a position description the board should consider whether and how the CEO role has changed since the previous appointment was made. The position description should also be explicitly linked to the business's forward strategy. The board might wish to delegate the drafting of a position description to a nominations committee or a remuneration committee.

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<sup>1</sup> **Appendix 3** also summarises the relevant legislative requirements for CEO removal, remuneration and other terms of employment for various government businesses.

<sup>2</sup> The NSW Government prefers non-executive director appointments to be made for three year terms with a maximum tenure of nine years in total (subject to any legislative requirements to the contrary). However, these Guidelines recognise that somewhat different considerations are in play in the case of a CEO appointment.

At the CEO level, it is considered best practice for government businesses to engage a suitably qualified executive search firm so that a strong and diverse range of candidates can be assembled.

An executive search firm should be well placed to advise the board whether vacancies should be publicly advertised or a more targeted approach taken. The target approach utilised may include drawing on network referrals and utilising established contacts with business and community groups.

The procedures adopted should not preclude consideration of internal candidates.

There should be timely consultation with shareholders with regard to both the position description and the proposed recruitment process.

All selection processes should be merit-based, fair and open to ensure attracting a diverse range of appropriate applicants.

### Workforce diversity

Because Section 63 of the GSE Act applies to government businesses, selection processes should recognise that diversity in government sector workforce management is a priority. In the GSE Act workforce diversity includes (but is not limited to) diversity with respect to gender, cultural and linguistic background, Aboriginal people and people with a disability.

Consideration should also be given to the gender mix and diversity of selection panels.

### 5.2.1 Probity checks

Prior to a contract of employment being finalised and an appointment being confirmed, the board should be satisfied that:

- the candidate's credentials are genuine
- relevant experience as presented during the selection process are true and accurate reflections of the candidate's employment history
- the candidate is of good fame and character.

Robust procedures should be followed when conducting probity checks to ensure that the Government and the public can have the highest level of confidence about the appointee. For example, that the appointee has a proven history of personal integrity and a demonstrated capacity to manage their financial and business affairs. Robust probity checks are vital in establishing this necessary level of confidence.

A list of appropriate checks is provided at **Appendix 4**.

Adequate time should be allowed so that all probity checks can be completed before an appointment is confirmed.

There may be circumstances where the appointment process needs to be expedited. In these cases it may be appropriate that the appointment is conditionally approved subject to the completion of satisfactory probity checks. Consultations with shareholders should include an explanation of this course of action and why the appointment is so time sensitive.

## 5.2.2 Declaration of private interests

Boards should require CEOs to make and maintain an accurate disclosure and declaration of private interests to identify any real or perceived conflicts of interest that could potentially present a significant risk to the operation or reputation of the government business.

The declaration should include the interests of spouses and dependants.

### The declaration of private interests should be made:

- prior to a CEO's initial appointment
- if the CEO is to be reappointed, prior to the reappointment
- at least annually during the term of the CEO's appointment
- whenever there is a material change in the CEO's interests.

Boards should also consider whether it would be prudent to require short-listed candidates to make declarations as part of the final stages of the selection process.

Given the demands of a CEO role with a government business it would be inappropriate for a CEO to be a non-executive director of more than one unrelated business requiring material time commitments. The board should be satisfied that any other directorships and/or other external positions should not result in a real or apparent conflict of interest or otherwise adversely affect the CEO's performance.

CEOs and other key management personnel should not be remunerated via their own private company. It is the appointed individual who must be held accountable in the exercise of their functions rather than their company. Also, payment via a company structure would not create an effective employment contract as it would amount to the engagement of a contractor or a consultant.

## 5.2.3 Privacy

All personal information provided by a candidate in support of a CEO appointment application should be treated in accordance with the NSW Government's privacy practices as regulated by the *Privacy and Personal Information Protection Act 1998* (NSW).

## 5.3 Contractual agreement

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The CEO and other key management personnel of a government business should have a clear understanding of their roles and responsibilities and of the business's expectations of them. To ensure this understanding the written agreement or letter of appointment should contain all relevant details.

### The CEO's written agreement or letter of appointment should include:

- a description of the position, duties and responsibilities, which will include the requirement to follow policy directions given by the board (or shareholders, as applicable), and ensure compliance with legislative and regulatory provisions
- remuneration and other employment benefits, including the basis for calculating any performance pay
- a performance agreement setting out clear and measurable performance objectives and appraisal methods
- termination provisions including the circumstances in which their service may be terminated, with or without notice
- any entitlements on termination
- applicable notice periods in the event of reappointment, resignation and termination
- procedures to identify and manage conflicts of interest through appropriate and timely declarations
- mechanisms to be employed in the event of a dispute (such as mediation, arbitration or other alternatives to court or formal tribunal proceedings)
- confidentiality provisions
- post-employment restrictions (in instances where competitive issues might arise)
- provisions for changing the terms of the agreement or contract.

## 5.4 Remuneration

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A remuneration package for a CEO of a government business should be market-based. It should be sufficient to attract, retain and motivate a senior executive of the quality required for the role.

At the same time, businesses should avoid compromising their commercial interests by paying more than is necessary for this purpose. Government businesses should also take account of community expectations with regard to remuneration policies applied in the public sector.

As noted in **Appendix 3**, government businesses are generally required to consult with shareholders prior to finalising an offer of remuneration to a CEO. Boards are encouraged to engage with shareholders as early as possible so that approvals can be secured in a timely fashion.

### 5.4.1 Remuneration committee

The board should establish a remuneration committee charged with making recommendations to the board relating to the policy and practice for executive remuneration and the individual remuneration packages for its CEO and other key management personnel.<sup>3</sup>

This committee should be of sufficient size and independence to discharge its mandate effectively and it should be governed by a written charter.

According to private sector best practice<sup>4</sup> a remuneration committee should have at least three members, a majority of whom are independent directors; and should be chaired by an independent director.

If the CEO or other executives are members of the remuneration committee, the committee's charter should specify that they should not be present for discussions or participate in formulating recommendations relating to their own remuneration. Potential conflicts of interest can also arise by CEOs and other key management personnel being involved in making recommendations regarding the remuneration for other executives. This is because doing so may indirectly affect their personal remuneration (for example, by implicitly setting a benchmark or by disturbing relativities). Managing such potential conflicts of interest should also be recognised in the Charter of the committee and appropriately managed by the committee's chair.

Each member of the remuneration committee should have:

- extensive knowledge of the business, its CEO and other key management personnel
- a good understanding of remuneration policy and issues, enhanced as considered appropriate to the circumstances of the business by appropriate training or access to expert advice
- access to benchmarking data to inform recommendations about remuneration and, if relevant, information about suitable performance payments schemes.

It is important that remuneration committee members have adequate knowledge, experience and awareness of the history and context of remuneration decisions so that remuneration policy will be consistent over time. Therefore, members of the committee should preferably serve for a period of at least three years.

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<sup>3</sup> These Guidelines also recognise the possibility that some boards might choose to make remuneration the province of a nominations committee or another committee charged with the oversight of other related human resources functions. The overriding concern is that the board should ensure that any committee charged with remuneration policy responsibilities is adequately resourced and has a majority of independent directors.

<sup>4</sup> For example, see *Corporate Governance Principles and Recommendations* (ASX Corporate Governance Council, 3rd edition, 2014).

## 5.4.2 Key considerations

The following key considerations should guide decisions regarding the remuneration of CEOs of government businesses.

|  |  |
|--|--|
| <p><b>Market-based remuneration</b></p> <p>A remuneration package for a CEO of a government business should be sufficient to attract, retain and motivate a senior executive of the quality required for the role. At the same time, businesses should avoid compromising their commercial interests by paying more than is necessary for this purpose. In short, CEO remuneration should be market-based.</p> | <p><b>Relativities</b></p> <p>Benchmarking is vital in ensuring that CEO remuneration is positioned competitively relative to other comparable organisations, especially those in the public sector and the same or similar industries.</p>  |
| <p><b>Characteristics of the business and industry</b></p> <p>The relative size of the business, the ease or difficulty encountered in recruitment and retention, competition in the relevant executive marketplace for special expertise, and the distinctive risks, challenges and complexities faced by the business should be taken into account when determining CEO remuneration.</p>                    | <p><b>Alignment of interests</b></p> <p>The remuneration package should align the CEO's interests with value creation for shareholders so that the CEO's focus will be on maximising short-term profits while, at the same time, ensuring the long-term growth and success of the business without exposing the business to inappropriate or disproportionate risks.</p> |
| <p><b>Community expectations</b></p> <p>Boards of government businesses must be cognisant of community expectations and sensitivities about executive remuneration in general and the remuneration of CEOs of government businesses in particular.</p>   | <p><b>Other considerations</b></p> <p>For all government businesses, CEOs who also sit on the board should not be paid separate director's fees. The CEO's involvement at board level, and the associated responsibilities and obligations, should be considered when determining the CEO's remuneration.</p>  |

## 5.4.3 Typical components

CEO remuneration might consist of:

- a substantive base (or fixed) salary
- incentive payments (or at-risk pay) based on a blend of short-term and long-term performance metrics
- other benefits as determined by the board on the basis of market considerations (such as provision of a motor vehicle) and prevailing regulations and practices (such as superannuation contributions).

A CEO's base salary will vary according to whether the board has decided to offer the CEO any performance pay in the form of incentive payments.

Any decision to introduce performance payments is a matter for the board and the shareholders and should be based on the circumstances of the individual business. Guidance on aspects of the design of performance pay schemes is provided below and in **Appendix 6**.

As previously noted at section 1.3, the application of the Wages Policy to SOCs limits increases in employee related expenses, including for executives and CEOs, to 2.5 per cent per annum with any additional increase to be funded by employee related cost savings. The introduction or enhancement of any performance payments is also subject to the Wages Policy.

### 5.4.4 Benchmarking

Benchmarking is a vital tool in arriving at well-framed remuneration recommendations.

To benchmark effectively, the remuneration committee should have access to reliable, up to date information about remuneration in public sector organisations and commercial entities operating in similar fields. The committee should assess any implications carefully, taking into account the extent of competition, size of the business, size of its market and industry norms.

Benchmarking should also be informed by an appreciation of the levels of risk and notions of public service involved in managing government businesses, as well as community expectations and sensitivities.

If a board or its remuneration committee makes recommendations without the benefit of benchmarking or due consideration of relativities, the factors considered when making recommendations should be fully disclosed when consulting with shareholders and seeking shareholder approval.

The committee may also need to draw on external professional advice (also see section 2.4.5). Advisers should have extensive market databases or ready access to market information relating to businesses of the size and nature of interest to the committee.

### 5.4.5 External advice

The board may seek expert external advice from a remuneration consultant to assist it in setting remuneration including performance pay parameters.

#### **Governance considerations relating to external advice<sup>5</sup>:**

- before entering into a remuneration consultancy contract, the proposed consultant must be approved by the board or the members of a committee (usually the remuneration committee)
- the remuneration consultant must provide recommendations directly to either or both of the board and/or the members of the remuneration committee
- the remuneration consultant must provide a declaration stating that the recommendations have been made free from undue influence by the CEO and other key management personnel - this declaration must be included with the recommendations.

<sup>5</sup> See various provisions of the *Corporations Act 2001*, particularly Sections 206K, 206L and 206M.

### 5.4.6 Performance pay and incentives

Any decision to introduce or modify existing at-risk pay arrangements is a matter for the board and the shareholders subject to the situation of the individual business .

If performance pay is considered appropriate, the components of a suitable scheme will vary depending on the specific circumstances of the business and the industry in which it operates.

Decisions relating to performance pay, including the amount of remuneration at risk, should also take into account community expectations and sensitivities regarding government businesses.

It should be noted that performance pay alone is unlikely to be an effective way of improving the performance of a business. To be successful the performance pay should be built on a foundation of properly structured performance measures and key performance indicators (KPIs). **Appendix 6** provides lists of commonly applied performance measures and KPIs for the information of boards.

#### Best practice features of at-risk pay include:

- payments should be linked to clearly defined short and long-term goals using indicators that are difficult to manipulate and can be measured or otherwise assessed on the basis of objective criteria
- incentive payments should be explicitly linked to the CEO's annual performance agreement and appraisal
- the blend of short-term and long-term incentives should match shareholders' expectations and align the interests of executives and shareholders
- rewards should either be linked to tangible improvements in financial results or demonstrable achievements related to non-financial objectives
- because shareholders have clear interests in the sustainability and long-term success of the business, elements of performance pay should be structured to provide long-term incentives
- performance pay should be dependent on the true performance of the business by excluding the impact of cyclical factors or industry trends

#### Long-term incentives

Where it is deemed appropriate private sector best practice regarding long-term incentives should be applied in a manner that reflects the nature of government businesses. In the case of listed companies, executives are often rewarded through equity in the business and, accordingly, performance share rights are often a large component of long-term incentive schemes. Obviously such mechanisms are not available for government businesses.

In a similar way to private sector counterparts, the shareholders of government businesses have an interest in ensuring that management delivers the highest possible returns to shareholders over time by optimising the growth of the business and maximising its net worth. Where the boards of government businesses decide to adopt at-risk pay, long-term incentives (for example, calculated over the period of the CEO's contract) should be formulated against this background.<sup>6</sup>

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<sup>6</sup> Such incentives might, for example, be linked to the achievement of long-term strategic objectives.

## 5.5 Reappointment

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If a board wishes to extend the term of the CEO or reappoint an incumbent CEO, the approval process applying to initial appointments and setting conditions of employment applies.

A formal offer should not be made to the CEO before the required approvals are received through consultations with shareholders.

In situations where the incumbent CEO is being considered for reappointment and other candidates are also being considered, the board should determine whether it would be appropriate for the incumbent CEO to participate in the same open and competitive selection process as other candidates.

In circumstances where it is more appropriate to reappoint without an open and competitive selection process, a performance review should be undertaken with relevant submissions or briefs for shareholders to include details of that performance review. If open and competitive recruitment is not possible or appropriate, the board must provide an explanation to the shareholders in writing.

The reappointment process should repeat probity checks that preceded the original appointment.

## 5.6 Termination

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The CEO's contractual agreement or letter of appointment<sup>7</sup> should specify a limited term of appointment (see section 2.1) and detail termination provisions, including the precise circumstances in which a CEO's employment may be terminated. There should also be clear procedures detailed relating to the termination of a CEO's services including:

- any notice periods for termination prior to the contracted period
- details of any payments in lieu of notice, including the treatment of performance pay if relevant
- appropriate restrictions on future employment by similar businesses and/or competitors.

There should be clear differentiation between no-fault terminations and terminations for cause.

Situations where termination of a CEO gives rise to substantial termination payments can be problematic from the perspective of shareholders. Boards should ensure that shareholders are made fully aware of the terms and conditions relating to termination payments through timely disclosures during the consultation and approval processes leading up to an initial appointment or reappointment.

When exercising powers of removal, the principles of procedural fairness should be afforded wherever possible depending on the particular facts and circumstances. Procedural fairness means that an employee is entitled to be advised, before their removal, that their removal is being considered, and that they should be given an opportunity to be heard on the question whether they should or should not be removed.<sup>8</sup>

## 5.7 Succession planning

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Boards should implement and maintain a succession plan for the CEO position to mitigate the risk of having to pay a premium to attract and recruit a new CEO. It is considered good practice to provide an annual assurance to shareholders that the plan is in place (for example through the annual Business Plan).

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<sup>7</sup> See Appendix 3 for more information on relevant provisions in the founding legislation for particular government businesses that apply to the termination of a CEO's services.

<sup>8</sup> Based on *Jarratt v Commissioner for Police for NSW [2005], High Court of Australia 50*

## 6. Performance agreements and appraisals

### 6.1 Performance agreements

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The board should enter into a comprehensive performance agreement with the CEO. Performance agreements should be reviewed at least annually. The following outlines the minimum requirements for the performance agreement.

#### The agreement should, at a minimum:

- complement and capture the essential elements of the business's Statement of Corporate Intent (SCI) or Statement Of Business Intent (SBI), as well as its Business Plan and any other agreements with shareholders
- reflect the fundamental results that the business is seeking to achieve
- define measures or indicators connected to achieving any distinct strategies and establish appropriate accountabilities
- include measures relating to accountability in areas such as
  - measurable improvements in the overall performance of the business
  - financial management
  - industry performance
  - relations with key stakeholders
  - customer service standards
  - human resources practices
- set goals that are challenging but achievable
- where relevant, clearly state any aspects of the performance agreement that are linked to performance payments and articulate the objective means by which they will be monitored and measured.

### 6.2 Performance appraisals

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An appraisal of CEO performance should be conducted at least annually. Performance should be assessed against the criteria specified in the CEO's performance agreement. Both organisational performance and personal performance should be recognised.

Usually the process will involve the chair and the CEO.

Feedback from key stakeholders, including other board members, shareholders, NSW Treasury as an agent of the shareholders, other key management personnel, auditors, other NSW Government agencies and the business's customers can often provide useful inputs to the appraisal.

Written records should be kept by the board and the business's SCI/SBI should confirm that the appraisal has taken place.

A performance appraisal should be completed at least six months before the CEO's appointment expires in cases where the board is considering reappointing the CEO.

If the CEO is eligible for performance payments the appraisal outcome should feed into the calculation of those payments.

## 7. Executive remuneration disclosure

### 7.3 Statements of intent and business plans

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To promote an open dialogue with shareholders, executive remuneration disclosures in statements of intent and business plans should be made in accordance with the specifications outlined in the SCI/SBI guidance issued by NSW Treasury each year.

### 7.4 Annual reports

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Government businesses are required to make CEO and other executive remuneration disclosures in line with the Annual Reports (Statutory Bodies) Regulation 2015 (NSW).<sup>9</sup>

These requirements should be viewed as minimum standards. Government businesses should consider whether it would be appropriate to provide additional remuneration disclosures and whether these additional disclosures should cover all key executives or just the CEO. Community interest in executive pay should be a factor in this consideration.

Such additional disclosures might include the details of individual executives' remuneration and/or a breakdown between the different components of total remuneration. It may also be appropriate to include a narrative on the businesses' overall approach to remuneration and setting remuneration rates. Where performance bonuses are part of the remuneration system, businesses may want to explain how performance bonuses are calculated as well as the governance regime around them.

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<sup>9</sup> Under this regulation the report of the operations of a statutory body is to include the following particulars about the staff of the statutory body:

- (a) the number of senior executives employed in the statutory body at the end of the reporting year (including the number employed in each senior executive band and the number of each gender employed in each senior executive band), compared with the numbers at the end of the previous reporting year
- (b) the average total remuneration package of senior executives employed in each senior executive band in the statutory body at the end of the reporting year, compared with the average total remuneration package at the end of the previous reporting year
- (c) the percentage of total employee-related expenditure of the statutory body in the reporting year that relates to senior executives, compared with the percentage at the end of the previous reporting year.

Bands are as defined in the most recent NSW Public Service Senior Executives Determination under the GSE Act.

## Appendix 1: CEO Appointment Guidelines – high level checklist

| Terms of employment          |  |
|------------------------------|--|
| <b>Appointment</b>           |  |
| <input type="checkbox"/>     | The board should adhere to the requirements set out in each business's enabling legislation or founding documentation.   |
| <input type="checkbox"/>     | The key principles set out in section 2.1 of these Guidelines should guide consideration of conditions of employment applying to the CEO.                                      |
| <input type="checkbox"/>     | An appointment should be for a fixed term.   |
| <b>Recruitment</b>           |  |
| <input type="checkbox"/>     | The CEO recruitment process should commence at least six months prior to the expiry of the incumbent's contract.   |
| <input type="checkbox"/>     | A detailed position description should be prepared that includes the items listed in section 2.2 of these Guidelines.  |
| <input type="checkbox"/>     | There should be timely consultation with shareholders with regard to both the position description and the proposed recruitment process.                                       |
| <input type="checkbox"/>     | All selection processes should be merit-based, fair and open in order to attract a diverse range of applicants.  |
| <input type="checkbox"/>     | Selection processes should recognise that diversity in government sector workforce management is a priority.   |
| <input type="checkbox"/>     | The probity checks outlined in Appendix 4 of these Guidelines should be undertaken.  |
| <input type="checkbox"/>     | Boards should require CEOs to make and maintain a declaration of private interests.  |
| <input type="checkbox"/>     | CEOs should not be remunerated via their own private company.  |
| <input type="checkbox"/>     | All personal information provided by a candidate in support of a CEO appointment application should be treated in accordance with the NSW Government's privacy practices.      |
| <b>Contractual agreement</b> |  |
| <input type="checkbox"/>     | The CEO and other key management personnel should have a clear understanding of their roles and responsibilities and of the business's expectations of them.                   |
| <input type="checkbox"/>     | The CEO's written agreement or letter of appointment should include the matters set out in section 2.3 of these Guidelines.  |
| <b>Remuneration</b>          |  |
| <input type="checkbox"/>     | A remuneration package for a CEO should be market-based but it should also take account of community expectations.   |
| <input type="checkbox"/>     | Government businesses are required to consult with shareholders prior to finalising an offer of remuneration and should ensure that approvals are sought early in the process. |
| <input type="checkbox"/>     | The board should establish a remuneration committee.   |
| <input type="checkbox"/>     | The key considerations set out in section 2.4.2 should guide decisions regarding the remuneration of CEOs of government businesses.  |

| <b>Terms of employment</b>                     |  |
|--|--|
| <b>Reappointment</b>                           |  |
| <input type="checkbox"/>                       | A formal offer should not be made to the CEO before the required approvals are received.   |
| <input type="checkbox"/>                       | The reappointment process should include repeating the probity checks that preceded the original appointment.  |
| <b>Termination</b>                             |  |
| <input type="checkbox"/>                       | Termination provisions and procedures should be detailed in the CEO's contractual agreement or letter of appointment.  |
| <input type="checkbox"/>                       | Boards should ensure that shareholders are made fully aware of the terms and conditions relating to termination payments through timely disclosures during the consultation and approval processes leading up to an initial appointment or reappointment.    |
| <b>Succession planning</b>                     |  |
| <input type="checkbox"/>                       | Boards should implement and maintain a succession plan for the CEO position to mitigate the risk of having to pay a premium to attract a new CEO.  |
| <b>Performance agreements and appraisals</b>   |  |
| <b>Performance agreements</b>                  |  |
| <input type="checkbox"/>                       | The board should enter into a comprehensive performance agreement with the CEO.  |
| <input type="checkbox"/>                       | Performance agreements should be reviewed at least annually.   |
| <b>Performance appraisals</b>                  |  |
| <input type="checkbox"/>                       | An appraisal of CEO performance should be conducted at least annually.   |
| <input type="checkbox"/>                       | Written records should be kept by the board and the business's SCI/SBI should confirm that the appraisal has taken place.  |
| <b>Disclosure</b>                              |  |
| <b>Statements of intent and business plans</b> |  |
| <input type="checkbox"/>                       | In order to promote an open dialogue with shareholders executive remuneration disclosures in statements of intent and business plans should be made in accordance with the specifications outlined in the SCI/SBI guidance issued by NSW Treasury each year. |
| <b>Annual reports</b>                          |  |
| <input type="checkbox"/>                       | It is recommended that boards make additional quantitative disclosures in their annual reports that follow at a minimum the format of either of the templates provided in Appendix 5.  |
| <input type="checkbox"/>                       | The populated templates should be accompanied by a narrative describing the remuneration policies and practices in place, and outlining how any performance bonuses are calculated.  |
| <input type="checkbox"/>                       | The governance regime applying to remuneration policies and practices, including monitoring and measurement mechanisms, should also be outlined.   |
| <input type="checkbox"/>                       | Boards that decide not to make the recommended additional executive remuneration disclosures in their annual reports should make their reasons known to shareholders as part of the employee related disclosures in their Business Plan.                     |

## Appendix 2: Relationship to other policies within the Commercial Policy Framework

These CEO Appointment Guidelines should be read in conjunction with the other components of the *Commercial Policy Framework*, which is a suite of policies that aims to replicate within NSW Government businesses the appropriate disciplines and incentives that lead private sector businesses towards efficient commercial practices.

CEO performance has a direct influence on the performance of a government business as a whole. Therefore, the monitoring and accountability regime for government businesses is an important backdrop for these Guidelines. The regime requires an annual written agreement between the Treasurer and/or shareholders and the board/management of each business known as a Statement of Corporate Intent (SCI) for SOCs and a Statement of Business Intent (SBI) for other government businesses. In the SCI/SBI the board is required to confirm that the CEO has an employment contract and a performance agreement, as well as disclosing information related to KPIs for the CEO and the business as a whole.

The *State Owned Corporations Act 1989 (NSW)* (SOC Act) provides the legislative basis for SOCs to indemnify their officers, including the CEO, to protect them against risks related to performing their duties while ensuring the government businesses and the Government are not liable for actions of gross negligence or criminal behaviour. The *Commercial Policy Framework* includes a Treasury Policy Paper on this: *TPP 03-6 State Owned Corporation Indemnity Policy*.

## Appendix 3: Legislative requirements for CEO appointment, removal, remuneration and employment conditions

| Entity                      | Legislation  | Appointment/removal  | Remuneration  | Terms, conditions   |
|-----------------------------|--|--|---|---|
| Essential Energy            | 1.SOC Act 1989<br>2. <i>Energy Services Corporation Act 1995 (NSW)</i>   | By the Governor on the recommendation of the portfolio minister and the board  | Determined by the portfolio minister on the advice of the board         | Fixed by the board with the approval of the portfolio minister                                |
| Forestry Corporation of NSW | 1.SOC Act 1989<br>2. <i>Forestry Act 2012 (NSW)</i>  | 1. Appointed by the board with the approval of the portfolio minister<br>2. Voting shareholders may remove CEO from office | Determined by the board with the approval of voting shareholders        | Fixed by the board with the approval of voting shareholders                                   |
| Hunter Water Corporation    | 1. SOC Act 1989<br>2. <i>Hunter Water Act 1991 (NSW)</i><br>3. Hunter Water Regulation 2015 (NSW)                            | By the Governor on the recommendation of the portfolio minister and the board  | Determined by the portfolio minister on the advice of the board         | Fixed by the board with the approval of the portfolio minister                                |
| icare                       | <i>State Insurance and Care Governance Act 2015 (NSW)</i>  | 1. Appointed by the board in consultation with the minister<br>2. May be removed by the board                              | Determined by the board   | Fixed by the board  |
| Landcom                     | 1.SOC Act 1989<br>2. <i>Landcom Act 2001 (NSW)</i>   | By the board after consultation with the voting shareholders and the portfolio minister                                    | Determined by the board after consultation with the voting shareholders | Fixed by the board after consultation with the voting shareholders                            |
| NSW Treasury Corporation    | <i>Treasury Corporation Act 1983 (NSW)</i>   | 1. Appointed by the Treasurer on the recommendation of the board<br>2. May be removed by the Treasurer                     | Determined by the board with the concurrence of the Treasurer           |   |
| Port Authority of NSW       | 1. SOC Act 1989<br>2. <i>Ports and Maritime Administration Act 1995 (NSW)</i><br>3. Ports and Maritime Regulation 2012 (NSW) | By the Governor on the recommendation of the portfolio minister and the board  | Determined by the portfolio minister on the advice of the board         | Fixed by the board with the approval of the portfolio minister                                |
| State Super                 | <i>Superannuation Administration Act 1996 (NSW)</i>  | 1. Appointed by the board<br>2. May be removed by the board or the chair   |   | Determined by the board subject to the concurrence of the minister                            |
| Sydney Motorway Corporation | Private company limited by shares and established by the NSW Government under the <i>Corporations Act 2001</i>               | 1. Appointed by the directors<br>2. May be removed by the directors  | Determined by the directors   | Determined by the directors   |
| Sydney Water Corporation    | 1. SOC Act 1989<br>2. <i>Sydney Water Act 1994 (NSW)</i><br>3. Sydney Water Regulation 2011                                  | By the Governor on the recommendation of the portfolio minister and the board  | Determined by the portfolio minister on the advice of the board         | Fixed by the board with the approval of the portfolio minister                                |
| Water NSW                   | 1.SOC Act 1989<br>2. <i>Water NSW Act 2014 (NSW)</i>   | By the board after consultation with the voting shareholders and the portfolio minister                                    | Determined by the board after consultation with the voting shareholders | Fixed by the board after consultation with the voting shareholders and the portfolio minister |

## Appendix 4: Probity checks

Robust procedures should be followed to ensure the Government and the public have sufficient confidence that an appointee has an appropriate history of personal integrity and a demonstrated capacity to manage their financial and business affairs. To facilitate this probity checks should be conducted before an appointment is finalised.

### The following probity checks should be conducted before an appointment is finalised:

- Verification of academic and professional qualifications.
- Professional references from at least two (and preferably three) referees.
- A National Criminal Record Check
- An International Criminal Record Check from all relevant jurisdictions if a candidate has lived in any overseas countries for more than 12 months, or has resided in Australia for less than 12 months
- A check of the Australian Securities and Investment Commission's (ASIC's) Register of Persons Banned and Disqualified under the provisions of the Corporations Act 2001
- A check of ASIC's Enforceable Undertakings Register listing enforceable undertakings accepted under the provisions of the Australian Securities and Investments Commission Act 2001 and the National Consumer Credit Protection Act 2009
- A check of the Australian Prudential Regulation Authority's (APRA's) list of individuals disqualified from holding prudentially significant roles within APRA-regulated entities under the provisions of the Superannuation Industry (Supervision) Act 1993 and the Insurance Act 1973
- A check of APRA's list of Enforceable Undertakings accepted under the provisions of the Superannuation Industry (Supervision) Act 1993 and the Insurance Act 1973
- An Australian Financial Security Authority National Personal Insolvency Index check.

## Appendix 5: At-risk pay arrangements in Australia<sup>10</sup>

Any decision to introduce or modify existing at-risk pay arrangements is a matter for the board and the shareholders subject to the situation of the individual business. Similarly, if performance pay is considered appropriate, the components adopted will vary depending on the specific circumstances of the business and its industry.

### At-risk pay in the Australian listed company sector

The chief benefit ascribed to at-risk pay plans for executives of private sector entities is that they help align the interests of executive management and shareholders by tying levels of executive remuneration to strategic business performance outcomes.

Many Australian listed companies use a mix of financial and non-financial performance measures, with 50 per cent to 80 per cent weightings typically allocated to financial KPIs, as well as both short-term and longer-term incentives.

Common financial performance measures include TSR, relative TSR, EBIT/EBITDA, NPAT, revenue, and cost controls/reduction. Non-financial performance measures include strategic and growth initiatives, safety, people and culture, and individual development or leadership goals.

### At-risk pay for government businesses

At-risk pay arrangements have been adopted by government businesses throughout various Australian jurisdictions. In the case of CEO remuneration, annual incentives bonuses are usually capped at around 15 per cent of base salary<sup>11</sup> and actual payments are often less than the maximum allowable amounts.

Typically, a range of both financial and non-financial performance measures are applied. Non-financial targets concerned with customer satisfaction, service standards, risk management, safety records and corporate culture might be highly relevant for government businesses where failures in these areas can have serious ramifications for ministerial shareholders.

The following tables summarise some of the common performance measures tied to the annual bonuses paid to CEOs of government businesses in various sectors and public financial entities respectively.

| Performance measures | Utilities   | Water  | Transport  | Ports   | Forestry, Environment  |
|----------------------|---|--|--|---|--|
| Financial            | <ul style="list-style-type: none"> <li>• EBITDA</li> <li>• Free cash flow</li> <li>• NPAT</li> <li>• Capex</li> <li>• ROE</li> </ul>                              | <ul style="list-style-type: none"> <li>• EBITDA</li> <li>• Current ratio</li> <li>• Gearing ratio</li> <li>• OPEX</li> <li>• ROE</li> <li>• ROA</li> </ul> | <ul style="list-style-type: none"> <li>• EBITDA</li> <li>• Net profit</li> <li>• Revenue</li> <li>• CAPEX</li> </ul>                                   | <ul style="list-style-type: none"> <li>• EBITDA</li> <li>• NPAT</li> <li>• Current ratio</li> <li>• CAPEX</li> <li>• ROA</li> </ul>                             | <ul style="list-style-type: none"> <li>• Revenue</li> <li>• NPAT</li> <li>• ROA</li> </ul>   |
| Non-financial        | <ul style="list-style-type: none"> <li>• Lost time injury frequency rate</li> <li>• Significant environmental incidents</li> <li>• Employee engagement</li> </ul> | <ul style="list-style-type: none"> <li>• Customer performance index</li> <li>• Water quality complaints</li> <li>• Water service performance</li> </ul>    | <ul style="list-style-type: none"> <li>• Lost time injury frequency rate</li> <li>• Fatalities claims</li> <li>• Total greenhouse emissions</li> </ul> | <ul style="list-style-type: none"> <li>• Lost time injury frequency rate</li> <li>• Number of community complaints</li> <li>• Environmental breaches</li> </ul> | <ul style="list-style-type: none"> <li>• Lost time injury frequency rate</li> <li>• Sustainable forest management</li> <li>• Safety</li> </ul> |

<sup>10</sup> The information summarised in this appendix was drawn from research commissioned by NSW Treasury and conducted by KPMG (see KPMG, *NSW Treasury CEO At-risk Pay Study*, Summary Report, May 2017).

<sup>11</sup> These Guidelines do not recommend that a particular percentage cap should be adopted.

| Performance measures | Treasury  | Insurance   | Superannuation   |
|----------------------|---|---|--|
| Financial            | <ul style="list-style-type: none"> <li>• NPAT</li> <li>• ROE</li> <li>• ROA</li> <li>• Tax revenue</li> </ul>                                     | <ul style="list-style-type: none"> <li>• Funding rate</li> <li>• Average premium rate</li> <li>• Average paid days of claim</li> <li>• Average cost of a claim</li> <li>• Break even premium</li> </ul> | <ul style="list-style-type: none"> <li>• Investment fund performance</li> <li>• Funds under management</li> <li>• Operating costs</li> </ul>                     |
| Non-financial        | <ul style="list-style-type: none"> <li>• State building (major projects)</li> <li>• Client satisfaction</li> <li>• Employee engagement</li> </ul> | <ul style="list-style-type: none"> <li>• Return to work %</li> <li>• Stay at work %</li> <li>• Staff attrition rate</li> <li>• Employee engagement</li> </ul>   | <ul style="list-style-type: none"> <li>• Attract new members</li> <li>• Digital technology solutions to engage members</li> <li>• Employee engagement</li> </ul> |

## References

*Government Sector Employment Act 2013 (NSW)*  
*State Owned Corporations Act 1989 (NSW)*  
*NSW Public Sector Wages Policy 2011*  
*Premier's Memoranda M2012-04 Application of NSW Public Sector Wages Policy 2011 to State Owned Corporations*  
*Corporations Act 2001*  
*Australian Securities and Investments Commission Act 2001*  
*National Consumer Credit Protection Act 2009*  
*Superannuation Industry (Supervision) Act 1993*  
*Insurance Act 1973*  
*Privacy and Personal Information Protection Act 1998 (NSW)*  
*Corporate Governance Principles and Recommendations (ASX Corporate Governance Council, 3rd edition, 2014)*  
*Jarratt v Commissioner for Police for NSW [2005]*, High Court of Australia 50  
*Australian Accounting Standards Board (AASB), Standard 124, Related Party Disclosures*  
*Energy Services Corporation Act 1995 (NSW)*  
*Forestry Act 2012 (NSW)*  
*Hunter Water Act 1991 (NSW)*  
*Hunter Water Regulation 2015 (NSW)*  
*State Insurance and Care Governance Act 2015 (NSW)*  
*Treasury Corporation Act 1983 (NSW)*  
*Ports and Maritime Administration Act 1995 (NSW)*  
*Ports and Maritime Regulation 2012 (NSW)*  
*Superannuation Administration Act 1996 (NSW)*  
*Sydney Water Act 1994 (NSW)*  
*Sydney Water Regulation 2011*  
*Landcom Act 2001 (NSW)*  
*Water NSW Act 2014 (NSW)*

## Further information and contacts

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