BETTER PRACTICE IN GOVERNANCE AND ACCOUNTABILITY

EXTRACT

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CPA AUSTRALIA

CONTENTS

1. OVERVIEW OF CORPORATE GOVERNANCE

1.1 GOVERNANCE

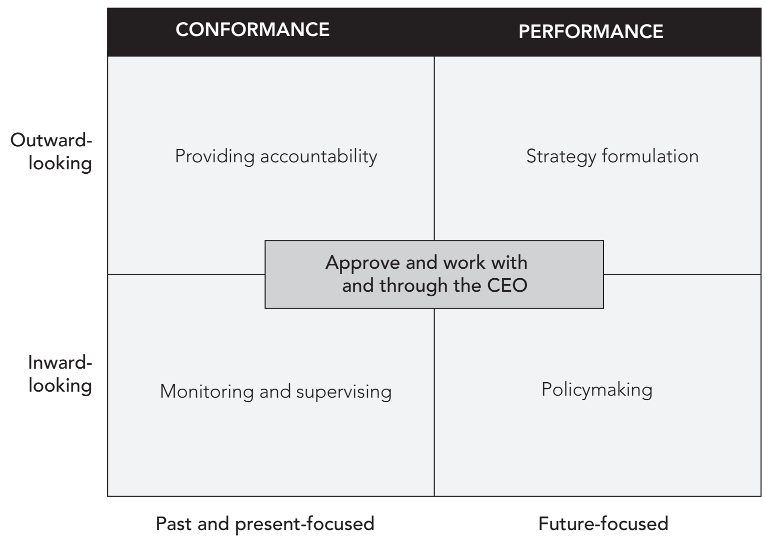
1.1.1 Background

Corporate governance refers to the way in which organisations are governed and is concerned with practices and procedures to ensure that the organisation is run in a way that achieves its objectives. For example, an organisation's objectives could be to maximise the wealth of its shareholders, subject to various guidelines and constraints, and with regard to the other stakeholders with an interest in what the organisation does. Constraints would include behaving in an ethical way and complying with laws and regulations.

The well-known Tricker model (Tricker, 1994; 2015) shown in Figure 1.1 sets out the corporate governance activities of an organisation's governing body, its board, as:

- setting, guiding and monitoring the organisation's future direction;
- ensuring the organisation complies with all relevant legalisation, regulations, standards, codes and internal policies;
- driving organisational performance (through the Chief Executive Officer (CEO) and management team); and
- establishing appropriate internal control processes and accountability systems.

Figure 1.1: A framework for analysing board activities – the Tricker model



Adapted from Tricker, 2015, p. 47.

Tricker's model broadly summarises the main governance roles and focus for corporate boards. In particular, it highlights the generally held belief that boards are fundamentally responsible for two areas:

- **Conformance**: Ensuring compliance through monitoring all aspects of the organisation's performance, ensuring that this performance is in the shareholders' interests and is meeting agreed goals and objectives. (This is done by monitoring financial and non-financial aspects of company programs, complying with all relevant legal requirements and by undertaking appropriate risk analysis.)

- **Performance**: Improving the performance of the organisation through strategy formulation and policymaking. The performance role is equally important to the compliance role.

1.1.2 Importance of corporate governance

Good corporate governance aims to ensure that organisations are properly run in the best interests of their stakeholders, including national and international economies.

At an organisational level, the behavioural styles and business management practices of managers (and other employees) or directors can result in outcomes that are not in the best interests of shareholders and other stakeholders. These situations can range from relatively minor technical breaches of policies or practices to cases that are more serious in which excessive risk-taking or poor controls place the ongoing survival of the organisation at risk.

To reduce undesirable consequences for shareholders and other stakeholders and to ensure personal accountability, organisations need an appropriate system of checks and balances in the form of a corporate governance framework. The Tricker framework emphasises both conformance and performance as vital elements of the way that companies are run.

An organisation with good corporate governance can instil confidence in its shareholders and other stakeholders. For example, transparent disclosure policies are crucial in ensuring shareholders and lenders continue to supply the finance required by organisations. How companies perform impacts on the national economy. Corporate governance is also one of the criteria that retail, institutional and foreign investors increasingly rely on when deciding in which companies to invest.

It should be noted that while good corporate governance can bring benefits to companies, it can also impede growth. For example, strict corporate governance policies and practices can lengthen the time to undertake mergers and acquisitions due to the requirement to follow extensive due-diligence procedures. The ability of management to make prompt and effective decisions can also be constrained by the need to observe proper corporate governance policies and practices.

These compliance-oriented rules need to be fully understood as they provide protection against excessive risk-taking. As was seen in the global financial crisis (GFC) of 2007–08, excessive risk-taking and management enthusiasm (often based on personal motivations) can ultimately result in devastating outcomes for shareholders and other stakeholders (Clarke, 2011). In many ways, good corporate governance is a balancing act between restricting excessive risk-taking and allowing appropriate freedom for decision-making.

1.1.3 Accountants and effective governance

Accounting, as part of the overall governance process, involves improving decision-making and achieving goals and objectives while maintaining and strengthening controls. One risk is that accountants spend too much time on conformance and compliance-based work and too little on enhancing business performance. It is important as accountants that our focus combines both value creation and value protection.

Clearly, the International Federation of Accountants (IFAC) recognises that performance as part of governance is specifically related to value creation and resource allocation. The skills, knowledge and judgment of accountants in this area of decision-making is crucial and professional judgment is fundamental to achieving performance success. The focus is on helping the board to make strategic decisions, understanding its appetite for risk and its key drivers of performance, and identifying its key points of decision-making (IFAC, 2004, p. 4). This course will show you how you can assist the board to achieve its desired outcomes.

Question 1.1

Do you think it is important for an accountant to have a good understanding of corporate governance? Why?

When you have completed this activity, check your work against the suggested answers at the back of the learning material.

SUGGESTED ANSWERS

1.2 THE NEED FOR CORPORATE GOVERNANCE

1.2.1 Background

The need for governance arises when an individual, group or entity agrees to look after the rights or interests of other individuals, groups or entities. Those assuming such responsibilities are called **agents**. Those whose rights or interests are being looked after are the **principals**. Agents can exist in a variety of situations. Consider the following table, which shows where a principal allows an agent (individual or group) to act on their behalf.

Table 1.1: Examples of agents and principles

Entity	Agent (acting on behalf of)	Principals
Listed public company	Directors	Shareholders
Government	Elected representatives	Citizens

In each case principals are represented by agents, and the principals give or delegate to their agents the freedom or authority to make decisions on their behalf. To ensure agents perform their role in a systematic way, we use a framework of corporate governance, defined as follows:

Corporate governance is the system by which business corporations are directed and controlled (CFACG 1992, para. 2.5).

DEFINITION

'Direction' refers to steering the organisation towards its performance goals. 'Control' relates at least in part to ensuring compliance (i.e. conformance) with rules. In general, 'corporate governance' comprises the activities of corporations that are usually accountable to a board of directors. Some will be publicly listed companies or privately owned and operated, e.g. business corporations. Others may be publicly owned, e.g. hospitals, schools, government business entities, etc. Note that the term 'corporate governance' is used by many different types of organisations outside of the traditional corporate sphere including not-for-profit organisations (e.g. charities and community service providers) or incorporated associations (e.g. sporting clubs).

It is important not to focus solely on the compliance and regulatory aspects of governance; these must always be balanced with a focus on pursuing an effective strategy and achieving organisational goals and objectives. In other words, corporate governance involves a balance between conformance with all the necessary rules for the proper conduct of the organisation, including compliance with external regulations and internal organisational policies, and performance, with a focus on economic success. If an organisation is a not-for-profit entity then its performance will relate to achieving its purpose or mission, efficiency and the effectiveness of its activities.

A large amount of discussion and effort in the corporate governance area has focused on compliance rather than performance. As a result, some people have argued that the term 'corporate governance' is limited and solely focused on compliance and that a different name, 'enterprise governance' (IFAC 2004) or 'organisational governance' (Kiel, Nicholson, Tunny & Beck, 2012), is needed to describe the broader focus on both conformance and performance. This course takes the perspective that this is not necessary, and 'corporate governance' is a broad enough term to capture both factors.

Thus, as illustrated in the Tricker (2015) model, the following important relationship exists:

Corporate governance
= conformance + performance

A more detailed explanation of corporate governance is provided by the Organisation for Economic Co-operation and Development (OECD), although there are numerous others that are equally useful and provide different perspectives:

> The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance (OECD 1999).

Professor Bob Tricker is credited with inventing the term 'corporate governance' – most notably in the title of his 1984 book, *Corporate Governance*, which dealt with the practices, procedures and powers in British companies and their boards of directors.

For Tricker (1984, pp. 6–7), corporate governance is concerned with 'giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations for accountability and regulation by interests beyond the corporate boundaries'. Therefore, 'if management is about running business, governance is about seeing that it is run properly' (Tricker, 1984, p. 7).

There are now numerous definitions of corporate governance. The definitions in Table 1.2 are examples of the various ways in which 'corporate governance' can be defined.

Table 1.2: Definitions of corporate governance

Source	**Definition**
Standards Australia, 2003, AS 8000-2003, p. 8	Corporate governance addresses the issues arising from the interrelationships between boards of directors, such as interaction with senior management, and relationships with the owners and others interested in the affairs of the entity, including regulators, auditors, creditors, debt financiers and analysts.
ASXCGC, 2014, citing Justice Owen (HIH Royal Commission), p. 3	Corporate governance is: 'the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations'.

Source	Definition
ANAO, 2003, *Better Practice Guide: Public Sector Governance*, p. 6	'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 organisation.
Mervyn King, 2006, *The Corporate Citizen*, p. 18	The standard definition of corporate governance is the way in which companies are directed and controlled. A more informed definition would be processes to help directors discharge and be seen to be discharging their responsibilities created by their duties. This definition applies equally to all entities which are governed.

The *Better practice in governance and accountability* course emphasises the conformance aspect of corporate governance. Both performance and conformance are equally important, with performance aspects covered in other CPA courses.

Question 1.2

How can the Tricker model assist you in your role as an accountant?

When you have completed this activity, check your work against the suggested answers at the back of the learning material.

SUGGESTED ANSWERS

1.2.2 Theories of corporate governance

A number of theories of corporate governance have evolved from disciplines such as finance, economics, accounting, law, management and organisational behaviour. For example, agency theory arises from the field of finance and economics, and stakeholder theory from a more socially-oriented perspective on corporate governance. All these disciplines have contributed to the development of theories of corporate governance.

Two of the most well known theories of corporate governance are:

- Agency theory.
- Stewardship theory.

Having an understanding of these theories helps to define the role of the modern Australian board, since they have shaped many of the practices seen today, such as having a majority of independent directors and separating the positions of board chair and CEO.