

Keeping up appearances: The quest for governance legitimacy

Graham Bowrey
University of Wollongong

Keywords: Corporate governance; institutional theory, non-executive directors; Commonwealth Authorities and Companies Act 1997

Acknowledgement

I wish to acknowledge the academic advice provided by Professor Prem Sikka through the University of Wollongong School of Accounting and Finance Academic Mentoring Scheme.

Keeping up appearances: The quest for governance legitimacy

Abstract

An effective corporate governance structure is as crucial to a public sector organisation as it is for a private sector organisation, however the impact of the failure of a governance structure in a public sector organisation is significantly different. There is no likelihood of a public sector organisation becoming bankrupt nor is there any likelihood of members of the public losing any financial investment in the organisation. So why has the public sector adopted and implemented governance structures based on those in the private sector? The misconception that private sector practices are superior to public sector practices has led to a push by governments to adopt private sector practices in an attempt to legitimise their existence and place in society. This is evident from the relatively recent wholesale move to a new managerialism within the public sector where the focus is on efficiency, effectiveness and performance rather than service to the public. This paper will focus on one component of corporate governance in the Australian public sector, the non-executive directors of the government controlled Commonwealth Statutory Authorities, and assess whether governing boards of directors improve governance or just maintain the appearance of good governance.

Introduction

The Australian public sector has undergone significant changes since the late 1980s. Many of these changes can be viewed as responses to both internal and external institutional pressures to adopt private sector behaviours, processes and values in an attempt to appear legitimate to the people of Australia and [more importantly?] to the businesses which operate in Australia.

The Australian system of government is based upon the Westminster system, which originated in the United Kingdom, where the head of state is not the head of government, and the ministers from the governing political party, the executive, are from and accountable to the parliament (APH 2003). This paper will focus on one component of executive accountability to the parliament, the non-executive directors of the government controlled Commonwealth Statutory Authorities. These Commonwealth Statutory Authorities, whilst operating outside the traditional departmental structure (Uhrig 2003, p.16), are created by legislation and have the power to hold money on their own account (DOFA, 2007a).

Consistent with the private sector, the Australian Commonwealth Government has significantly increased its focus on corporate governance arrangements for Government, government departments, agencies, and statutory authorities. Corporate governance can be defined simply as the system by which organisations are directed, controlled and managed (ASX 2003; O'Regan *et al* 2005). A more precise definition, developed by the Australian National Audit Office, and adopted by the Department of Prime Minister and Cabinet for Commonwealth Public Sector Annual Reports, states “corporate governance refers to the processes by which organisations are directed, controlled and held to

account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organization” (ANAO, 2003a, p.6). This definition of public sector corporate governance is supported by Uhrig (2003) who in his 2003 reportⁱ explained that it is concerned with “the power of those in control of the strategy and direction of an entity ... taking into account risk and the environment in which it is operating” (2003, p.2).

The corporate governance structures of both public and private sectors have areas of commonality (Edwards 2002, p.52) particularly in relation to performance and the roles and responsibilities of their governing boards and executive. For example the governing boards of organisations in both sectors include executive directors (directors who also hold executive positions within the organisation) and non-executive directors who come from outside the organisation. For the public sector the increased focus on performance and responsibilities is consistent with the move to “new managerialism” in the public sector (Jackson and Lapsley, 2003, p. 360) and the perceived need of the public sector to improve its efficiency, effectiveness and accountability (Guthrie 1998, p. 2; Barton 2005, p. 138). Dr Peter Boxall, the previous Secretary of the Commonwealth Department of Finance and Administration, explained the main objectives of new managerialism as the encouragement of a culture of performance and making the public sector more responsive to the needs of government (Boxall 1998, p. 18). These comments imply that the public sector before “new managerialism” was inefficient and unresponsive to the needs of the government and in turn unresponsive to the needs of the Australian public. This follows from the common misconception that the best way for the

public sector to improve its performance would be to adopt private sector behaviours such as appointing governing boards of directors for some government organisations.

Professor Meredith Edwards, a former Deputy Secretary of the Department of Prime Minister and Cabinet, suggested the commonality of the sectors has led to a significant push, over the past decade, for the public sector to adopt private sector corporate governance processes and structures (Edwards 2002, p.52). This commonality is confirmed by the Australian National Audit Office in its Better Practice Guide on public sector governance

Corporate governance has received extensive attention in recent times, with much interest presently focused on regulatory and other responses to improving corporate governance in the private sector. The public sector has often been considered to lead the private sector in the adequacy and conduct of its governance (ANAO 2003a, p. 6).

The confusion about which sector leads or informs the other is not significantly relevant in this paper. What is relevant is the commonality of the structures of the governing boards of public and private sector organisations and the lack of commonality in the power of the board of directors between organisations in the two sectors.

In line with the commonality of the structures of the governing boards of public and private sector organisations and the recent public sector focus on “new managerialism” this paper will examine the roles and mix of public sector non-executive directors through the lens of institutional theory. Institutional theory has often been used to explain how private sector organisations react to socially rationalised concepts on the practices, procedures and structures of organisations. However with the recent focus on performance, efficiency and effectiveness in the public sector, institutional theory is becoming more appropriate in the evaluation of public sector organisations.

One of the key processes required to develop an effective corporate governance structure in any organisation is the clarification of appropriate roles for management and for the board of directors (ASX 2003, p.3). While the roles and powers of directors on public sector boards appear similar to those of directors on private sector boards there are fundamental differences. These differences are due primarily to the Australian system of government, whereby the Ministers, as members of the government, are both from and accountable to Parliament. To alleviate the real and perceived conflicts from this situation the Australian Constitutionⁱⁱ outlines the power for making laws [legislative power], administering laws [executive power] and the interpretation or application of laws [judicial power]. The most significant difference between directors of private sector governing boards and directors of public sector governing boards is in relation to the level of power the directors have to act. Directors on the board of a private sector company usually have full power to act and the responsibility to do so. This includes the power to formulate and approve the strategy of the organisation and to develop and implement important company policies (Uhrig 2003, p.4).

In contrast, a board governing a public sector organisation has limited power due primarily to the fact government organisations are created for the implementation of established government policy and the realisation of intended outcomes (Uhrig 2003, p.31). The real power in a public sector organisation rests, not with the board of directors, but with the responsible Minister who controls the appointment of board members, therefore influencing their behaviour and reducing the autonomy of boards (Howard and Seth-Purdie, 2005 p.60). The Minister is also provided with legislative powers over the organisation that can also significantly impact on the level of autonomy of public sector

boards. For example, under sections 28 and 43 of the *Commonwealth Authorities and Corporations Act 1997 (CAC Act)*, the Minister has the power to provide, after consultation with the board, written notification to the board about general government policy which the board is obliged to ensure is carried out (ANAO 2003b, p.3). The Minister, along with other board members, also has the authority to appoint the Chief Executive Officer or Managing Director. The former Deputy Secretary of the Department of Finance and Administration, Professor Steven Bartos, explained that “the power to appoint or remove CEOs is one of the most prized powers of government” (Bartos 2005, p.96). It is also worth considering, when examining the effectiveness and independence of a public sector board, that the Minister also has the “the power of the purse, through portfolio budget allocations” (Howard and Seth-Purdie, 2005 p59).

Regardless of the level of power and autonomy of public sector boards, they still need to ensure the corporate governance structures of their organisation enable them to effectively meet their responsibilities to their key stakeholders, which include Parliament, Government [particularly via the Departments of Finance and Administration, Treasury and Prime Minister and Cabinet], Ministers, public service officers and the Australian public. To assist, the Australian National Audit Office has developed comprehensive Better Practice Guides for use amongst the public sectorⁱⁱⁱ. These guides outline quite explicitly the frameworks, processes and practices government organisations should take to ensure their corporate governance arrangements meet the expectations of their key stakeholders and effectively discharge their accountabilities.

There are two specific pieces of legislation which have been introduced to outline the financial reporting requirements and financial accountabilities for Commonwealth

government organisations. The first is the *Financial Management and Accountability Act 1997* which provides the “framework for the proper management of public money and public property by the Executive arm of the Commonwealth” (DOFA 2006). The second is the *Commonwealth Authorities and Corporations Act 1997* which “regulates certain aspects of the corporate governance, financial management and reporting of Commonwealth authorities, which are in addition to the requirements of their enabling legislation; and the corporate governance and reporting of Commonwealth companies which are in addition to the requirements of the *Corporations Act 2001*” (DOFA 2005). The following diagram shows the Commonwealth government organisations that operate with the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.

Take in diagram 1

The Australian National Audit Office’s Better Practice Guidelines, along with a number of other Australian and international documents and reports on corporate governance, will be referred to in this paper. For example the Higgs Report^{iv} 2003, based on the United Kingdom context, is considered to be of particular relevance as it was written specifically for the guidance of non-executive directors. This paper will also refer to the Uhrig report 2003 and the ASX^v Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations. The following section of this paper will discuss the background and various sections of the *Commonwealth Authorities and Companies Act 1997*, the primary legislation for Commonwealth Statutory Authorities. This background discussion will also access the impact the Westminster

system of government in Australia has on the Ministers responsible for Commonwealth Statutory Authorities. Following this discussion the paper will focus on institutional theory, the theoretical lens used to analyse the empirical data. This data comprises an analysis of the board composition according to certain key criteria of 19 Commonwealth Statutory Authorities. The paper concludes with a concise summary of this initial research and outlines possible future areas for research.

Commonwealth Authorities and Companies Act 1997 (CAC Act)

The *Commonwealth Authorities and Companies Act 1997* was developed to regulate the financial reporting and accountability of Commonwealth Statutory Authorities (referred to as CSAs for the remainder of this paper) and Commonwealth Companies (referred to as CCs for the remainder of this paper). CSAs are body corporates incorporated for a public purpose by an Act or by regulations under an Act (CAC Act ss.7) and hold money on their own account and are separate legal entities to the Commonwealth. CCs are *Corporations Act 2001*^{vi} companies in which the Commonwealth has a controlling interest (ss.34).

The creation of CSAs and CCs is based on various decisions made by government to operate government-controlled entities “outside a traditional departmental structure” (Uhrig 2003 p.16). To ensure these detached organisations operate effectively and in line with government expectations, the majority of CSAs have a governing body such as a council or board where the members are defined as directors (CAC Act, ss.5). These directors are selected and appointed by the responsible Minister and their role is rather more complex than the role of directors of private sector corporations. CSA directors are

subject to the specific requirements for directors of private sector companies outlined in the *Corporations Act 2001*. For example, section 27E of the *CAC Act 1997* states:

If the directors of a Commonwealth authority delegate a power under its enabling legislation, a director is responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves.

This is comparable to section 198D of the *Corporations Act 2001*:

The directors of a company may delegate any of their powers ... the exercise of the power by the delegate is as effective as if the directors had exercised it.

The Australian system of government requires that the Executive Government [the government], while coming *from* the members of Parliament, is also responsible *to* the Parliament (House of Representatives 2004, p. 1). Therefore, Parliament has a responsibility to hold the government and the public service accountable for the management of public sector resources and activities (DOFA 2003, p. 1). While overlaps exist between the Executive Government and Parliament they have different powers in relation to the governing of the country. The Parliament has the power to make laws [legislative power] while the Executive Government has the power to carry out and enforce laws [executive power]. Uhrig (2003, p. 35) outlines that, in relation to CSAs, the role of Ministers is supervising. As Ministers are key members of the Executive Government accountable to the Parliament for the management of public sector resources the level of control Ministers have in directing the governing boards and the directors is significantly greater than is the norm for the private sector. The different powers within the Westminster system and the responsibility of the Executive Government to

Parliament create additional requirements for directors of statutory authorities as outlined in the *CAC Act 1997*.

The directors of a CSA are required to prepare an annual report that is tabled in Parliament, and forwarded to the responsible Minister (*CAC Act 1997*, ss.9). In addition, they are also required to prepare budget estimates for each financial year (ss.14). These budget estimates contain the proposed annual expenditure of the CSA and are published in Portfolio Budget Statements. The Portfolio Budget Statements outline the Government agreed outcomes of all government organizations, including CSAs and explain the budget estimates used to achieve these outcomes.

The Portfolio Budget Statements are referred, via the Government, to one of the Senate's legislation committees for examination and report. These legislation committees consist of six senators, three from the government (one of whom is the committee chair), two from the opposition, and one representing the minority parties or independents (Senate, Brief 5). Mr Harry Evans (2004), Clerk of the Senate, explains that the legislation committees' scrutiny of the estimates provides an opportunity for the Senate to assess the performance of the public service and its administration of government policy and programs. The review of the budget estimates is one of the most important accountability functions of the Parliament. Therefore the directors must not fail to provide the responsible Minister with the budget estimates in the format specified by the Department of Finance and Administration and by the required deadline. This process of Senate legislation does not directly involve the non-executive directors of statutory authorities. Only the Minister and the executive directors appear before the committees to answer specific questions in relation to the CSA's proposed expenditure and the

effectiveness and efficiency of various government initiated programs. This indicates that the non-executive directors of CSAs are not held to account to the same level as executive directors.

Further requirements of directors of a CSA are outlined in the *CAC Act 1997* (ss. 16 & 17). Directors must inform the Minister of the operations of the authority and provide the minister and the Finance Minister reports, documents and information as the Ministers' require (ss.16). They must also prepare, on an annual basis, a corporate plan which includes the objectives of the authority, business assumptions based on the organisation's operating environment and community service obligations as well as details on the organisation's strategies on price and quality control (ss.17).

Consistent with the requirements for directors of private sector companies under the *Corporations Act 2001*, the directors of CSAs are legally required to ensure the financial statements of the organisation are audited by an appropriately qualified auditor. However the directors of a CSA do not have the authority to choose an auditor, rather

... the directors of a Commonwealth authority must do whatever is necessary to ensure that all relevant subsidiary's financial statements are audited by the Auditor-General.
(ss.12.1)

In support of this requirement the *CAC Act 1997* (ss.12.3) states that the Auditor-General must provide a copy of the report for the responsible Minister.

While directors of both private and public sector entities have fundamental differences they do have similar duties required by the legislation governing corporations. The next section of the paper will use institutional theory to examine some of these similarities, and explore some of the differences.

Institutional Pressures on Public Sector Governance

Along with the move to “new managerialism” public sector organisations are now under increased pressures “to conform to external expectations about what forms or structures are acceptable (or legitimate)” (Hoque 2005, p. 370). The use of a governing board of directors in private sector organisations to ‘improve’ their corporate governance is an external expectation [institutional pressure] that the Commonwealth public sector has succumbed too to ensure the CSAs can remain, or at least be seen to be, legitimate within Australian society.

The institutional pressures which result in organisations changing and adopting structures and processes may be explained by institutional theory. Dillard *et al* (2004, p. 508) defined institutional theory as “a way of thinking about formal organisation structures and ...the social processes through which these structures develop”.

Consistent with the notion that institutionalisation is a ‘rational’ response, one of the key outcomes of institutionalisation is a homogeneous organisational structure (DiMaggio and Powell, 1983, p. 147) which would include the presence of governing boards for statutory authorities. The process of homogenisation, including the development and acceptance of governing boards as the preferred form of organisational governance control, illustrates the concept of isomorphism (DiMaggio and Powell 1983, p.148).

Two types of isomorphism identified by DiMaggio and Powell (1983) are competitive isomorphism, which refers to the impact of market forces, and institutional isomorphism, which refers to the impact of organisations including government institutions and professional bodies. This paper will focus primarily on institutional

isomorphism, which is explained by three different mechanisms, coercive, mimetic and normative (DiMaggio and Powell 1983; Scott, 1987; Pollitt 2001; Dillard *et al* 2004).

Coercive isomorphism results from both formal and informal pressures exerted on organisations by other organisations upon which they are dependent (DiMaggio and Powell; Dillard *et al* 2004). It occurs when pressure to adopt a particular form comes from other organisations which can exercise power over the subject organisation. (Pollitt 2001, p. 937). In the Commonwealth public sector the main organisations that apply coercive pressure, besides the Government and Parliament, are the three central agencies, the Departments of Finance and Administration, Treasury and Prime Minister and Cabinet. These central agencies direct many of the processes, practices and policies required to be implemented by other government organisations.

Mimetic isomorphism is a process that takes place when an organisation attempts to imitate a more successful organisation, often because of uncertainty and lack of guidance in its own environment (DiMaggio and Powell 1983, p. 151; Dillard *et al* 2004, p. 509). This view is supported by Oliver (1991), who explains that it is expected organisations will conform to certain practices when the practices are validated externally by other organisations (p. 148). The move to new managerialism and the adoption of processes and practices associated with new managerialism in the public sector could be considered the result of mimetic isomorphic processes.

Normative isomorphism focuses on processes of professionalisation. Professional staff undergo relatively uniform training, and then carry the ideas they have learned to the different organisations which employ them (Pollitt, p. 938). This isomorphic mechanism is situated in the “collective struggle of members” of an occupation to define conditions

and methods of work (DiMaggio and Powell 1983, p. 152; Dillard *et al* 2004, p. 510). Zucker (1987, p. 443) suggested that organisations are influenced by normative pressures which sometimes arise from within the organisation itself. An examples of normative isomorphism is where professionally qualified accountants may drive to adopt or at least trial new techniques within their organisation such as activity based costing^{vii} and balanced score card^{viii}. For example the Australian National Audit Office in its publication *Better Practice in Annual Performance Reporting* outline states “another tool that agencies have used to enhance their performance reporting frameworks is the balanced scorecard approach. This approach is concerned with aligning strategy and operations so that they are consistent with the overall purpose of the organisation” (ANAO 2004).

Meyer and Rowan (1977, p. 356) identified decoupling as a mechanism organisations use to assist in maintaining the appearance of operating with a rational structure and processes while the actual practice may be quite different. Decoupling, defined as the process of un-coupling the structural elements of different parts of the organisation in response to institutional pressures to comply with inconsistent norms (Meyer and Rowan 1977; Brignall and Modell 2000), is evident in many organisations and is due to the significant differences between the formal structure of an organisation and its actual day-to-day work activities (Meyer and Rowan 1977, p. 342). When organisational goals are ambiguous it is not too difficult for an organisation to decouple its actual practices from its formal structure. It is important to note that decoupling is not a mechanism to hide dishonest practices but rather it is seen as an attempt to maintain some rough equilibrium between inconsistent norms (Brignall and Modell 2000, p. 300).

Institutional theory offers a satisfying explanation of the move over the past decade to a “new managerialism” in the public sector (Jackson and Lapsley, 2003, p. 360). Based on a culture of performance (Hoque and Moll, 2001; Boxall, 1998) and an increased focus on accountability, efficiency and effectiveness, this new managerialism requires public sector organisations to be more responsive to the needs of government (Hoque and Moll, 2001; Boxall, 1998). Global expectations of improved productivity and competitiveness in the public sector (Boxall, 1998) have been institutionalised in Australian public sector practice. These institutional pressures have resulted in mimetic isomorphic processes changing the governance structures of the CSAs which reflect a desire to increase their legitimacy in society. The following empirical data is reflective of the impact of institutional pressures CSAs have been exposed to in the public sector’s misguided path to legitimacy.

Empirical tests

Sample selection

There are 71 statutory authorities which are CSAs according to the definition in the *CAC Act 1997*. Of these, 25 are defined as material entities, as they comprise 99% of revenues, expenses, assets and liabilities of all the CSAs (DOFA, 2007). From the 25 material CSAs, six were eliminated leaving 19 for this review. The 19 remaining CSAs, refer to appendix 1, are part of 11 different Commonwealth government portfolios. The six CSAs eliminated from the study include the Australian Securities and Investments Commission, which was excluded because it operates under the *Financial Management and Accountability Act 1997*, the Australian Government Solicitor, Comcare, and the

Civil Aviation Authority were excluded as they have a “single person at the apex of the body rather than a multi-member board” (DOFA, 2007). The Australian Industry Development Corporation and Coal Mining Industry (Long Service Leave Funding) Corporation were also excluded as their operations and structure are significantly different from the other CSAs.

Results

Number of directors

The 19 CSAs in the review had a total of 176 directors with approximately 9 directors per CSA board, consistent with the findings of the Higgs (2003, p. 22) report which stated that “the board should be of sufficient size that the balance of skills and experience is appropriate for the requirement of the business”. One of the better practice recommendations of the Uhrig Report (2003) is that 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”. The ASX Corporate Governance Principle 2 recommends that the size of the board should be conducive to encourage expedient and efficient decision making (ASX 2003, p.22). The Uhrig and Higgs reports and the ASX principles indicate that board size should be based on individual organisational needs rather than prescribing a definite size. Another important recommendation of these reports is that the majority of directors should be non-executive directors who are generally considered to be independent of the executive and “free from any business or other relationship which could materially interfere with the exercise of their independent judgement” (Higgs 2003, p.36).

In addition to the information about the number of directors, the 2005 - 06 Annual Report for each of the 19 CSAs were used to collect the following information: mix of executive and non-executive directors; gender of directors;; highest level of qualification of directors; average length of service of directors; remuneration of non-executive directors; and number of other directorships. This data is presented in the following section.

Mix of Executive and Non Executive Directors

Of the 176 directors, 161 (91%) could be classified as non-executive directors (NED), however of these 161 directors, 23 are also current senior public servants or members of parliament and are considered to be non-independent non-executive directors. That is, while these directors are not executives of the organisation they have conflicting interests in relation their position on the board in areas such as funding and the setting of the strategic direction of the organisation. For example, Senator George Bandis (member of the Government) and Martin Ferguson MP (member of the Opposition) are both on the board of the National Library and their presence would be to ensure the interests of Parliament are represented. However as members of different political parties they may need to be excluded from a number of board decisions, such as the implementation of government policy, where their roles as members of specific political parties could result in a conflict of role^{ix}. There are currently two Departmental Secretaries^x holding directorships on the boards of organisations within their portfolios. These are Ms Lisa Paul, Secretary of the Department of Science, Education and Training and Ms Helen Williams, Secretary of the Department of Communications, Information

Technology and the Arts Ms Paul is a director on the board of the Commonwealth Scientific and Industrial Research Organisation which is a CSA within her portfolio. Ms Helen Williams sits on the boards of the National Library of Australia and the Australian Sports Commission again both of which come under the umbrella of her portfolio department. This high level of non-independent directors was criticised in the Uhrig (2003, p.13) report because representational appointments have the potential to place the success of the entity at risk. Further, it has been suggested that having the portfolio secretary as a member of the board, regardless of whether or not he or she has voting rights, is “a further complication, particularly when financial matters are at stake” (Howard and Seth-Purdie, 2005 p56-57). Both Ms Paul and Ms Williams assist in preparing and signing-off the Annual Reports and Budget Estimates of their CSAs and, as departmental secretaries, are required to consider and approve funding requests from these same statutory authorities.

Howard and Seth-Purdie (2005, p.62) describe this “independence paradox” as an interesting position where “a secretary would be simultaneously policy advisor to the minister, major client of the authority and authority board member”. They (Howard and Seth-Purdie 2005, p.61) further assert that new public sector non-executive directors who come from the private sector, initially struggle to come to terms with the processes and practices of public sector organisations as they lack the exposure to public sector norms. This situation contributes to the independence paradox as the non-executive directors, in the course of fulfilling their responsibilities, rely heavily on the information and guidance provided by the same executives from whom they are to said to be independent (Hooghiemstra and van Manen 2004).

Take in figure 1

The results from figure 1 are consistent with the recommendations of the Higgs report that “at least half of the members of the board, excluding the chairman, should be independent non-executive directors” (2003, p.35) and the ASX Corporate Governance Principles “a majority of the board should be independent directors” (2003, p.19).

Gender of directors

The proportion of female non-executive directors (29%) is significantly higher than comparable studies of non-executive directors in the private sector. Kang, Cheng and Gray’s (2007, p.200) study of the top 100 Australian companies in 2003 indicated 10% of non-executive directors were female where Cortese and Bowrey’s 2007 study of the top 50 Australian listed companies in 2006 found 16% were female .

Take in figure 2

Even more significant than the larger proportion of female non-executive directors is the fact that all statutory authority boards in the study had one or more female non-executive directors. The Kang, Cheng and Gray (2007, p.200) study showed in 2003 of the top 100 Australian companies 67% did had a female director (p.200) while the Cortese and Bowrey 2007 study indicated 83% of the top 50 Australian listed companies had one or more female board members.

Along with gender, age is also a much measured characteristic of directors of boards. The Cortese and Bowrey (2007) and the Kang, Cheng and Gray (2007) studies both measure and discuss the age mix of directors, however unlike the annual reports of private sector companies, the annual reports of CSAs do not disclose the ages of the

directors. The ethnicity of directors is also not explicitly disclosed in the annual reports. This information would be useful in determining the level of representation of the various minority groups in society which in turn would demonstrate the breadth of accountability to the Australian public.

Qualifications of directors

The qualifications of 113 directors could be determined from the various CSAs' annual reports (64% of the sample). Figure 3 shows the highest level of formal qualifications these 113 directors have attained.

Take in figure 3

It is apparent from the data most directors have some level of tertiary qualifications. Of the directors with post graduate qualifications a significant proportion (25%) have been awarded PhDs, with the remainder holding Masters degrees and/or professional qualifications such as CPA Australia status. This result can be explained due to the normative isomorphic process where the selection of appropriate people to become non-executive directors is guided by their level of perceived suitability based on their qualifications and membership of particular organisations.

Length of service

The length of service of non-executive directors has also been identified as a possible key indicator of board performance and the level of director independence. The ASX listing rules suggest non-executive directors should serve on a board only for a period of time where it would not interfere with the director's ability to act in the best

interests of the company (ASX, 2003, p.20). This view is reflected in Uhrig's (2003, p.53) report, which suggested a maximum board service period be set so as to allow for appropriate rotation of directors. Higgs (2003, p.53) concluded that non-executive directors could appropriately serve two three-year terms with a company and it would be of questionable value for a non-executive director to serve a longer term as a non-executive director (2003, p.53).

Take in figure 4

Figure 4 shows the average length of service of non-executive directors in the sample statutory authorities to be 4.5 years, which is similar to the findings of the comparable study of ASX 50 corporations (Cortese and Bowrey 2007). There is, however, some concern, as approximately 8% of the non-executive directors in the sample have served as non-executive directors on their respective boards for 10 or more years. This length of service could present problems, particularly in relation to the independence of non-executive directors, since "the substantial length of time served by some non-executive directors could reasonably be perceived to interfere with the independence of these board members" (ASX, 2003, p.20).

Director Remuneration

The most obvious difference between non-executive directors of CSAs and private sector companies is the level of remuneration for non-executive directors. Cortese and Bowrey (2007) found that the majority of the ASX 50 companies provided their non-executive directors with average remuneration in excess of \$140,000. Figure 5 shows the

majority (68%) of non-executive directors in the sample received remuneration between \$15,000 and \$45,000 per year with the average level of remuneration \$32,000.

Take in figure 5

Excluded from the above figure is the average level of remuneration for the non-executive directors of the Reserve Bank of Australia board. This is because the Reserve Bank of Australia's 2005-06 Annual Report only discloses in the financial notes (Note 12, p.85) the consolidated remuneration of key management personnel, which includes the Governor and Deputy Governor, eight non-executive Reserve Bank of Australia's Board members, five non-executive Payments System Board members and five senior staff. Even though the Reserve Bank of Australia is a statutory authority operating under the CAC Act 1997 it was not possible to identify separately the remuneration of its board members. This lack of clear disclosure, in relation to director remuneration of the Reserve Bank of Australia is not in accordance of ASX Corporate Governance Principle 9 (ASX 2003) which requires the disclosure of non-executive directors' remuneration to be clear and adequately distinguished from the remuneration structure applied to company executives.

Also not included in Figure 5 is the remuneration of the non-executive directors who are also senior public servants and members of parliament, as they do not receive any remuneration for their directorships on statutory authorities boards. This is generally made clear in the Notes to the Financial Statements. For example, the National Library of Australia 2005-06 Annual Report Note 13 (page 115) states "Parliamentary members of Council do not receive any remuneration from the Library for their service on Council."

The average remuneration of non-executive directors who had been a director for one year was \$29,000 while those with who had been a director for six or more years was \$31,000, indicating no correlation between non-executive director remuneration and the length of time they serve on the boards of material CSAs.

Number of directorships

The data collected shows that 84 directors of statutory authorities (48% of the sample) held at least one other directorship.

Take in figure 6

However, of all the directors in the sample, only five held at least one other directorship with another material statutory authority. Two of these were non-independent non-executive directors, Mr Mark Paterson Secretary of the Department of Industry, Tourism and Resources (DITR) and Ms Helen Williams Secretary of the Department of Communications, Information Technology and the Arts (DCITA). This relatively high percentage of non executive directors holding at least one directorship in both the private and public sector tends to indicate that the non-executive directors of CSAs are able to contribute a significant amount of private sector corporate experience to the boards of CSAs. This is a very clear example of how institutional pressures to have access to the CSAs and how mimetic and normative isomorphic processes are in a position to be internally exerted. It could also be considered this level of ‘private sector’ experienced non-executive directors will contribute to legitimising the existence, role and responsibilities of CSA’s governing board of directors.

Discussion

The boards of directors of CSAs are unique in a number of ways when compared to the boards of private sector organisations. On the surface they appear similar, for example their size and composition, but beneath the surface are a range of different characteristics and requirements. The initial surface similarities could be explained by institutional theory as the result of coercive isomorphic processes, with the *CAC Act 1997* specifying certain governance requirements of CSAs. In the private sector there is a definite drive to increase the proportion of non-executive directors to improve the level of, or at the appearance of, independence of the board from the management of the organisation. However, independence does not appear to be a characteristic required nor encouraged of directors in statutory authorities. The findings from this study indicate the proportion of non-executive directors is comparable if not higher than public corporation boards, but the fact the Minister selects and appoints (or recommends for appointment) board members negates the independence of these non-executive directors. This high level of institutional pressure supports the notion that the public sector has adopted this governance structure, not to improve corporate governance, but to legitimise the organisations in the sector. This institutional pressure from the Minister, also results in the de-coupling of the governance structure as the board appears to be relatively highly independent, due to the presence of a high proportion of non-executive directors [which are usually considered independent]. However, because they are appointed by those who are not independent of the CSA the reality of their existence is different from the appearance they present.

Besides executive and non-executive directors, some boards of CSAs also include non-independent non-executive directors who are literally representational directors. These directors are either senior public servants or members of parliament. Their role is to represent the government or parliament and protect their interests, rather than participate independently in the governance of the CSA. Their presence may be explained as function of the coercive isomorphic process.

In addition to appointing board members, the responsible Minister can also direct the board to comply with general government policies (ss.28 of the *CAC Act 1997*) as well as determine the overall strategy of the CSA (Uhrig 2003, p.35). This creates a situation where there is very little real independence and autonomy of the board. Uhrig (2003, p.23) commented that the power to act is essential to a board's ability to govern effectively. However, due to the powers of the responsible Minister, it appears the boards of CSAs are not able to govern effectively as they do not have the power to act with autonomy.

There is no doubt corporate governance structures are critical in the public sector, however, as the environment is so different to the private sector the need for and value of similar governance arrangements is questionable. Why adopt private sector governance practices when some of the most spectacular corporate collapses have occurred recently in spite of their governance structures? It could be argued the presence of implementing similar governance arrangements is based on the misconception that private sector is more efficient and effective rather than improving public sector governance. The Uhrig Report (2003) suggested that for CSAs focused on regulating or service delivery objectives they would be better served having a Chief Executive Officer reporting

directly to the Minister rather than a board. Bartos (2005) reflected, that should the Uhrig model be accepted many statutory authorities including Commonwealth Scientific Industrial Research Organisation, Australian Broadcasting Corporation, Special Broadcasting Services Corporation, National Gallery, National Library, National Museum and Australian War Memorial (p.97) would no longer have a board. However, at present these statutory authorities still have governing boards. The continuing presence of governing boards in these public sector organisations can be considered to be the result of the impact of various institutional pressures which have been placed on the CSAs with the goal of contributing to their legitimacy to both the government and Australian public.

Conclusion

The adoption of private sector practices by the public sector can be seen not as an attempt to improve efficiency, effectiveness and performance, which are the objectives the new managerialism in the public sector, but rather as a need for public sector organisations to legitimise themselves within society (Hoque 2005, p. 370). The strong belief that private sector organisational practices and structures are superior to public sector practices and structures has led to various institutional pressures being exerted, both internal and externally, on public sector organisations with a mix of results. One such institutional pressure is the belief that good corporate governance is based on the presence of a governing board consisting of particular mix of directors.

This study has shown that the majority of CSAs have a governing board consisting of both executive and non-executive directors which is consistent with private sector organisations. Indeed, based on the data above, the boards of CSAs appear to be

more in line with the recommendations from bodies such as the Australian Stock Exchange than private sector organisations. However while it appears the presence of CSA governing boards should improve the corporate governance of the organisations, and in turn increase their legitimacy in this era of new managerialism, the structures behind the boards and the legislated roles of the directors contradict some of these aspects such as independence. The increased legitimacy of these CSAs, associated with the presence of governing boards can be considered as a part of the de-coupling mechanism that persists throughout the public sector. That is, while these CSAs have governing boards who undertake many of the roles of private sector boards the real power to set the strategic, financial and operational directions of the CSAs is not in the hands of the directors but in the hands of the responsible ministers.

This study has drawn data from the boards of “material” CSAs. Further research could extend this study to include the board compositions of non-material statutory authorities. This would be particularly interesting as materiality is defined according to the value of assets and liabilities and not the social value of the services provided. As these organisations operate in the same environment as the material CSAs it would be interesting to examine whether the financial situation of an organisation influences the composition of their governing boards or whether there are other influencing factors at play.

A future research project could perform an analysis of the changing board structures of the material CSAs since the enactment of the *CAC Act 1997*. This research project would provide an interesting account of the impact of this Act in line with the

public sector's move to new managerialism and the corresponding increased focus on public sector organisation performance.

Appendix 1: Statutory Authorities included in the analysis

Statutory Authority	Portfolio
Grains Research and Development Corporation	Agriculture, Fisheries and Forestry
Australian Broadcasting Corporation (ABC)	Communications, Information Technology and the Arts
Australian Postal Corporation	Communications, Information Technology and the Arts
Australian Sports Commission	Communications, Information Technology and the Arts
National Gallery of Australia	Communications, Information Technology and the Arts
National Library of Australia	Communications, Information Technology and the Arts
National Museum of Australia	Communications, Information Technology and the Arts
Special Broadcasting Service Corporation (SBS)	Communications, Information Technology and the Arts
Defence Housing Australia (DHA)	Defence
Australian Nuclear Science and Technology Organisation (ANSTO)	Education, Science and Training
Commonwealth Scientific and Industrial Research Organisation (CSIRO)	Education, Science and Training
Indigenous Business Australia	Employment and Workplace Relations
Export Finance and Insurance Corporation	Foreign Affairs and Trade
Australian Hearing Services	Human Services
Tourism Australia	Industry, Tourism and Resources
Australian Reinsurance Pool Corporation	Treasury
Reserve Bank of Australia	Treasury
Australian War Memorial	Veteran's Affairs
Airservices Australia	Transport and Regional Services

Appendix 2

The Uhrig Report 2003 - Summary of Better Practice Guidance for Boards

1. 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.
2. 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.
3. In getting the best from boards, appropriately experienced directors are critical to good governance.
4. Representational appointments to boards have the potential to place the success of the entity at risk.
5. Responsible Ministers should issue appointment letters detailing government expectations of directors.
6. Maximum board service periods allow for a structured rotation of directors.
7. All boards should have orientation programs and directors should have the opportunity for ongoing professional development.
8. Annual assessments of the board need to occur to ensure government gets the best from the board.

References

- ASX, 2003, Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations [Internet document] (Australian Stock Exchange) [created March 2003; cited 3 January 2007], available from http://www.asx.com.au/supervision/governance/principles_good_corporate_governance.htm
- Australian National Audit Office (ANAO) 2003a, *Better Practice Guide: Framework, Processes and Practices. Public Sector Governance Vol 1*
- Australian National Audit Office (ANAO) 2003b, *Better Practice Guide: CAC Boards, Guidance Paper No. 3*
- Australian National Audit Office (ANAO) 2003c, *Better Practice Guide: Conflicts of Personal Interest, Guidance Paper No.6. Public Sector Governance Vol 1*
- Australian National Audit Office (ANAO) 2004 *Better Practice in Annual Performance Reporting* [Internet document] [cited 25 September 2007], available from http://www.anao.gov.au/uploads/documents/Better_Practice_in_Annual_Performance_Reporting.pdf
- Australian Plaintiff Lawyer Association (APLA) 2007, Corporation Law [Internet document] [cited 20 August 2007], available from http://www.apla.com.au/law/corporation_law.php
- Barton, A., 1999, "Public and Private Sector Accounting — The non-identical twins", *Australian Accounting Review*, Vol. 9, No. 2, pp. 22–31.
- Barton, A., 2005, Professional Accounting Standards and the Public Sector – a Mismatch, *Abacus*, 41(2), pp. 138 – 158
- Bartos, S., 2005, The Uhrig Report: Damp Squib or Ticking Timebomb?, *Australian Journal of Public Administration*, 64 (1), 95 - 99
- Boxall. P., 1998, "The revolution in government accounting", *Australian CPA*, 68(3), pp. 18 – 20.
- Commonwealth Authorities and Corporations Act 1997 (CAC Act) [Internet document] [created 15 November 2006, cited 20 January 2007], available from [http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/01616BBD8E44C3F0CA257227001C049E/\\$file/CwlthAuthCompanies1997_WD02.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/01616BBD8E44C3F0CA257227001C049E/$file/CwlthAuthCompanies1997_WD02.pdf)

- Corporations Act 2001. [Internet document] [created 18 December 2006, cited 20 January 2007], available from [http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/F00C3CEA9D2C32E6CA25724900014544/\\$file/Corps2001Vol01_1282_WD02.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/F00C3CEA9D2C32E6CA25724900014544/$file/Corps2001Vol01_1282_WD02.pdf)
- Cortese, C., and G.Bowrey, 2007, Profiling non-executive directors in Australia, Working paper (University of Wollongong, Wollongong, NSW)
- Department of Finance and Administration (DOFA), 2003, Federal Risk Manager, Issue No. 14, Winter 2003 [Internet document] [cited 10 April 2007], available from http://www.finance.gov.au/comcover/docs/agrm_14.pdf
- Department of Finance and Administration (DOFA), 2005, CAC Legislation: Commonwealth Authorities and Companies Act 1997 [Internet document] [created 7 November 2005, cited 9 September 2007], available from http://www.finance.gov.au/finframework/cac_bodies.html
- Department of Finance and Administration (DOFA), 2006, FMA Legislation: Financial Management and Accountability Act 1997 [Internet document] [created 15 August 2006, cited 20 September 2007], available from http://www.finance.gov.au/finframework/fma_act.html
- Department of Finance and Administration (DOFA), 2007 Chart of 99 bodies under the Commonwealth Authorities and Companies Act 1997# (CAC Act) [Internet document] [created 11 January 2007, cited 20 January 2007], available from http://www.finance.gov.au/finframework/docs/FMA_CACFlipchart11January2007.pdf
- Edwards, M., 2002 Public Sector Governance – Future Issues for Australia, *Australian Journal of Public Administration*, 61(2), pp. 51 - 61
- Evans, H., 2004, *Odgers' Australian Senate Practice*, 11th edn, Canberra, Department of the Senate, 2004. [Internet document] [created 1 December 2004, cited 20 January 2007], available from <http://www.aph.gov.au/senate/pubs/odgers/index.html>
- Guthrie, J., 1998 Application of accrual accounting in the Australian Public Sector – Rhetoric or Reality?, *Financial Accountability and Management*, 14(1), pp. 1 – 19

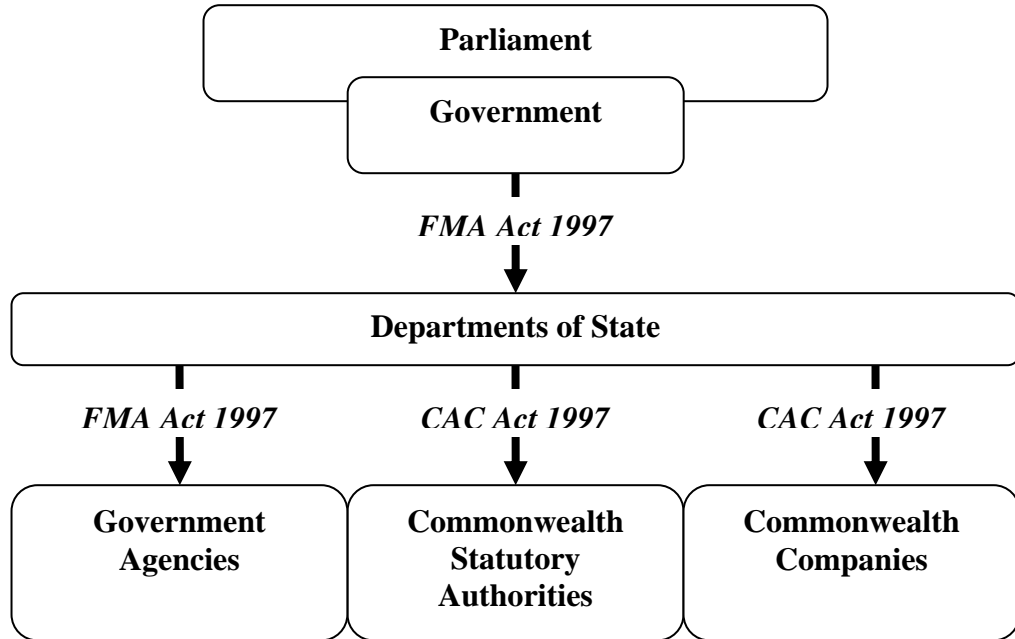
- Higgs, D., 2003, Review of the role of non-executive directors [Internet document] (The Department of Trade and Industry) [created cited 4 January 2007], available from www.dti.gov.uk/files/file23021.pdf
- Hoggett, J., Edwards, L. and Medlin, J., 2006, *Accounting*, 6th Edition, John Wiley & Sons Australia, Ltd
- Hooghiemstra, R. and J. van Manen, 2004, The Independence Paradox: (im)possibilities facing non-executive directors in The Netherlands, *Corporate Governance*, 12, pp. 314-324.
- Hoque, Z. and Moll. J., 2001, “Public Sector Reform: Implications for accounting, accountability and performance of state-owned entities — an Australian perspective”, *The International Journal of Public Sector Management*, Vol. 14, No. 4, pp. 304–326.
- Hoque, Z., 2005, “Securing institutional legitimacy or organizational effectiveness? A case examining the impact of public sector reform initiatives in an Australian local authority”, *International Journal of Public Sector Management*, Vol. 18, No. 4, pp. 367-383
- House of Representatives, 2004, *The Australian System of Government*, Infosheet No. 20, [Internet document] [cited 10 April 2007], available from <http://www.aph.gov.au/house/info/infosheets/is20.pdf>
- Howard, C and R. Seth-Purdie, 2005, Governance Issues for Public Sector Boards, *Australian Journal of Public Administration*, 63(3), pp.56 - 68
- Jackson, A. and Lapsley, I., 2003, “The diffusion of accounting practices in the new ‘managerial’ public sector, *International Journal of Operations and Production Management*, 16(5), pp. 359–372.
- Kang, H., Cheng, M, and Gray, S.J., 2007, Corporate Governance and Board Composition: Diversity and Independence of Australian Boards, *Corporate Governance: International Review*, 15(2), pp. 194 - 207
- National Library of Australia Annual Report 2005 – 06) [Internet document] [cited 20 January 2007], available from <http://www.nla.gov.au/policy/annrep06/index.html>
- Parliament of Australia (APH) 2003, Glossary [Internet document] [cited 10 September 2007], available from <http://www.aph.gov.au/find/glossary.htm#const>

- Parliament of Australia (APH) 2004, Infosheet No.13: The Constitution [Internet document] [created December 2004, cited 20 September 2007], available from <http://www.aph.gov.au/house/info/infosheets/is13.pdf>
- Parliament of Australia (APH) 2005, Parliamentary Handbook [Internet document] [created 31 October 2005, cited 10 September 2007], available from <http://www.aph.gov.au/Library/handbook/constitution/index.htm>
- Pass, C., 2004, Corporate governance and the role of the non-executive directors in large UK companies: an empirical study, *Corporate Governance*, 4, pp. 52 - 63
- Public Service Act 1999 (PSA Act 1999), [Internet document] [created 1 July 2006, cited 20 August 2007], available from [http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/78202C7C8CE75AC0CA2572B400082C69/\\$file/PublicService1999WD02_Version1.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/78202C7C8CE75AC0CA2572B400082C69/$file/PublicService1999WD02_Version1.pdf)
- Reserve Bank of Australia 2005-06 Annual Report, [Internet document] [cited 20 January 2007], available from http://www.rba.gov.au/PublicationsAndResearch/RBAAnnualReports/2006/Pdf/2006_annual_report.pdf
- Senate Brief No.5, *Consideration of Estimates by the Senate's Legislation Committees*, February 2005, [Internet document] [cited 20 January 2007], available from <http://www.aph.gov.au/Senate/pubs/briefs/brief5.htm>
- Uhrig, J., 2003, *Review of the Corporate Governance of Statutory Authorities and Office Holders*, Commonwealth of Australia, Canberra

Diagrams

Diagram 1

Legislation outlining Commonwealth Public Sector financial accountability and reporting requirements



Figures

Figure 1

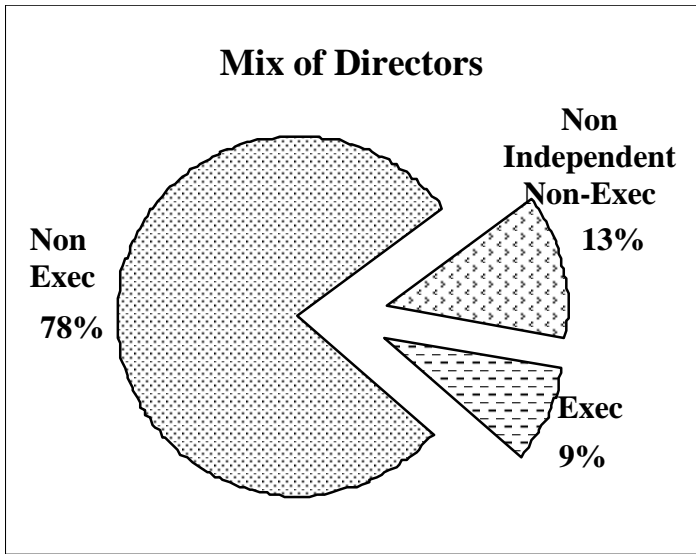


Figure 2

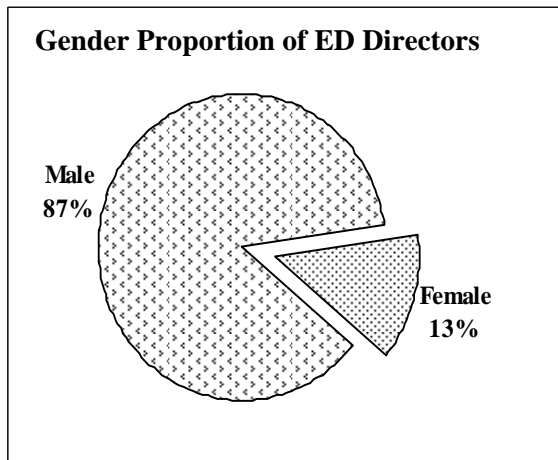
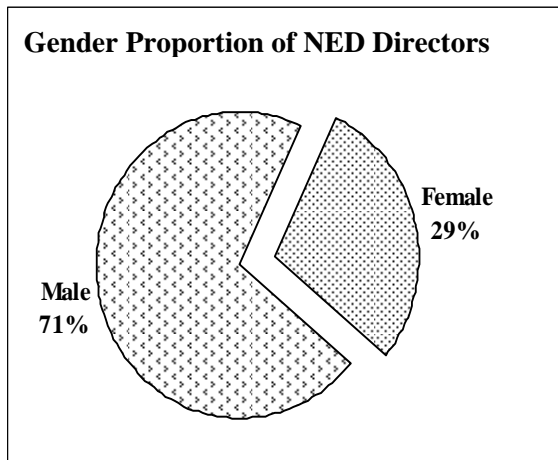


Figure 3

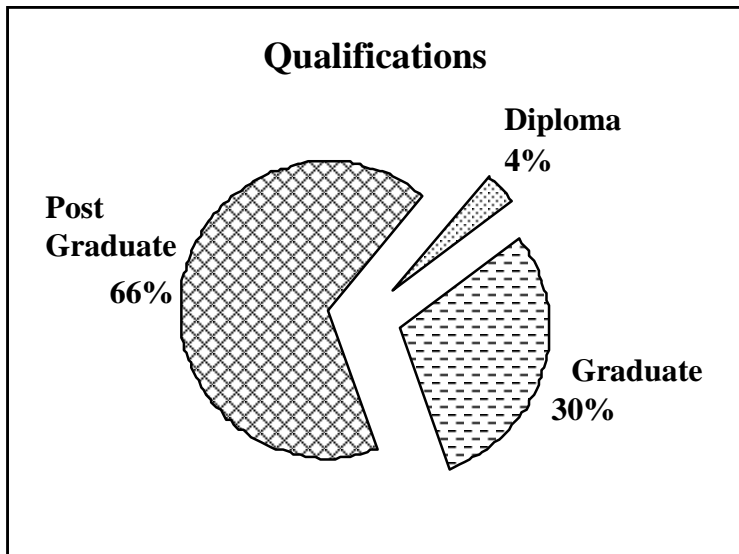


Figure 4

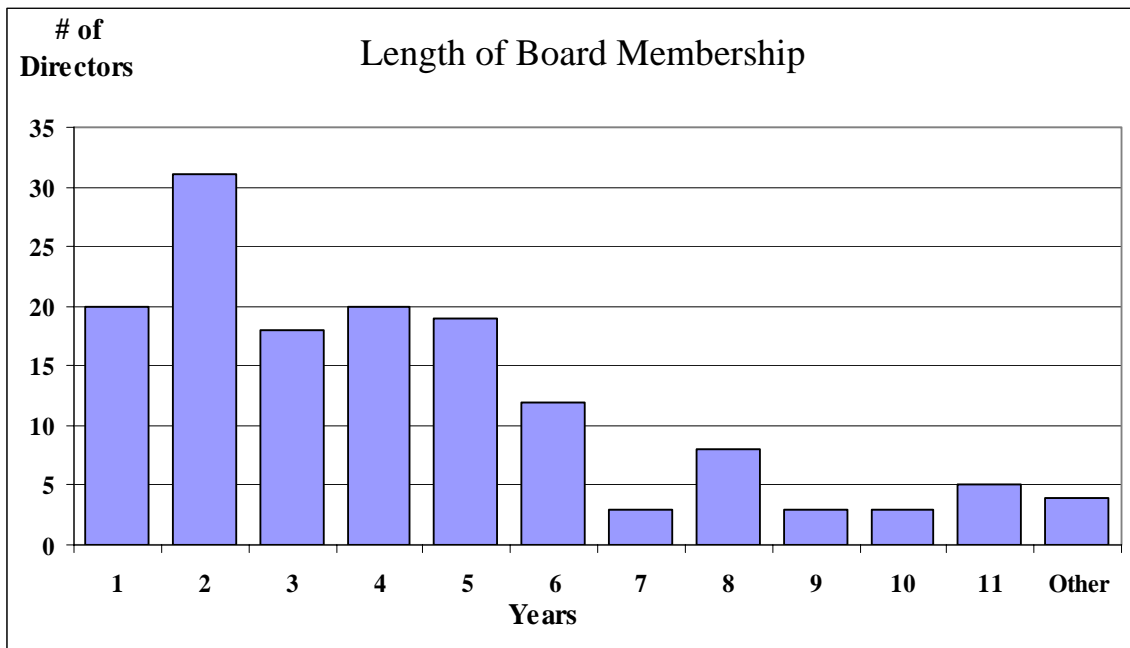


Figure 5

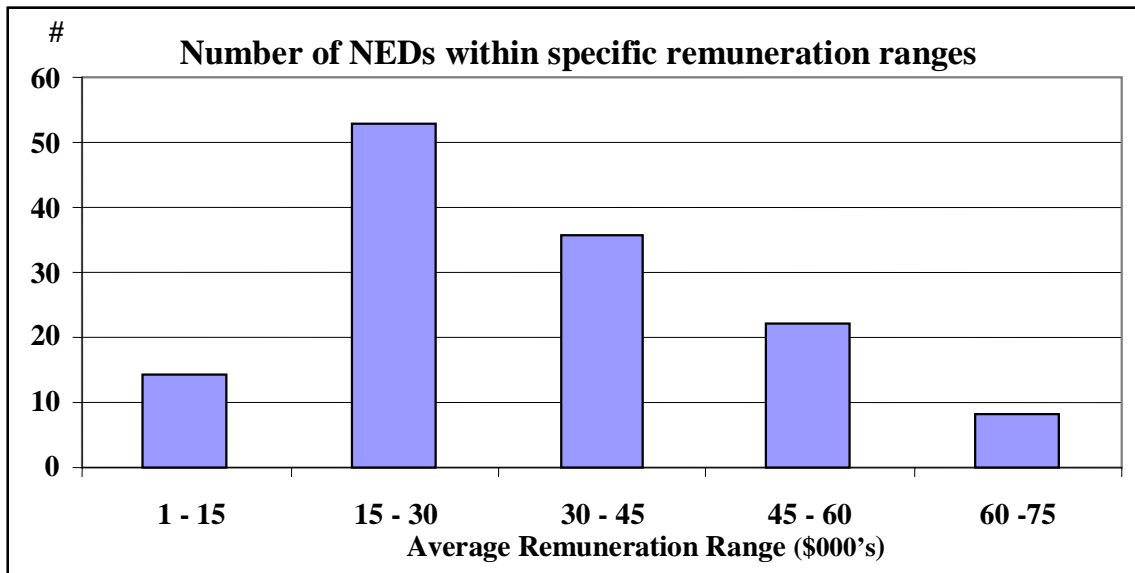
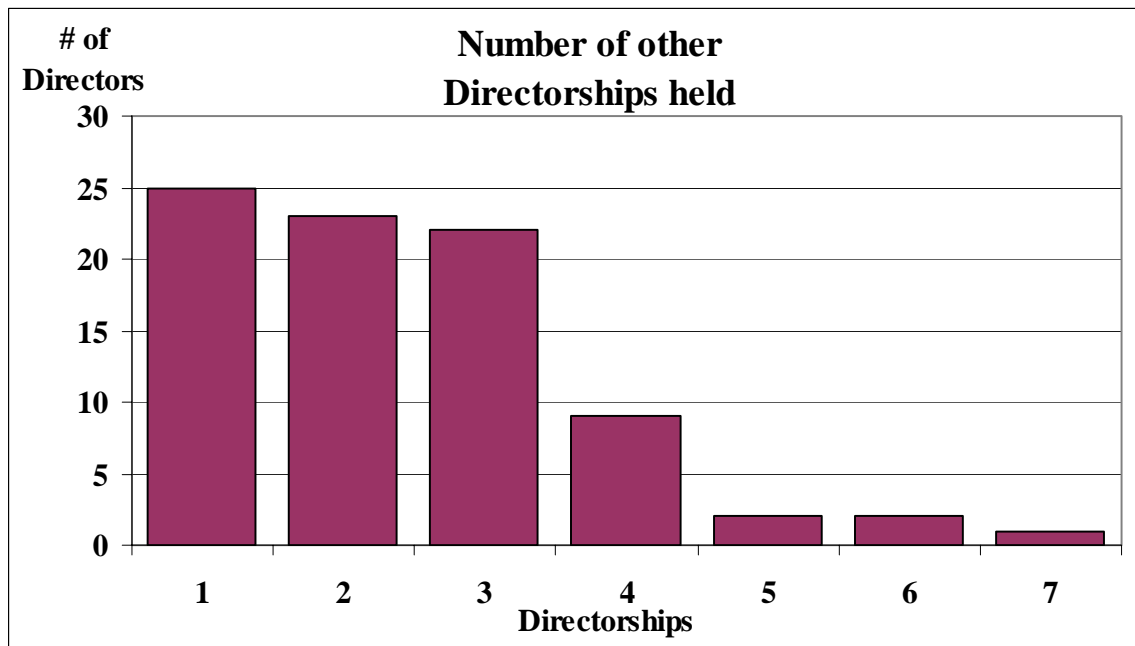


Figure 6



ⁱ The Uhrig Report was based on a review of the corporate governance of Commonwealth Statutory Authorities and office holders. The objective of the review was to identify issues surrounding existing governance arrangements and to provide options for Government to improve performance and get the best from statutory authorities, office holders, and their accountability frameworks. For a list of the recommendations of the Uhrig Report refer to appendix 2.

ⁱⁱ The Constitution of Australia establishes the form of the federal government, its powers and the basis for relations between the Commonwealth and the States. The Australian Constitution cannot be changed in the same way as other laws can be changed and it is a supreme law in that it overrides other laws. (APH 2005)

ⁱⁱⁱ There is also specific legislation developed for Commonwealth Government entities which prescribe the required processes and functions that affect the governance of these entities. This specific legislation includes the Auditor-General Act 1997, the Public Service Act 1999 (PS Act), the Financial Management and Accountability Act 1997 (FMA Act), the Commonwealth Authorities and Companies Act 1997 (CAC Act) and the Corporations Act 2001 (ANAO 2003 a, p.10).

^{iv} In April 2002 the UK Secretary of State and the Chancellor appointed Derek Higgs to lead a short independent review of the role and effectiveness of non-executive directors.

^v Australian Stock Exchange

^{vi} The Corporations Act 2001 is the principal legislation regulating companies in Australia. It regulates matters such as the formation and operation of companies, duties of officers, takeovers and fundraising (APLA, 2007)

^{vii} A cost accounting system in which costs are assigned to products based on cost drivers for the various production activities required to produce a product or service (Hoggett, Edwards and Medlin 2006, p. 1107)

^{viii} A measurement based management system which aligns business activities with the vision and strategies of an organisations (Hoggett, Edwards and Medlin 2006, p. 1108).

^{ix} Conflicts of role arise when an officer is required to fulfil multiple roles that may be in conflict with each other to some degree. Unless properly handled, such conflicts can impair the quality of working relationships across government organisations and lead to a loss of credibility and effectiveness (ANAO 2003c).

^x The Secretary of a Department is responsible for managing [head of] the Department and must advise the Agency Minister in matters relating to the Department (PSA Act 1999, ss. 57.1). That is, a Secretary is the equivalent of the CEO of a private sector organisation.