

Corporate Governance Disasters and Developments

Implications for University Governing Bodies

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The last decade has seen a series of financial disasters in large corporations worldwide, many of them precipitated by shoddy and unethical corporate governance. The higher education sector has for the moment avoided disasters of this scale. But according to David Holloway the threat is a real one. We need to seriously consider international best practice lest Australia experience a 'Unigate'.

Introduction

This paper investigates parallel issues in corporate governance and university governance. It analyses the recent recommendations for reform of university governance embedded in the federal government's 2003 *Our Universities: Backing Australia's Future* document, in the wider context of proposed reforms to corporate governance. I advocate an expansion of the role of the chair and the independent members of university governing bodies as well as the role of independent directors on company boards. In addition, I argue that the construction of a healthy 'boardroom' culture is central to the effective functioning of the governance process.

Corporate governance has been a contentious area internationally since the global stock market meltdown of the late 1980s (Goodjik 2003; Sonnenfeld 2002; Baker and Owsen 2002; Vinten 1998; Firstenberg and Malkiel 1994; Leighton and Thain 1990). High level corporate failures during the late 1980s and early 1990s such as Bond Corporation and Quintex Corporation in Australia and Polly Peck and BCCI in the United Kingdom had initiated moves towards reform. Recommendations for change accelerated in the late 1990s and early 2000s with further major corporate failures including Marconi in the UK; Enron, Worldcom and Tyco in the United States; and, Harris Scarfe, OneTel, Ansett and HIH in Australia. This has resulted in a perceived legitimacy problem and what has been described as a 'general crisis in corporate governance' (Bargh, Scott and Smith 1996, p. 170). A series of reports (government and non-government) in several nations have resulted in supposedly enhanced 'best-practice' corporate governance guidelines and suggestions for changes culminating in recent legislation enacted in the United States - the *Sarbanes-Oxley Act* in July 2002 (*The Economist* 2002) aimed at curtailing (misbehaving) senior managers of corporate entities.

University governance has a different emphasis to corporate governance with a greater concern for stakeholder groups. There have been no large-scale financial failures (yet) or scandals involving inflated earnings in the tertiary sector so this is not a reform driver. However, there have been similar moves to analyse and reform university governance practices in Australia and overseas (Nelson 2003; Edwards 2003; Bain 2002; Department of Education and Training 2002; Committee of University Chairmen 2001; Ingram 1997). The latest move, by the Australian Federal Government, enforces changes to governance protocols and reduce the size of university governing bodies. This would give them a more 'corporate' flavor and therefore an implied 'better' approach to governance. The incentive for change is backed up by funding in the order of \$404 million being conditional on meeting governance reforms.

In what follows I analyse the notion of management prerogative in decision-making the public sector, and detail international developments in corporate governance during the 1990s and later. I then focus on events and changes in the Australian context and try to determine the best of the 'best-practice' models that have emerged from this reform fervor and discusses whether this has had any impact (negative or positive) on corporate performance. I conclude by exploring the implications for senior university managers and members of governing bodies.

Managerial Prerogative - Public Sector

The concept of managerial prerogative has developed over time such that senior managers of organisations have a perception that they are solely responsible for all the key decisions merely because of the organisational position they occupy. This is closely connected to the additional desire of

senior management to maintain control over strategies, decisions, the future, customers, employees, markets etc. (Mintzberg 1994, pp 201-202). This enables top management to feel more comfortable and in charge of what is 'going on' in the organisation.

This managerial viewpoint is evident in public sector organizations – including universities, which are statutory authorities established under their own enabling Acts. Managerialism, the early umbrella term for the reforms that have occurred in the past two decades in this country, involves the introduction to the public sector of private sector concepts and approaches. These include the use of statements of objectives; corporate plans; development of performance indicators; devolution of responsibility; greater use of risk management and (ultimately) evaluation of outcomes and objectives. The result is a shift away from concentrating primarily on accountability to a minister of the crown to a greater emphasis on 'what governments do and how well they do it' (Weller and Lewis 1989, p. 1). The intention of this management reform (conventionally termed New Public Management or NPM) is to have outcome and achievement-oriented public sector organisations maximising value for money in a world of scarce resources. These reforms have also extended to the university sector (Holloway 2004; Christensen 2004; Boden 2001; Stewart 1997; de Boer & Goedegebuure 1995).

Despite their many critics over the years, Hughes (2003) argues that these public sector reforms are not a passing management fad and are here to stay. Proponents of New Public Management argue that public institutions have to be more accountable for public resources and show that their organisational outcomes are worth the investment of funds by the taxpayer and society. These are positive and necessary changes given that the public funding process is not bottomless. On the negative side, however, is the importation of the corporate notion of a dominant managerial hegemony in which management decides all things organisational. The resulting management decision-making approach is usually a tightly controlled, top-down process.

In many cases university Vice-Chancellors and their senior executive have enthusiastically embraced the NPM approach. As a result, collegiality in decision-making has become a pejorative term. The focus instead was, and is, on 'managers managing' the institution with the appropriate level of accountability and responsibility for outcomes. This focus is usually embedded in respective delegations and university regulations, although not often reflected in the original university enabling Acts.

It is clear that a managerial hegemony exists in the tertiary sector in Australia and overseas. Given this, and the move towards greater commercialisation and corporatisation of universities, it is necessary to locate what is happening in corporate governance developments and analyse the likely impact

of these on university governing bodies. This next section explicates the international developments in this field.

Corporate Governance – International Developments

There have been a series of inquiries and reports since the beginning of the 1990s with the aim of identifying required changes to corporate governance practices. These have virtually all had the aim of constructing general guidelines and principles for the composition, roles and rules of disclosure for boards of directors. Very few of these have been subsequently enshrined in a legislative framework.

The first major committee and report in the UK, chaired by Sir Adrian Cadbury, was prompted by the failures of major corporations such as Polly Peck and BCCI. The 1992 report contained three major recommendations: the notion of duality – separation of the chairman of the board from the company's chief executive officer role (a substantial break from the notion of managerial hegemony); the appointment of at least three non-executive (independent) directors to each board; and, the setting up of board sub-committees (Cadbury 1992).

Cadbury's was followed up by a series of further reports (Greenbury 1995; Hempel 1998; Turnbull 1999) that between them recommended additional 'beefing up' of the role and responsibilities of boards and their directors, both executive and non-executive. The latest in this series is the UK government commissioned Higgs report (2003), which was specifically tasked to provide an independent review into the role and effectiveness of the non-executive (independent) directors. However, the thrust remained focussed on recommended practices. Higgs argues that the 'brittleness and rigidity of legislation cannot dictate the behaviour, or foster the trust, I believe is fundamental to the effective unitary board and to superior corporate performance' (2003, p. 3).

Higgs repeated again the need for duality, in that the role of chairman and chief executive should be separated. Further, independent directors should constitute at least half the membership of the board and that the key sub-committee memberships of the board (audit, remuneration and nomination) should comprise solely of independent directors. These recommendations if incorporated into the Combined Code through the Financial Reporting Council and Financial Services Authority will certainly enhance the role and responsibility of independent directors. The question still remains as to whether these enhancements to the role and structure of boards will make any real difference to the (mis)behaviour of senior management.

The most spectacular recent corporate failures have been in the USA. This has been further compounded by the series of companies who have subsequently confessed to overstating revenues and/or understating debts in the past two years. This has led to significant disquiet and strong shareholder activism

resulting in a political response with the enactment of the *Sarbanes-Oxley Act*, rushed into law by Congress at the end of July 2002. The Act requires chief executive officers and chief financial officers to 'swear' (in front of a notary) to the correctness of their financial statements (*The Economist* 2002, p. 11). The US is the only nation, so far, to respond to the growing outcries about management corporate misbehaviour by enacting specific legislation to supposedly deal with the problem. Yet the response appears to be a knee-jerk political reaction by the Federal Government to be seen publicly at least that 'something' is being done.

A more effective and lasting impact is likely to be the recent move by the New York Stock Exchange in April 2003 to tighten listing requirements of companies by implementing the governance guidelines produced by its Corporate Accountability and Listing Standard committee (2002). Stock exchanges around the world are acknowledged as having more effective regulatory power over companies because of their ability to delist a company if they do not comply with their listing rules.

The recent mainland European approach to this topic is not a great deal different to the events and experiences in the UK and USA. The European Association of Securities Dealers guidelines (2000) was preceded and influenced by the OECD report (1999) and the contents were not significantly different from the earlier UK and USA principles and recommendations. There is in fact a general international convergence on 'best-practice' recommendations particularly with respect to the expanding role of independent directors. There is, however, a less individualistic and managerial approach to decision-making in companies within Europe. Instead there is a greater willingness to use a more participatory approach and allow enhanced stakeholder, particularly employees and shareholders, involvement in the governance and internal management of companies.

Corporate Governance - Australian Issues

The recent major, and very public, corporate failures in Australia, ranging from the retail sector (Harris Scarfe), to telecommunications (OneTel), aviation (Ansett) and insurance (HIH), have brought similar issues to public attention here. Justice Neville Owen was appointed in August 2001 to head up a Royal Commission into the HIH debacle and recently the Australian Stock Exchange (ASX) produced its own set of listing requirements in this area.

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The main result of the HIH Royal Commission, which provided its final three-volume report in April 2003, was the documenting of significant corporate governance failings. Owen pointed out that the debacle was more than an unfortunate series of mistakes and corporate aberrations: HIH was mismanaged and decisions were ill conceived and executed within an unsound management culture (2003, vol. 1, p. xvi). Yet he does not recommend legislative action. He argues instead that 'any attempt to impose governance systems or structures that are overly prescriptive is fraught with danger. By its very nature corporate governance is not something where one size fits all' (vol 1, p. 105).

Owen focuses in part on the role of boards and directors and does recommend that the board of directors should actually carry out its role of setting strategic direction and oversight of management, which plainly did not occur with HIH. He specifically points out the failings of the independent directors who placed too much reliance (incorrectly) upon management (and executive directors) decision-making and management supplied information. In the end he identifies the corporate culture of the organization and the culture of the board itself as having marked shortcomings which he explains is why he does '... not make any formal recommendations' on a corporate governance model or system because he concludes that HIH would on paper not have deviated significantly from 'best practice' codes (vol 1, p. 133).

The current trial of the Harris Scarfe CEO and Chairman of the board Adam Trescowthick (on thirty-seven charges) has heard allegations that a pattern of financial misinformation given to the board commenced in March 1998. This was alleged to be deliberate and false inflation of gross profit and financial returns and continued until the January 2001. The amount overstated was \$46 million over six years.

The charges allege that the Chairman forced the Finance Director Allan Hodgson to produce these misleading financial statements and outcomes. In an earlier trial in June of 2002 Hodgson was jailed for six years after pleading guilty to making false accounting entries to comply with the CEO's request (McGuire 2003, p. 37).

It is highly unlikely that any current corporate governance models or systems could effectively prevent this type of senior management misbehaviour. This raises a serious conundrum. Does a 'best practice' corporate governance model result in improved corporate performance and prevent poor and/or fraudulent management decision-making?

Best Practice Corporate Governance

We can distill a world's best practice model from the above developments and pronouncements made across the different nation state jurisdictions. Such a construct would supposedly deliver better governance and one would expect better corporate performance.

First, the chair of the board would be a non-executive position with enhanced responsibilities in relation to decision-making, management oversight and information gathering: this would also have expanded legal responsibility beyond that expected of other independent directors. The structure of the rest of the board would then compose of executive and independent directors with the majority of the membership being non-executive. One of these would also be a designated senior independent director separate from the chair. The independent members would also chair and fill exclusively the membership of the key sub-committees (audit, remuneration and nomination). Again this would be expected to enhance the management oversight role as well as better comply with the fiduciary duty expected of independent directors.

The other essentials would include a publicly available code that would explicate the governance/ethics protocols to be used by the board; a relatively small sized board (the average is eleven directors); a professionally designed and conducted induction training for new directors as well as ongoing professional development; independent directors to have at least two three-year terms to retain appropriate corporate knowledge; a tighter definition of independence for prospective directors to avoid conflicts of interest; and, an appropriate range of board directors ages and skill sets including financial, industry knowledge, strategic skills and representation of immediate community and general society interests.

Implications for University Governing Bodies

There is clear evidence that the conventional wisdom is inadequate: corporate and university governance needs to be reconceptualised and reconstructed. Sound board structures and processes may be necessary, but not sufficient, conditions for effective organisational performance. There are, however, additional elements that can be introduced and would deliver more robust outcomes to ensure effective and sustainable

reform. The starting point is the set of guidelines recently produced by Education Minister Brendan Nelson as part of the *Crossroads* reform agenda.

It is evident that the federal government is serious about reform of university governance. A recent report about the 'new, slim-line council of Charles Darwin University' indicates that the new enabling legislation to be presented to the Northern Territory Parliament will follow the guidelines of the Nelson governance protocols (Morris 13 August 2003, p. 33). In particular, protocol 5, which specifies an arbitrary size

limit of twenty-two on University councils (Nelson 2003, p. 47). This initially meant that student stakeholder representation was to be eliminated from the new University council (the Board of Trustees) until the federal government confirmed that their inclusion would not jeopardise future funding. Students will now be on the new governing body. I would expect that the rest of the tertiary sector is likely to follow this lead when implementing the new federal guidelines.

In themselves the bulk of the twelve protocols in the Nelson (2003) document would be recognised by anyone familiar with the series of national and international corporate governance 'best practice' guidelines and recommendations. All stakeholder groups including senior management would support, I believe, the intent and content of the protocols.

However, protocols 3 and 5 do raise issues of concern. Protocol 3 specifically requires governing body members to '...act solely in the interests of the university rather than as a delegate or representative of a particular constituency' (Nelson 2003, p. 46). This could result in instances of misbehaviour and misconduct or fraud being kept in camera when they should be publicly raised to protect the longer-term interests of both the institution and the sector. Protocol 5 limits the size of councils, when the research evidence is that size is not as important as the range of experiences, skills, ages and backgrounds that members bring to the governing body. The protocols are also silent about the existence of important sub-committees such as audit and remuneration and the encouragement and protection of whistleblowing.

The real concern is that senior management can use a 'form over substance' approach and still operate as if the governing body function is an unavoidable annoyance and unnecessary intervention into their managerial prerogative to be the key decision-makers in the organisation. The following elements need to be seriously considered if reform is to be effective.

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Stakeholder Governance Model

Different approaches are required to profit oriented corporate governance and university governance. Universities have no shareholders and need to have cognisance of a wider set of internal and external stakeholder groups as a result including local, state and federal governments, staff, students, local and regional communities, unions, business, suppliers and society in general. Edwards (2003, pp. 19-21) makes a strong case for just such a model in her report for the Ministry of Education on university governance for New Zealand tertiary education institutions.

A stakeholder model would build on the notion of 'shared governance' as it exists in the United Kingdom and the United States, which 'refers specifically to collaboration between academic faculty, college or university managers, and independent members working together' (Edwards 2003, p. 20). Key stakeholder groups would need to be identified and then represented on governing bodies under a trusteeship or stewardship approach as reflected by the Nelson recommendations. Although representing different stakeholder groups, these stakeholder members would have a shared commitment for the present and future outcomes and health of the institution. In certain defined circumstances, they would have the right and even the obligation to speak out publicly about what is happening within the institution.

In this scenario the size of the governing body becomes an issue. A limit of twenty-two members may mean that all stakeholder groups may not be fully represented. The range of professional, industry and education skills, background and experience would be insufficient and the result would be detrimental to good governance. Universities need to consider these aspects carefully when making changes to the structure of their governing bodies to accommodate the Nelson agenda.

Healthy Boardroom Culture

Sonnenfeld (2002) argues that it is not the rules and regulations of the governing process that count but the way people work together that is vital. Therefore, what distinguishes exemplary (effective) boards is that they are robust, effective social systems (2002, p. 108). In other words they exhibit a healthy boardroom culture. This is the most critical of the additional elements needed to ensure that good governance practice is translated into 'better' organisational performance. Justice Owen (HIH) would support wholeheartedly such a response. Jack Welch, ex-CEO of General Electric also advocates this approach as opposed to a tighter set of governance



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rules 'The characteristics you want are integrity, common sense and willingness to speak out' (Gottlieb 2003, p. 21)

Vital elements constructing such a culture are the creation of a climate of trust and candour with full access to relevant information; effective governing body teamwork which avoids groupthink and social loafing; encouragement of open dissent and debate; regular rotation of roles among members or directors; individual accountability of members or directors for their roles to the rest of the board; and regular reflection and evaluation of the board's own performance (Sonnenfeld 2002, pp. 109-112). In particular, there is a need for active debate and open questioning of management.

The key to this 'healthy culture' is open debate and discussion. This means that members must have the capacity and willingness to challenge each other's assumptions and beliefs and relies on their personal fortitude and external trust to allow for opposing viewpoints and challenging questions. Sonnenfeld's analysis shows that 'the highest performing companies have extremely contentious boards that regard dissent as an obligation and that treat no subject as undiscussable' (2002, p.111). In this way they avoid the problem of groupthink where conformity and consensus are seen as virtues. One needs to construct, at the governance level, robust and effective teams. The role of the chair and the independent members is central to guaranteeing that this robustness occurs by ensuring that individual voices/opinions are heard and valued.

Role of the Chair

All universities already operate at the 'best practice' level in this area. The Chair (usually a Chancellor) acts independently from the effective CEO of the institution, the Vice-Chancellor.

It is a pivotal role. In the corporate world, the duty of care and responsibility being placed by regulators and the courts on this position is growing (*Financial Review* 2003). Chairs of university governing bodies can expect to have similar expectations placed on their roles and responsibilities. In other words they carry more and higher responsibilities than other members of such bodies. Their actions or inactions have significant impact on the effectiveness of meetings and the conduct and resolution of business, which is set before the governing body.

The role of the chair needs to include responsibility for ensuring independence in the construction of meeting agendas; ensuring that full and appropriate information is provided to the governing body (without information overload being used as a control tactic); ensuring that meetings are not captured by senior management; enabling all members to debate issues and work effectively together; and, arranging some meetings without management being present (a key recommendation in the corporate arena).

The chairs should also set up a formal representative group of Chancellors and university Secretaries in a move similar to the existing Committee of University Chairmen in the UK and the Association of Governing Bodies in the USA. It would exist in addition to their current arrangement of conferences on governance. This would permit a more unified voice and a separate group independent from the Vice-Chancellors who have their own representative body in the Australian Vice-Chancellors' Committee (AVCC). Such a body would be able to lobby government more effectively because it could claim greater impartiality on key issues. It would also act as a repository for good governance practice and enable the construction of better induction and professional development programs for new and continuing members of governing bodies.

Role of Independent Members

The role of independent members is a critical one both in the corporate world and the university sector. Again universities are operating at the optimum recommendation level, with the majority of members of governing bodies being independent of the senior executive. However, the concern here is to ensure that these members are fulfilling an effective governance function. One way to deliver this outcome is to strengthen the ability of independent members to participate fully in the decision-making and oversight process. It is also important to ensure that there are members who are 'experts' in financial analysis and business risk assessment skills. The remaining members of a governing body should participate in professional development programs to raise their awareness and understanding of these crucial skills.

Independent members need to be involved in serious and critical debate about key issues. The Chair and other senior

independent members should encourage open and constructive dissent through the use of alternative decision options to be tabled and discussed (Sonnenfeld 2002). Thoughtful minority positions and opinions should not be dismissed once a majority decision is reached but preserved for later reconsideration if the original decision(s) reached raise legitimate doubt or concern about their validity in the future. Independent members also need to play an active role in carrying out the tasks and functions of the governing body. One or more senior independent members need to be selected to chair key permanent sub-groups such as the nomination, audit and remuneration committees. Other independent members need to be given specific tasks and roles and should be responsible and held accountable for their actions/decisions. These roles need to be rotated on a regular basis.

Staff members (academic faculty and general) have an additional and unique role. They are 'embedded' in the workings of the institution and have access to inside information about what is 'going on' that other lay members do not have. Information access for all members is an important feature of a well functioning governing body. Thus, members should be able to drill down and data mine throughout the organisation for information sources that are independent of the senior executive. This right to gather independent information needs to be codified within each institution.

A final key feature is the need for the protection of whistleblowers. Whistleblowing is a contentious area for most organizations and more so for universities where reputation and integrity are paramount. Justice Owen (of the HIH Commission) stated specifically that '... those responsible for the governance of a company should have an interest in inculcating within the company a culture and processes that enable instances of questionable conduct to be brought to attention outside normal reporting lines without fear of retribution' (2003, vol. 1, p. 131). However, the reality is that whistleblowers in universities who bring issues to organisational and public attention find themselves targeted for retribution including sacking by the university in question (Martin 2003). Independent members can play a crucial role here by acting as the official conduit for such allegations and the subsequent investigation into the claims by the governing body. This would protect whistleblowers by providing organisational anonymity. Given the dominance of managerial prerogative such a mechanism would be a very positive move in both the corporate world and the university sector.

Conclusion

If boards continue to be dysfunctional and managerial hegemony (top-down decision-making where senior managers make all the decisions) continues to be the dominant model in corporate and academic institutions, there will be more corpo-

rate failures and scandals. Governments will respond to the resulting public outcry with intensive legislative programs tightening further the rules and regulations of university and corporate governance. Universities and companies will be given no 'self-regulating' options. Clearly it makes sense for corporations and universities alike to clean up their own houses.

Good governance is not guaranteed, however, merely by implementing 'best practice' guidelines and recommendations. The evidence is clear. Sound board structures and processes may be necessary, but not sufficient, conditions for effective governance but they do not of themselves deliver 'better' organizational performance. Focusing exclusively on structural elements such as size, independent chair, and a majority of independent members and existence of special sub-committees is an easy but inadequate solution.

Organisations also need to ensure that governing boards meetings do not become 'rubber-stamping' exercises and implement both 'form and substance' changes emanating from the best practice governance recommendations. In particular, they should create a 'healthy' boardroom culture, one that encourages debate and dissent and constructs an effective and robust team approach to the governing process. The role of the chair and that of the independent members (particularly staff members) needs to be expanded to help deliver this 'healthy' culture. Such a culture is enabled by openness, trust and strong relationship building amongst the differing parties and members. This will allow organisations to reap the benefits from their existing knowledge/intellectual capital and unlock and realise the full future potential of the organisation. ■

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Endnotes

1 Corporate governance has no universally accepted definition but is generally accepted as the practice of companies having boards of directors whose role is primarily one of setting broad policy and strategic direction plus oversight and control over senior management and corporate financial performance (ASX 2003).

2 University governance focuses more on ensuring stewardship of public assets, efficiency/effectiveness of resources, transparency and accountability of the institution to its (wider set) stakeholders because these governing bodies '... must be judged on criteria that go beyond financial performance to include impact on human capital and communities.' (Edwards 2003, p. 11).

3 University governing bodies use different names in Australia but have similar roles and responsibilities. There are five Senates (UWA, Murdoch, ACU, Sydney and UQ), one Board of Trustees (UWS), one Board of Governors (UNDA) and the remainder are Councils (Bain 2003).

4 Or as Haigh (2003, *The Age Review*, p. 1) explains corporate culture 'the way people work when they think nobody is looking' – which in the case of HIH means they are '... looting the stationery cabinet, forging expense chits and downloading porn...'

5 Attributes include composition – size of boards and mix of directors; characteristics – directors backgrounds and skill sets; structure – board organisation and information flow; and, process – decision-making activities and the conduct of board meetings (Korac-Kakabadse et al 2001, p. 25).

6 The new Charles Darwin University is being formed by the merger of the Northern Territory University and Centralian College (Morris 2003).

7 *Social loafing* is where group members do not participate effectively in groups and rely on other members to do the work. *Groupthink* refers to group mediocrity in decision-making by chasing consensus (falsely) at all costs (Baker et al 2002, pp. 328-331).

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