Parliament of South Australia

Economic and Finance Committee

10th ACPAC Conference

Wellington, NZ, April 2009

Questions Worth Asking:

Reviewing the South Australian Economic and Finance Committee's inquiries into Franchising and Local Government Audits.

It is a commonplace of these conferences that the South Australian Economic and Finance Committee's paper is prefaced by a qualifying statement about how we do things differently from other States.

It is equally commonplace that most people in the room agree, whether they are thinking about public accounts committees or not.

This year the differences will be demonstrated rather than explained.

In 2007 and 2008, the Committee conducted inquiries into Local Government Audit and Oversight and Franchising. In both cases the inquiries operated at the borders not just of what most delegates here would understand to be the functions of a public accounts-type committee, but at the borders of even our broad authority.

Nevertheless, what both inquiries demonstrate is a commitment to improved accountability and transparency of process - whether it be in local government or the regulatory schemes affecting private enterprise – that

should strike a familiar chord with all delegates in this room.

First, local government.

In March 2007 the Committee initiated an inquiry into local government audit and administrative accountability in response to remarks made by the former South Australian Auditor General, Mr Ken MacPherson, in his Annual Report 2006 and in a hearing before the Committee in December of that year.

Mr MacPherson told the Committee that the current audit standards applied to the local government sector were largely restricted to financial reporting and of a lesser quality than the positive assurance standard applied to the state public sector and administered by the Auditor General's Department.

Mr MacPherson's evidence to the Committee was unambiguous: a level of government that has taxing and punitive powers, as does local government, should be held to the highest oversight standards and at the very least as high as that applied to the state public sector under the *Public Finance and Audit Act 1987.*

While the *Local Government Act 1999* contains a series of accountability provisions designed to protect the integrity of the local government sector - including provisions for Ministerial intervention in the case of irregularities and investigation by the Auditor-General if instructed by the Minister - Mr MacPherson asserted a "bottom line" to the Committee:

> ...local government derives its power from state legislation. That legislation ought to

> ensure that the arrangements that apply with respect to local government are adequate to ensure there is protection in the public interest of those members of the community that local government has the power to influence or prosecute.
>
> Without an Auditor-General's ability to be there in the background to intervene to correct something, exercising the powers that are available to an Auditor-General, and which when they are exercised really bring things to the surface, people are going to be vulnerable until such time as that is in place

Mr MacPherson's concerns were echoed by a member of the Committee, Mr John Rau MP, who provided his own lengthy submission to the inquiry.

The inquiry proceeded to receive evidence from auditors involved in the local government sphere, the current Auditor General and the Minister for State/Local Government Relations among others.

The inquiry also received submissions from individuals relating to specific matters in specific councils but the Committee was restricted in its ability to pursue those matters because of jurisdictional limits imposed on it under the *Parliamentary Committees Act*. As a result the inquiry focused on broad policy issues but this further reinforced the Committee's opinion that a form of extensive and ongoing Parliamentary oversight – notwithstanding the role and powers of entities such as the Ombudsman – was needed in this area.

In assessing the existing oversight standards, the Committee noted negotiations between the Minister and

previous and current Auditors General to enhance the audit standards and requirements for local government. These negotiations resulted in regulatory changes in January of 2007, just prior to the inquiry, which strengthened the existing audit regime.

These changes included:

- Requiring audit committees to have independent members;
- Excluding the current auditor from the committee;
- Requiring councils to rotate auditors ever 5 years, maximum;
- That auditor fees and reasons for terminating auditors be published;
- Prohibiting auditors from being hired to perform any other service for the council.

Further, the Local Government Association - local government's peak body - had implemented a range of policies to enhance financial competence and planning within councils following a 2005 report which found up to a third of South Australian councils were financially unsustainable.

Nevertheless, the Committee took evidence from auditors in the local government sector indicating that even with the recent changes, local government still operated with a lesser standard of audit scrutiny than the State sector.

The Committee also conducted a comparative survey of interstate local government audit regimes.

The Committee made twelve recommendations to further improve the standard of local government audit and oversight.

The primary recommendations of the report were that:

- The Auditor General should set local government standards and scope – and have recourse to those powers provided to his remit in the state public sector under the *Public Finance and Audit Act*;
- The Auditor General should be able to perform compliance and performance audits at his discretion;
- The Auditor General's Department should directly audit a certain percentage of local governments and retain a panel of private auditors to conduct the balance of audits according to powers and standards set by the Auditor General's Department;
- The Auditor General should table an annual report in the Parliament providing comprehensive comparative data from across the local government sector;

- Councils should continue to bear the cost of audits with appropriate provisions in place to ensure their cost burden does not unduly increase;
- A parliamentary committee - whether the Economic and Finance Committee or another designated body - should be established to provide further ongoing oversight of local government audit and administrative accountability.

Other recommendations were of a logistical nature and sought to ensure the transition to such a system would not place undue administrative or financial pressures on either the local government sector or the Auditor General's Department.

In the period since the report was tabled in June 2007, the local government sector has continued to preoccupy both the Minister and the Committee.

After retiring as Auditor-General, Mr MacPherson was appointed Acting Ombudsman and returned to the Committee in 2008 with further evidence as to ongoing areas of concern in local government. As Ombudsman, Mr MacPherson's focus was on broad issues such as:

- Competencies within councils;
- Obstacles to Ministerial intervention;
- Abuse of power within councils;
- Resistance to Ombudsman's inquiries;
- Failure to properly exercise powers under the Development Act;
- Legal advice to councils and the use thereof;
- Record keeping;
- Dealing with complainants;
- Freedom of Information.

These issues have since been raised with the Local Government Association and the Minister.

In December 2008 the Committee received information from the Minister outlining a further enhancement of local government accountability across a range of financial and administrative areas – including audit, access to information and internal council processes.

Of interest to the Committee amongst the proposals currently up for public discussion is the proposed requirement that an auditor:

Provide a formal audit opinion on the adequacy of a council's internal controls, and whether the internal controls are sufficient to provide a reasonable assurance that the financial activities of the council have been conducted properly and lawfully.

This was at the centre of the then Auditor General's report in 2006, and the Committee's report of 2007 and has been under discussion since.

While the matter is not fully resolved, and the Committee intends to continue discussions with the Minister on this matter, it is still pleasing that such an important issue has been moved forward, at least in part, by the Committee's pursuit of transparency in the "third tier" of government.

And so, to Franchises.

In October 2007 the Committee initiated an inquiry into Franchising laws, with an emphasis on current regulations relating to:

- Disclosure of information to potential franchisees;
- Dispute resolution processes; and

- Requirements on franchisors wishing to conduct a franchise.

The inquiry came soon after the announcement by the Western Australian government that they would hold an inquiry into franchising. In that state the inquiry arose out a specific dispute between a major franchisee and a franchisor and was initiated by the relevant Minister, whereas in South Australia the impetus to have an inquiry grew from individual Committee members' experience of constituent complaints arising from franchises gone wrong.

Franchising is largely regulated by the Franchise Code of Conduct (the Code), a mandatory industry code under the *Trade Practices Act*. So, apart from some interfaces between franchises and State-based retail tenancy and consumer protection and business regulations, the

majority of the legislation governing franchising operates at a Commonwealth level.

The decision of the Committee to pursue the inquiry, however, reflected the concerns of Committee members after hearing of the sometimes severe financial and personal problems brought about by often unwise or unwitting investments in the franchise sector: exposing the system to some scrutiny was in itself a useful thing to do.

Essentially a franchisee buys the right to operate under the name, and system, established by the franchisor. As a result, the franchisor has the capacity to protect the integrity and reputation of their brand through the terms of the contract agreed with the franchisee.

As the Committee discovered, this contract forms the hub around which most of the critical problems afflicting the franchise sector revolve.

The Committee heard some truly disturbing evidence from people who entered these agreements in good faith and then found themselves in financial positions that were not - and indeed in some cases never seemed designed to be - sustainable.

It is also true, however, to say that many people did not - or perceived themselves as unable to - obtain adequate financial and legal advice before entering into these agreements and paid the price for it.

Yet even in these latter instances the Committee found flaws in the current regulatory regime that, if addressed properly, could provide real assistance to those people

seeking to do all the necessary due diligence, even if -as is often the case - they lacked experience in the business world.

The Committee's investigations and recommendations applied across the jurisdictional divide and were designed to produce tangible changes in the State sphere where possible while encouraging, through Ministerial representation at National Councils and the like, Commonwealth reform.

I will not recount a detailed description of all the evidence received except to say that the inquiry was extensively and enthusiastically supported by large sectors of the franchise sector. That being said, the Committee also received a stout defence of the prevailing regime from franchisor representatives who expressed concerns that a realignment of rights within the franchise system between

franchisors and franchisees would add costs to franchisors and inhibit their capacity to grow their business.

The Committee received around 50 individual submissions and conducted 10 hearings - many of them videoconferences with interstate experts from the academic and business sector.

Indeed the level of interest from interstate - and overseas - was a notable element of the inquiry, reflecting a wider desire for a re-examination of this sector, which has been grown rapidly during the past decade.

The range of problems canvassed by the inquiry can perhaps be best described by looking at the broad sweep of the Committee's recommendations and their focus on the provision of relevant information to potential franchisees, the codification of their rights and

encouragement for a more active role on the part of the Australian Competition and Consumer Commission (ACCC).

The recommendations included:

- Compulsory federal registration with the ACCC of all disclosure documents;
- Full disclosure of franchisor financial reports with no exceptions;
- Full disclosure to potential franchisees of the risks of failure;
- Publication of the names of those who persistently breach the Code;
- Penalties for insufficient disclosure;
- Amending the Code to include a duty to act in good faith;

- Amending the Code to require parties to a franchise contract consider goodwill or other exit payments;
- A range of alternative dispute resolution processes - including a body such as a Franchising Ombudsman or franchising tribunal;
- Recognising franchisees' interests on the leases between franchisors and landlords;
- Encouraging the ACCC to pursue test cases in the courts to refine and strengthen existing, but largely unused, legislative protections for franchisees;
- Enhanced education campaigns at State and Commonwealth level.

Recommendations regarding retail tenancies were directed to the Minister for Consumer Affairs. The report as a whole was also provided to the Minster for Small Business so that it may inform discussions with interstate

and Commonwealth colleagues at relevant Ministerial Councils. The response from these Ministers indicated that many of the retail tenancy and education issues raised by the Committee were currently the subject of review at a Ministerial Council level.

A further development came when in June 2008 the Commonwealth Parliamentary Joint Committee on Corporations and Financial Services initiated its own inquiry into franchising.

The Economic and Finance Committee submitted its report to the Commonwealth inquiry and EFC member, Mr Tony Piccolo MP, appeared before the Commonwealth inquiry to provide further evidence.

The Report, "Opportunity not opportunism: improving conduct in Australian franchising", was published in December 2008.

The recommendations of the Commonwealth report correspond in many areas with those of the EFC. Noteworthy among the Commonwealth recommendations were:

- Development of an online registration system for franchise documents;
- A review of disclosure regulations;
- Provisions to be made for the end of a contract term;
- A specific good faith provision in the Code;
- Pecuniary penalties for breaches of the Code; and
- An improved profile for the Office of the Mediation Adviser as a dispute resolution service.

Such recommendations reflect similar concerns to those raised in the South Australian inquiry and we all look forward to the response of the commonwealth government to the committee's report.

I would encourage any delegates interested in exploring any of the issues raised in this paper further to visit our committee website and read the reports in more detail.

In conclusion these inquiries demonstrate the scope and capacity of our Committee to investigate and instigate a debate - and, as these reports demonstrate, effect some measure of real change - across a wide range of economic, social and public governance fields.

I would like to thank the New Zealand Finance and Expenditure Committee and the New Zealand Parliament

for their hospitality and the audience here today for your attention.

If there are any questions I am happy to answer them.

Leon Bignell, MP

Member for Mawson

Economic and Finance Committee

House of Assembly

South Australia